

**SYMPOSIA ON
TRANSATLANTIC PERSPECTIVES ON ECONOMIC
AND SECURITY RELATIONS WITH CHINA**

**U.S.-CHINA ECONOMIC AND SECURITY
REVIEW COMMISSION**

**ONE HUNDRED EIGHTH CONGRESS
SECOND SESSION**

—
**BRUSSELS, BELGIUM
NOVEMBER 30, 2004**

—
**PRAGUE, CZECH REPUBLIC
DECEMBER 2, 2004**

Printed for the use of the
U.S.-China Economic and Security Review Commission
Available via the World Wide Web: <http://www.uscc.gov>



U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 2004

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
Fax: (202) 512-2250 Mail: Stop SSOP, Washington, DC 20402-0001

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The Commission's Statutory Mandate begins on page 207.

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

JANUARY 19, 2005

The Honorable TED STEVENS,
President Pro Tempore of the U.S. Senate, Washington, D.C. 20510
The Honorable J. DENNIS HASTERT,
Speaker of the House of Representatives, Washington, D.C. 20515

DEAR SENATOR STEVENS AND SPEAKER HASTERT:

On behalf of the U.S.-China Economic and Security Review Commission, we are pleased to transmit this report on our meetings and symposia in Brussels, Belgium and Prague, Czech Republic from November 29–December 3, 2004. These discussions gave the Commission the opportunity to examine European perspectives on the EU's growing commercial and security relations with China. The Commission delegation met with over 65 European officials and experts in these two cities and hosted two public symposia entitled, "Transatlantic Perspectives on Economic and Security Relations with China." By visiting both Brussels, the seat of EU government, and Prague, a Central European capital, the Commission was able to absorb a wide spectrum of opinions as well as learn how perspectives differ among countries and institutions.

The Commission heard from a broad range of experts from Europe's think-tanks, universities, companies and labor groups as well as representatives of EU member countries and European officials from all three major EU governing bodies (European Commission, European Council, European Parliament). Our Commission delegation also met with NATO and U.S. Mission to NATO officials to discuss that organization's dealings with China. This trip was timely in that it took place one week prior to the EU-China summit in The Hague and several days after an EU-China economic summit in Hamburg.

Among the key topics discussed were European deliberations over lifting the current EU arms embargo against China and potential areas for U.S.-EU cooperation in improving Chinese compliance with its World Trade Organization (WTO) commitments. The Commission's primary goal was to gain a better understanding of the issues where U.S. and European interests align and where differences exist. During the course of our trip, the Commission focused on how an enhanced dialogue between U.S. and European parties can improve cooperation in addressing key economic and security concerns relating to China.

STRATEGIC ISSUES

OVERVIEW

The European officials and scholars the Commission met with were uniformly welcoming of the opportunity to have discussions with American interlocutors regarding China. At all levels they expressed the view that an enhanced dialogue between the United States and Europe on China and broader global strategic issues was overdue.

One of the overarching themes that emerged during our meetings is the different level of priority and focus Europeans appear to place on the security dimensions of their overall relationship with China as compared to the United States. EU officials acknowledge that the United States has a more direct security interest in developments regarding China and the Asian region, given U.S. force posture in Asia and commitments to Taiwan.

Moreover, many European leaders, such as German Chancellor Gerhard Schroeder and French President Jacques Chirac look to China as a political partner in their goal of increasing multipolarity in the world. European governments see increasing economic, social, and political strains on a modernizing China as factors that may lead to social and political instability, which many Europeans consider a greater security concern than rising Chinese military power.

Although the European Union will continue to play a greater role in shaping a common foreign and security policy among member states, implementation of any comprehensive policy, especially for China, is complicated by the fact that while the EU has assumed significant responsibility for management of external trade relations, member states have retained final authority over security and foreign policy. While the EU is moving toward developing more common foreign and security policies, the most critical security related decisions will be determined at the national level.

A consistent message the Commission heard was that the United States needs to better communicate its overall strategic concerns, both to European governments and to the European public, particularly to the newer EU members. In one prominent example, Jiri Schneider, a senior Czech Foreign Ministry official, told the Commission that the U.S. needed to engage in more active public diplomacy with Europe regarding its strategic views and “is making a mistake” by relying too heavily on formal diplomatic channels. (Transcript of Prague symposium, p. 159).

“An Emerging Strategic Relationship”

Europe sees China as an increasingly important player in the world and is seeking to develop a beneficial relationship with Beijing. European Commission officials noted that five years ago Europe’s relationship with China was primarily an economic one, but now there is an “emerging strategic relationship” between the EU and China. Although one senior European Commission official noted it is premature to label the EU-China relationship as a “strategic partnership,” we note that many senior EU officials, including High Representative Javier Solana and former Commissioner for External Relations Chris Patten, have called it such in prominent speeches and statements. Nonetheless, there was a lack of clear articulation by the European officials the Commission met with as to what a “strategic partnership” with China should involve or what they understand the Chinese side to believe in this regard. European officials stressed that they do not regard the phrase “strategic relationship” to include a military dimension. However, as Commissioners noted, the Chinese word for “strategic” carries military connotations.

In general European governments, especially in Western Europe, want to cooperate with China in hopes of bringing it further into the international community. At the same time, despite tensions with the United States over the proposed lifting of the arms embargo, European officials expressed a desire to enhance EU cooperation with the United States on addressing security concerns with China. One EU member state official told the Commission delegation that European governments share most U.S. concerns about China in the security realm.

The EU Arms Embargo

China is employing what one member state official described as a “forceful and consistent” effort to pressure the EU into lifting the arms embargo. The consensus view among discussants was that the embargo will likely be lifted within the next year, possibly within the next six months. Despite disappointment in human rights progress, most Europeans believe that the embargo would be lifted once the EU Code of Conduct on Arms Exports has been “strengthened” to prevent undesirable weapons transfers to China. The Code of Conduct, currently a politically binding (rather than legally binding) agreement issued by the European Council, lists a number of conditions that must be met by a country before an EU member can export arms. Such conditions include the country’s governance system and threats to regional stability. The Code has been cited more often than the embargo as the grounds for preventing European arms sale to China.

In its current form, the EU arms embargo is a legally binding but vaguely worded single sentence provision calling for an “interruption by the member states of the community of military cooperation and an embargo on trade in arms with China.” Individual states are left to determine what is and is not permissible to sell to the Chinese under this text. The prevailing view of the European Commission officials the delegation met with is that lifting the embargo would be predominately a symbolic gesture that would not result in enhanced European arms sales to China or effectively alter the balance of power in the region, particularly with a strengthened Code of Conduct. The Commission’s interlocutors in Prague, as well as in the European Parliament and human rights community, put a much higher premium on the strategic importance of maintaining the arms embargo and believe that lifting the embargo would send a signal to China’s leaders that Europe is implicitly satisfied with China’s progress on human rights and rule of law developments and tacitly approves of Beijing’s provocative language vis-à-vis Taipei.

During discussions on this issue, the Commission delegation made clear its view that the embargo served vital strategic purposes and that a lifting of the embargo was not warranted at this time on human rights grounds. The delegation emphasized that it had advised the U.S. Congress of its strong concerns with any removal of the embargo and would continue to do so.

While the EU member states have been divided on the question of the arms embargo, European parliaments have taken an active stance against lifting it in the absence of a strengthened and mandatory Code of Conduct and/or human rights improvements. The European Parliament expressed overwhelming support this past November for retaining it as leverage to improve Beijing’s human rights’ record. Both the German Bundestag and Dutch Parliament have opposed lifting the embar-

go. The Bundestag's action is particularly noteworthy given German Chancellor Schroeder's strong and vocal support for removing the ban. These actions suggest that European parliaments may play a more active role on this and other China related issues in the future.

NATO Not Actively Discussing the Issue

In meetings with NATO officials and U.S. Mission to NATO representatives, the Commission learned that U.S. efforts to raise strategic issues regarding China within the organization have been met with resistance. Many member states argue that China is outside the scope of NATO's charter. At the same time, NATO has enhanced its liaison activities with China, including inviting Chinese representatives to participate and present a paper at a NATO proliferation conference held in Rome in March 2004. China's main interests in its interactions with NATO have been anti-terrorism, Central Asia, and Afghanistan.

Cross-Strait Tensions

Several European experts expressed frustration with China's lack of willingness to begin a dialogue with Taiwan without preconditions. On the surface it appears that the United States and Europe share a very similar view of the Taiwan question; both adhere to a "One-China Policy" and believe that China and Taiwan should work to peacefully resolve their differences. However, a more in-depth analysis reveals that U.S. security interests in the region, coupled with U.S. obligations under the Taiwan Relations Act, add an additional dimension and commitment that is not present for European nations. Questions regarding the sale of military or dual-use technology to China appear to be of greater concern to the United States than the EU given U.S. defense commitments in Asia.

Some of the Commission's European interlocutors noted that the ongoing arms race in the Strait is taking place despite the EU arms embargo, and that this tension would grow regardless of Europe's decision to lift the embargo. However, others noted the embargo's symbolism and were wary of the message that could be sent to Beijing if it is removed and not accompanied by an appropriate strengthening of the Code of Conduct. Prematurely ending the embargo, they claimed, might embolden Chinese military strategists and their Russian arms suppliers. As such, the threat of lifting the embargo comes not only in the increased sale of arms and military technology from Europe, but also in terms of enhancing the possibility for Chinese miscalculation in the Taiwan Strait.

A common theme throughout the delegation's numerous talks in Brussels and Prague was a shared desire to encourage a framework for meaningful dialogue between Beijing and Taipei in an effort to lower cross-Strait tensions. There is a need for the United States and the EU to have more candid discussions on cross-Strait concerns, in both official and non-official forums, and to work toward a collective effort in addressing this flashpoint issue. According to Willem van der Geest, Director of the European Institute for Asia Studies, "We [Europe] should also seek what I would call a major Taiwan dialogue initiative from the Chinese side." (Transcript of Brussels symposium, p. 89).

Human Rights Concerns

Although the European Commission cites some Chinese human rights improvements, many EU officials remain highly concerned about continuing abuses. Currently the European Commission and individual member countries are pursuing bilateral dialogue programs with China in hopes of encouraging improvement.

The European Parliament has been particularly vocal about China's human rights record and, as noted above, recently called for the EU not to lift the arms embargo. Charles Tannock, the Vice Chairman of the Parliament's Human Rights Subcommittee, told the Commission that while China has made significant strides in developing its industrial base, Beijing "has barely reformed at all in terms of human rights or democracy." (Transcript of Brussels symposium, p. 104). Bureaucrats within the European Commission also voiced concern noting that while the average citizen of China is better off than they were in 1989, there are still large problems in the areas of rule of law and religious freedom.

The Commission's meetings in Prague highlighted the particularly strong sentiments in the Czech Republic regarding China's human rights practices, which may be indicative of Central European nations in general given their recent history under authoritarian and repressive regimes. In remarks during the Prague symposium, Jan Ruml, the Vice President of the Czech Senate harshly critiqued China's repression and human rights abuses. (Transcript of Prague symposium, p. 146). More poignantly, in a letter to the Commission in advance of the Prague symposium, Vaclav Havel, former President of the Czech Republic, wrote:

China's rapid economic growth and dynamism have impressed the world, but no modern state can long prosper without justice, human decency and respect for individual liberties. China's central challenge in the period ahead will be the replacement of authoritarian rule with a vibrant democracy. (Transcript of Prague symposium, p. 141).

SECURITY RELATED RECOMMENDATIONS

Shaping An Effective Arms Export Control Structure

With increasing pressure inside the EU to lift the arms embargo against China, it is vital for the United States government to pursue a multi-track approach to limit the prospect of sensitive arms transfers to China.

- **Continued High-level Pressure to Maintain the Embargo.** As the Commission recommended in its 2004 Report to Congress, the President and Secretaries of State and Defense should press their European counterparts to maintain the embargo. U.S. officials must emphasize in the starkest terms that removal of the embargo is not merited on human rights grounds. Moreover, they should emphasize that there are important strategic considerations that warrant review and reinforce the need to maintain the embargo.

Congress should consider adopting a resolution urging the Administration to maintain pressure on the Europeans to ensure the embargo remains in place, commending the actions of the European Parliament and the German and Dutch legislatures in opposing the removal of the embargo, and encouraging other European parliaments to take action.

- **Strengthening EU Restrictions on Arms Exports.** Given ongoing European discussions over strengthening the EU Code of Conduct for Arms Exports, U.S. officials should urgently engage with their European interlocutors on appropriate enhancements to the EU's arms export control system. Strengthened controls should include, at a minimum, the following components:
 - The provisions of the Code of Conduct should be made into a legally binding and enforceable agreement for all EU member states.
 - A mandated list of criteria for assessing European arms exports should retain the existing criteria from the Code of Conduct requiring that member states weigh arms exports against the "risk that the intended recipient would use the proposed export aggressively against another country or to assert by force a territorial claim," "the need not to affect adversely regional stability in any significant way," and the "risk of reverse engineering or unintended technology transfer."
 - The arms export control regime should require more intra-EU transparency. Establishing shared principles and standards on arms export approvals and denials between EU arms exporting countries is critical to the effective enforcement of the Code.
- **Limitations on Defense Cooperation.** The Commission reiterates the recommendation from its 2004 Report that Congress should consider imposing restrictions on U.S. defense cooperation—both government and private sector—with foreign firms that sell sensitive military technology to China. Enactment of such legislation would signal Congress' concern towards any loosening of European restrictions on sensitive arms transfers.

Enhanced Dialogue to Develop Coordinated Transatlantic Strategies and Approaches

The United States needs to work closely with the EU and European member states to address areas of mutual security concerns regarding China. These efforts should be conducted at the Congress-to-parliament level in addition to ongoing discussions between the executive branches.

- **Facilitating Cross-Strait Dialogue.** The U.S. government should urgently coordinate with the EU to develop a strategy for obtaining near-term progress on promoting cross-Strait dialogue. A collective effort by the United States and the EU on this vital issue could help to jump-start this stalled process. As an initial matter, the United States and EU should issue a joint statement urging China to refrain from formally adopting a pending anti-secession law aimed at Taiwan and calling on both sides to make renewed overtures for dialogue. This is a particularly opportune time to engage Europe on this as U.S. concerns over lifting the embargo revolve in large measure around the cross-Strait implications.
- **Coordination on Human Rights.** European governments and organizations remain significantly concerned about China's human rights record and the United States should build on this common concern to increase joint cooperation

in this area. Specifically, the U.S. and EU governments should increase cooperation on capacity building programs in such areas as rule of law, journalist rights and labor standards. Moreover, the United States and the EU should establish a joint public benchmark system to gauge China's progress on human rights.

ECONOMIC/TRADE ISSUES

OVERVIEW

The United States and the EU have similar interests vis-à-vis economic and trade relations with China. Both have a large and growing trade deficit with China, have been hurt by Chinese infringement of intellectual property rights, and are anxiously monitoring Beijing's compliance with its WTO obligations. The Commission found that there was widespread agreement among the EU Parliament, Commission and Council as well as economists and experts on the state of Chinese economic development. Peter Nightingale, Chairman of the Euro-China Business Association, summarized the feelings of many the Commission delegation met with:

The rules and regulations in China I think are second to none ... but it's the way those rules and regulations are implemented across an enormous country which still lacks really enough educated people ... to make sure that the regulations are understood, and then of course, enough political will to make sure that the regulations are implemented fairly and transparently. (Transcript of Brussels symposium, p. 11).

Like their American counterparts, many Europeans find aspects of today's Chinese business environment troubling. During the Brussels symposium, Bernhard Speyer, Director, Head of Banking and Financial Markets at Deutsche Bank Research, gave an example of his concerns: "The minimum capital requirements for [bank] branches ... are actually five times as high as those for the domestic institutions, so ... [one] could say that this might be in violation of the principle of national treatment under the WTO rules." (Transcript of Brussels symposium, p. 63).

A Widening Trade Gap

The EU's 2003 trade deficit with China was \$54.7 billion (exports: \$46b, imports: \$100.7b), which represents an increase of 33 percent from 2001. That number is expected to rise in 2004. Europeans the delegation met with were quick to cite China's growing importance in trade relations, but did not seem as concerned as Washington with the growing Chinese trade gap. This likely results from the fact that the EU's global trade deficit is only a fraction of the U.S. global trade deficit; with the smaller subset of Eurozone countries having a global trade surplus. One high-level European Commission trade official told the delegation that the Chinese trade deficit issue "gets no traction in the EU."

While some acknowledged that China's currency peg to a dollar that is falling against the euro was a growing trade problem for Europe, this did not seem to be a significant issue for EU officials. Generally, Europeans appear to be more focused on specific concerns, such as counterfeiting or market access, than in the widening trade deficit with China.

Unfair Chinese Trade Practices

European Commission officials said that despite their hope that the Chinese will improve their trade practices, there are still serious concerns, specifically, non-tariff barriers targeted at EU exports to China. For example, despite a construction boom occurring in China, few European companies are granted contracts and China's banking environment makes it difficult for European financial institutions to establish a presence since they are restricted to a 25 percent ownership limit and cannot freely conduct domestic currency transactions. Counterfeiting is also a major concern for European producers. The delegation heard statistics that 60 percent of all counterfeited items in Europe originate in China. One senior EU trade official described Chinese intellectual property rights (IPR) enforcement as a "big open sore" for Europe.

Nonetheless, many European experts on Chinese economic developments believe that China is making progress, albeit slowly, on reforming its unfair trade practices. They cite poor implementation and local protectionism as often undermining Beijing's attempts to tackle the problem. But in order to address continuing non-tariff barriers the European Commission needs to engage in hard bargaining. This includes greater coordination between the EU and the United States since China often attempts to "play one off the other." Many of the Commission's interlocutors acknowledged that the state still plays a dominant role in the governance of Chinese firms and that it remains difficult to draw the line between where state involvement ends and where the private sector begins.

In several private meetings with European Commission officials, they were critical of China's poor legal and accounting frameworks and the lack of proper corporate governance standards. One senior official voiced concerns that Chinese authorities could confiscate or nationalize European assets and operations, particularly in a time of crisis, and that European firms had not appropriately calculated this sovereign risk. In Prague, panelist Michele Tajariol described a disturbing experience. He explained how his firm's Chinese joint venture operation lost its initial investment as well as design and production techniques after transferring its machine tool production process to their Chinese "partner." (Transcript of Prague symposium, p. 192).

Mixed Messages on the WTO

Depending on whom the delegation spoke with, European faith in remedying trade issues through the WTO varied. Despite mentioning that the import prices of Chinese goods to Europe have dropped 60 percent in the last two years, some noted progress on China's WTO commitments. Some officials opined that China is "anxious" about the WTO and thus is "willing to go the extra distance" to comply with its WTO obligations. Bernhard Speyer of Deutsche Bank agreed in his statement: "As regards banking and securities services, China has so far complied with the commitments made upon accession to the WTO—and, in our view, can be expected to do so looking forward." (Transcript of Brussels symposium, p. 64).

But several others we spoke with had less faith in the WTO's ability to effectively monitor and enforce China's compliance. One notable area of discussion was the effectiveness of the WTO's Transitional Review Mechanism (TRM) as a means for identifying China's WTO compliance problems. The TRM was negotiated as part of China's WTO accession agreement and requires a special annual review by the WTO of China's compliance with its accession commitments. A number of European meeting participants concurred with the Commission's view that the TRM was not functioning as an effective mechanism for putting collective pressure on China to address compliance shortfalls due in large part to China's lack of cooperation with the process. According to one senior European trade official "the TRM is getting worse, not better." Another noted that at times the Chinese will discount the TRM dialogue, claiming that it was never consented to by the current Chinese leadership.

Commissioners stressed the need for better coordination between U.S. and EU trade officials on areas of common concern with China. European interlocutors agreed in principle, but at times disagreed on specific tactics. For instance, in concept the EU does not support the use of the safeguards, but will likely feel pressured to activate them in response to U.S. safeguard use, so as to counter any diversion of textiles and other products from the U.S. market.

Market Economy Status

China has been staging an international diplomatic campaign to obtain "market economy status" (MES), which would dramatically alter the calculations in anti-dumping and other unfair trade cases brought by its trading partners. Over twenty nations have granted MES to China, including recently Brazil and Argentina, and Europe is feeling pressure to do the same. China is the single largest target of anti-dumping cases brought by the U.S. and granting market economy status would significantly benefit Chinese producers and reduce the potential effectiveness of our trade laws—including the special safeguard provisions that China agreed to as part of its WTO accession commitments.

According to the European Commission's recent assessment of MES for China, the country has only met one of the five necessary preconditions the EU uses to determine MES. The criterion China had met was the "absence of State-induced distortions in the operations of enterprises linked to privatization" and the "absence of barter trade." The criteria, which China had not yet satisfied, are:

- **State influence:** ensuring equal treatment of all companies by reducing state interference, which takes place either on an ad hoc basis or as a result of industrial policies, as well as through export and pricing restrictions on raw materials.
- **Corporate governance:** increasing the level of compliance with the existing Accounting Law in order to ensure in general the usability of accounting information for the purpose of trade defense investigations.
- **Property and bankruptcy law:** ensuring equal treatment of all companies in bankruptcy procedures and in respect of property and intellectual property rights.
- **Financial sector:** bringing the banking sector under market rules, i.e. by removing discriminatory barriers, in order to ensure rational allocation of capital by financial institutions.

ECONOMIC AND TRADE RELATED RECOMMENDATIONS

More Active Efforts to Coordinate on Mutual Trade-related Problems

As China's two biggest trading partners, the United States and EU have substantial leverage to wield in pressing China to address shortfalls in its WTO compliance, particularly in key areas of concern to both sides.

- **Improving IPR Protections.** European governments share U.S. concerns about continuing large-scale IPR violations in China. Brussels and Washington should integrate their strategies on improving Chinese IPR compliance, particularly through joint action in the WTO.
- **Coordination on Addressing China's Undervalued Currency.** U.S. and EU officials should work together within the International Monetary Fund (IMF), the WTO and other appropriate forums to move China toward a meaningful revaluation of the Chinese yuan that is more reflective of current economic realities.
- **Improving the Transitional Review Mechanism.** The WTO's TRM was intended as a means for initiating collective pressure on China to identify and address key WTO compliance problems. As recommended in the Commission's 2004 Report, U.S. and EU officials should work to enhance the effectiveness of the TRM within the WTO and consider undertaking an annual joint assessment of China's compliance record (if possible, in conjunction with China's other major trade partners) that could serve as an alternative mechanism for measuring and improving China's compliance shortfalls.
- **Granting Market Economy Status.** The granting of market economy status to China has significant ramifications for the application of trade remedy laws to Chinese trade practices. China's WTO accession protocol provided for a lengthy review period to evaluate China's actions and steps to open and reform its market before it earned market economy status. U.S. and EU officials should engage with each other to evaluate China's progress toward meeting U.S. and EU criteria with the goal of arriving at a consistent analysis that ensures that China had taken concrete and irreversible steps to earn market economy status.

Sincerely,



C. Richard D'Amato
Chairman



Roger W. Robinson, Jr.
Vice Chairman

CONTENTS

	Page
TUESDAY, NOVEMBER 30, 2004	
BRUSSELS, BELGIUM SYMPOSIUM ON TRANSATLANTIC PERSPECTIVES ON ECONOMIC AND SECURITY RELATIONS WITH CHINA	
Opening remarks of Chairman C. Richard D'Amato	1
Prepared statement	3
Opening remarks of Vice Chairman Roger W. Robinson, Jr.	4
Prepared statement	5
PANEL I: CHINA TRADE AND INVESTMENT: INDUSTRY AND LABOR PERSPECTIVES	
Statement of John Monks, General Secretary, European Trade Union Confederation	6
Statement of Peter Nightingale, Chairman, Euro-China Business Association .	9
Prepared statement	13
Statement of Francesco Marchi, Director of Economic Affairs, European Apparel and Textile Organization	16
Prepared statement	18
Panel I: Discussion, Questions and Answers	36
PANEL II: TRENDS IN EU-CHINA ECONOMIC RELATIONS	
Statement of Peter Ferdinand, Director, Centre for Studies in Democratisation, Department of Politics and International Studies, University of Warwick, Coventry, United Kingdom	51
Prepared statement	56
Statement of Bernhard Speyer, Director, Head of Banking, Financial Markets, Regulation, Deutsche Bank Research/Economics, Frankfurt, Germany	60
Prepared statement	64
Panel II: Discussion, Questions and Answers	68
PANEL III: PERSPECTIVES ON EU-CHINA SECURITY RELATIONS, THE ARMS EMBARGO AND TAIWAN	
Statement of Frank Umbach, Resident Fellow, Head of the Asia-Pacific Program, and Co-Chair, CSCAP Europe, Research Institute of the German Council on Foreign Relations (DGAP), Berlin, Germany	76
Prepared statement	82
Statement of Willem van der Geest, Director, European Institute for Asia Studies	88
Prepared statement	91
Panel III: Discussion, Questions and Answers	92
PANEL IV: EU PERSPECTIVES ON HUMAN RIGHTS IN CHINA	
Statement of Charles Tannock, Member of European Parliament, Vice Chairman, European Parliament's Subcommittee on Human Rights	101
Prepared statement	104
Statement of Jim Cloos, Director, General Secretariat of the Council of the European Union	108
Prepared statement	111
Statement of Philippe van Amersfoort, Administrator, European Commission Directorate General for External Relations, Human Rights and Democratisation Unit	113
Prepared statement	116
Panel IV: Discussion, Questions and Answers	117

XII

	Page
ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD	
Prepared Statement of Françoise Lemoine, Senior Economist, Centre D'Etudes Prospectives, Et D'Informations Internationales (CEPII), Paris, France	125
Prepared Statement of Kay Möller, Senior Research Associate, Asia Unit, German Institute for International and Security Affairs, Berlin, Germany ...	137
THURSDAY, DECEMBER 2, 2004	
PRAGUE, CZECH REPUBLIC SYMPOSIUM ON TRANSATLANTIC PERSPECTIVES ON ECONOMIC AND SECURITY RELATIONS WITH CHINA	
Opening remarks of Chairman C. Richard D'Amato	140
Prepared statement	142
Opening remarks of Vice Chairman Roger W. Robinson, Jr.	143
Prepared statement	144
PANEL I: PERSPECTIVES ON SECURITY DIMENSIONS OF THE RELATIONSHIP I	
Statement of Jan Ruml, Vice President, Senate of the Czech Republic, Chair- man of the Olympic Watch Committee	145
Prepared statement	147
Statement of Jiří Schneider, Political Director of the Foreign Ministry of the Czech Republic	149
Panel I: Discussion, Questions and Answers	152
PANEL II: PERSPECTIVES ON SECURITY DIMENSIONS OF THE RELATIONSHIP II	
Statement of Senator Josef Jarab, Chairman, Senate Committee on Inter- national Affairs, Defense and Security, Czech Republic	164
Statement of Jean-Pierre Cabestan, Senior Researcher, French National Cen- ter for Scientific Research (CNRS), University of Paris, France	168
Prepared statement	172
Panel II: Discussion, Questions and Answers	176
PANEL III: INDUSTRY AND LABOR PERSPECTIVES ON CHINA'S ECONOMIC AND TRADE POLICIES	
Statement of Jan Musil, CEO, Škoda Energo a.s., Plzeň, Czech Republic	180
Statement of Oldrich Schwarz, Director, Libra Management Group Limited, Prague, Czech Republic	182
Prepared statement	184
Statement of Vladimir Matousek, Head, International Department, Czech- Moravian Confederation of Trade Unions, Prague, Czech Republic	186
Prepared statement	189
Statement of Volker Riemann, Head, Purchasing Department, Skoda Auto a.s., Mladá Boleslav, Czech Republic	190
Statement of Michele Tajariol, Sales Director, Tajmac-ZPS, a.s., Zlin- Malenovice, Czech Republic	191
Prepared statement	193
Panel III: Discussion, Questions and Answers	195

**BRUSSELS, BELGIUM SYMPOSIUM
ON TRANSATLANTIC PERSPECTIVES ON
ECONOMIC AND SECURITY RELATIONS
WITH CHINA**

TUESDAY, NOVEMBER 30, 2004

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION,
Washington, D.C.

The Commission met in the American Center of the Embassy of the United States in Brussels, Belgium at 9:00 a.m., Chairman C. Richard D'Amato and Vice Chairman Roger W. Robinson, Jr. presiding.

OPENING REMARKS OF CHAIRMAN C. RICHARD D'AMATO

Chairman D'AMATO. Good morning. On behalf of the U.S.-China Economic and Security Review Commission, which is an advisory body to the United States Congress, I welcome our panelists and our guests to what we anticipate will be a productive exchange of views and ideas about China's growing role in the world and the appropriate policy responses of the United States and the European community and Union. We are very pleased to be hosting today's symposium, which we've entitled "Transatlantic Perspectives on Economic and Security Relations with China."

Our Commission was established by the United States Congress with a clear mandate to evaluate the national security implications of the broad-ranging economic relationship in all of its various guises between the United States and China. In setting out our mandate, the Congress directed us to take a broad view of security to include an assessment of both traditional national security issues, as well as how our economic relationship with China is impacting the United States' economic health, be it our manufacturing base, our research and development operations, our jobs in national growth levels.

The Members of the Commission were appointed by the Republican and Democratic leaders of both the United States House of Representatives and the Senate. It is a bipartisan effort to address a number of very important issues. This is what brings us to Europe, where we will be conducting symposia and meetings first here in Brussels, and then later this week in Prague. We are here in Europe because an understanding of the relationship between Europe and China is critically important to U.S.-China relations. Unfortunately, this has not been the focus of sufficient attention in the United States. We think that a renewed dialogue is in order between the United States and the European community, and we appreciate your hospitality.

We believe that U.S. policy towards China and Asia needs to be informed by a better understanding of the views and perspectives of our European friends and allies that we are receiving here today.

Economically, China presents a picture of rapid growth in sector after sector, from labor-intense products to high technology. EU-China trade, like U.S.-China trade, is both booming and unbalanced. On this point we hope that today's symposium will give us some insight into Europe's apparently greater success in exporting to China. China is also a primary destination for foreign direct investment from both Europe and the United States. Thus, we have a shared interest in making sure that these new and dynamic global economic patterns work to all of our advantages.

We have been closely monitoring China's record of compliance with its World Trade Organization commitments, and evaluating the effectiveness of WTO mechanisms to enforce compliance. While we recognize that China has made progress in many areas, we continue to be dismayed at the compliance shortfalls in critical areas such as intellectual property, agriculture, and the failure of the WTO's Transitional Review Mechanism to adequately press China to address these shortfalls. There appears, in our view, to be a need for the U.S. and the EU to better coordinate our WTO activities with regard to China.

We are also interested in a discussion that compares EU and U.S. perspectives on traditional security matters. China's military strength, along with its intentions toward Taiwan and countries in the region are global concerns. So are human rights, consistently emphasized here in Europe, and which are a concern of people everywhere. On both points we think that the manner in which the EU and the U.S. deal with these issues will be of paramount importance in determining the future security and human rights situations globally. Today's discussion is an important one for both sides and we look forward to conversing with such a distinguished group of panelists.

Finally, we would like to take this opportunity to recognize the outstanding support and assistance we have received from Ambassadors Tom Korologos, Rockwell Schnabel and Nicholas Burns. Special recognition and thanks to their very capable staffs for their hard work and personal efforts on our behalf. A special thanks goes to Van Reidhead, and Peter Stonier, with the U.S.-EU mission, who assisted us with all the meetings and logistical arrangements.

We owe a special thanks and our deep gratitude also to Paul Hogue, Peter Stonier, Yannick Pauweis, Florence Vanholsbeek, Anne Barbaro, Jean-Marc Libert, Ed Kemp, Jeannine Johnson, and Marijke Hendricks. They did an outstanding job for us. Thanks to each of you for your support. You were instrumental in our ability to conduct this important event.

I'm now going to turn the microphone over to the Commission's Vice Chair, Mr. Roger Robinson. I just would like to mention that at the end of the panel, we will set aside 15 minutes for questions from the audience, and there will be a microphone available if you have any questions for us on the Commission or for the panelists.

With that, I'll turn the microphone over to our Vice Chairman, Roger Robinson.

[The statement follows:]

Prepared Statement of Chairman C. Richard D'Amato

Good Morning Everyone:

On behalf of the U.S.-China Economic and Security Review Commission, an advisory body to the U.S. Congress, I welcome our panelists and guests to what we anticipate will be a productive exchange of views and ideas about China's growing role in the world and the appropriate policy responses of the EU and the United States. We are very pleased to be hosting today's symposium titled: "Transatlantic Perspectives on Economic and Security Relations with China."

Our Commission was established by the U.S. Congress with a clear central mandate—to assess the national security implications of our broad ranging economic relationship with China and to make recommendations to correct situations or practices which are adverse to our interests. In setting out our mandate, the Congress directed us to take a broad view of security to include an assessment of both traditional national security issues as well as how our economic relationship with China is impacting U.S. economic health, be it our manufacturing base, the development of vital technologies, the state of our economic growth and research and development efforts, and the impact on employment. The Members of the Commission were appointed by the Republican and Democratic leaders of both the U.S. Senate and House of Representatives. It is a bipartisan effort to address a number of very important issues. This is what brings us to Europe where we will conduct symposiums and meetings, first in Brussels and later in Prague. We are here in Europe because an understanding of the relationship between Europe and China is critically important to U.S.-China relations. Unfortunately this has not yet been the focus of sufficient attention in the United States. We think that a renewed dialogue is in order, and we appreciate your hospitality.

We believe U.S. policy towards China and Asia needs to be informed by a better understanding of the views and perspectives of our European friends and allies that we are receiving here today. The U.S.-EU-China relationship is a very dynamic situation, with many implications for our mutual economic and security interests.

Economically, China presents a picture of rapid growth in sector after sector, from labor-intense products to high technology. EU-China trade, like U.S.-China trade, is both booming and imbalanced. On this point we hope that today's symposium will give us some insight into Europe's apparently greater success at exporting to China. China is also a primary destination for foreign direct investment from both Europe and the U.S. We thus have a shared interest in making sure that these new and dynamic global economic patterns work to all of our advantages.

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We are also interested in a discussion that compares EU and U.S. perspectives on traditional security matters. China's military strength, along with its intentions toward Taiwan and countries in the region, are global concerns. So are human rights, consistently emphasized in Europe, and which are a mutual concern of people everywhere. On both points we think that the manner in which the EU and U.S. deal with these issues will be of paramount importance in determining the future security and human rights situations globally. Today's discussion is an important one for both sides, and we greatly look forward to conversing with such a distinguished group of panelists.

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I am now turning the microphone over to the Commission's Vice Chair, Mr. Roger Robinson.

OPENING REMARKS OF VICE CHAIRMAN ROGER W. ROBINSON, JR.

Vice Chairman ROBINSON. Thank you, Mr. Chairman, and good morning.

I'd like to add my thanks to all those individuals who have assisted in putting this important event together, and the subsequent event that we'll hold, as the Chairman mentioned, later this week in Prague.

As the nations of Europe are interacting more frequently and on numerous levels with China, we're interested in learning how the relationships those countries have with China impact the relationships they have with the United States. As Chairman D'Amato mentioned, trade with the EU and China is growing at a very rapid pace. While China provides a vast market opportunity for European companies, there are also a number of areas of concern, such as counterfeiting, market access and others. Generally, American companies have the same concerns as their European counterparts, and we'd like to learn how Europe is addressing these concerns. We'd also like to better understand how European firms gauge the risks and rewards associated with such ventures.

We will also consider security issues, in particular the much-discussed EU arms embargo, which has been in place since 1989. We look forward to a candid exchange about European views and concerns regarding the embargo and the prospect for possible alternatives, such as a strengthened Code of Conduct, possibly even strengthened export controls as well. We in turn hope to serve as an informal conduit in relaying American misgivings on this issue. The changing dynamics in the cross-Strait relationship are a major focus of the Commission's work, and we'll look forward as well to a dialogue on EU and U.S. views on prospects for conflict, as well as the outbreak of peace in the Strait. An enhanced and candid dialogue between the U.S. and EU, particularly with the many European friends that we've had the opportunity to interact with thus far on these vital security concerns is, in my judgment and that of my colleagues, considerably greater than it's ever been before.

We are going to open today's activities with a panel discussing trade and investment flows between the EU and China. We're pleased to have a group of panelists who will be able to provide us with perspectives on both the labor and business fronts. In 2003 EU-China trade was valued at \$146.7 billion. The EU trade deficit with China this year was \$54.7 billion. This is clearly a substantial issue for European economies, just as it is for ours.

Our second panel will further examine economic issues, but from a macroeconomic perspective. We hope that the comparisons we draw today will be useful for those on both sides of the Atlantic. Thus, we also hope to locate key areas where European and U.S. interests coincide, and where the potential exists for better coordination in our respective trade policies.

In the afternoon we'll consider security issues. As mentioned, we'll discuss the cross-Strait situation, how to maintain peace and stability there, and in the region more broadly. We'll also discuss the arms embargo and implications of a possible lifting, the positive signal that we think is going to be sent to the Chinese, for example, in the context of the December 8 summit, and followed several months later by possible action in the May/June timeframe, or

soon thereafter. Obviously, this entire activity has a number of regional security and relationship implications.

Our fourth panel will examine progress on human rights in China, an issue of deep concern to both of our communities. Europe and the U.S. have very close positions on human rights across the globe. Given the same broad goals, we hope a dialogue today can help us think about appropriate strategies each side should pursue toward China to accomplish or advance those goals. And, as with the balance of the symposium, we also want to identify those areas where transatlantic cooperation can be strengthened.

I want to note that we're recording today's symposium, and this will permit us to produce a report on the proceedings that we hope will prove useful to policymakers in the U.S. Congress, which is, of course, our sponsoring operation, and also to European researchers, scholars and policymakers as well.

So with that, I'd like to turn to our first panel. Joining us will be Mr. John Monks, of the European Trade Union Confederation. Peter Nightingale from the Euro-China Business Association, and Francesco Marchi of The European Apparel and Textile Organization.

I turn the podium over to Mr. Monks.
[The statement follows:]

Prepared Statement of Vice Chairman Roger W. Robinson, Jr.

Thank you, Mr. Chairman.

I would like to add my thanks to all those individuals who have assisted in putting this important event together and the subsequent event we will hold in Prague later this week.

As the nations of Europe are interacting more frequently and on numerous levels with China, we are interested in learning how the relationships those countries have with China impact the relationships they have with the United States. As Chairman D'Amato mentioned, trade between the EU and China is growing at a rapid pace. While China provides vast market opportunities for European companies, there are also many areas of concern such as counterfeiting and market access. American companies have the same concerns as their European counterparts and we would like to learn how Europe is addressing these concerns. We are also interested in hearing the views of Europeans as they invest in China. We would like to understand better how European firms gauge the risks and rewards of success.

We will also consider security issues, in particular the much-discussed EU arms embargo, which has been in place since 1989. We look forward to a candid exchange about European concerns regarding the embargo and the prospect for possible alternatives such as a strengthened Code of Conduct. We in turn hope to serve as an informal conduit in relaying American concerns on this issue. The changing dynamics in cross-Strait relations are a major focus of the Commission's work and we look forward as well to a dialogue on EU and U.S. views on the prospects for conflict and the possibilities for peace in the Strait. An enhanced and candid dialogue between the U.S. and our European friends on these vital security concerns is in my judgment of greater need today than ever before.

We open the day with a panel discussing trade and investment flows between the EU and China. We are pleased to have a group of panelists who will be able to provide us with the perspectives of both the labor and business communities. In 2003, EU-China trade was valued at \$146.7 billion. The EU's trade deficit with China that year was \$54.7 billion. This is clearly a substantial issue for the European economy, just as it is for the U.S. economy.

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will also discuss the arms embargo and implications that a possible lifting of it may have on regional security and transatlantic relations.

Our fourth panel will examine progress on human rights in China, an issue of deep concern to both our countries. Europe and the U.S. have very close positions on human rights across the globe. Given the same broad goals, we hope that a dialogue today can help us think about appropriate strategies each side should pursue toward China to accomplish those goals. And, as with the rest of the symposium, we also want to identify areas where transatlantic cooperation can be improved.

I want to note that we are recording today's symposium and from this will produce a report on today's proceedings that we believe will be of great use to policymakers in the U.S. Congress and to American and, we hope, European researchers and scholars on China.

So with that, let me turn to our first panel. Joining us will be John Monks of the European Trade Union Confederation, Peter Nightingale of the Euro-China Business Association and Francesco Marchi of the European Apparel and Textile Organization.

PANEL I: CHINA TRADE AND INVESTMENT: INDUSTRY AND LABOR PERSPECTIVES

STATEMENT OF JOHN MONKS, GENERAL SECRETARY EUROPEAN TRADE UNION CONFEDERATION

Mr. MONKS. Thank you for the invitation to come along today to talk about this extraordinarily important subject that's exploded on the western world in the last decade. I'm the General Secretary of the European Trade Union Confederation that represents something like 60 million workers in 35 countries. It goes beyond the EU to Turkey, and it includes non-EU countries like Norway, Iceland, and Switzerland.

I was the General Secretary of the TUC in Britain for 10 years, which is the equivalent of the AFL-CIO, just so you get the bearings straight.

This is a subject you're thinking about and we're certainly thinking about a lot. And we, like our American counterparts, are very much aware of the whole phenomenon of jobs emigrating to China and other places. But let's take China as our major location of emigration of work at the moment.

There are many situations where jobs have been lost, industries have gone. Textiles are a particular case in point, but increasingly there are others. I would say in France at the moment, what they call delocalization, which we might call off-shoring, is the number one issue in French public opinion polls. It varies across other countries, but it's the number one issue and worry on people's minds at the present time.

Having said that, we, in the ETUC, we're aware that this is certainly not a game where the West loses all the time. There's a boom going on in the European steel industries at the moment, and the reason for that is the China trade. The demand from China has led to a tremendous—much needed, by the way—boost to the European—and I think American too—steel industries, particularly construction steel, but all kinds of steel are doing very well. Machine tools too as factories get opened up at a very quick rate, countries that are strong in machine tools—Germany, Switzerland, Netherlands are doing well. And power generation has done very well. I mean the French national grid is added to China's electricity generating capacity every two years. So if you're selling power stations and so on, clearly China is the place to be, rather than more mature economies like ours.

So there are much quieter developments nobody talks about it, but there are groups of workers that are in jobs today because of China, as well as groups of workers around who are out of work because of China. Obviously, we are very concerned about the ones who are out of work, but we've got to remember that there are winners as well as losers in this period of tremendous growth.

China contributed one-third of the world's economic growth last year. And in the European situation, the economy has been, certainly of the core countries, Germany, France, Italy, has been rather sluggish. The China demand factor has been a major encourager of economic growth.

Looking at the EU in relation to the States, exports are a share of the GDP, very similar to that of the United States, at around about 8 percent. The internal market is by far the over mighty side of GDP in Europe as in the United States. But we do know with the companies that are increasingly locating production abroad, that there are two things that you've got to try and distinguish between. Firstly, I think nearly all big western companies want to be in China because (A) the number of people, and (B) the size of the developing market. So there's huge demand being created by China's growth.

The issue that becomes much more sensitive is when the location, the new plant in China is used to relocate, re-import rather, goods into the U.S. or into the EU. There's nothing new about it. In a way my organization in Britain, my old one, the TUC, founded in 1868 on its 10-point plan, was concerned about exports from the Asian colonies—well, take out “colonies”—and it is a very similar situation now. But clearly the scale made possible by IT, logistics improvements, and transportation improvements and so on, are the new factors in terms of scale.

But trying to get the right perspective and the right sense of proportion on this is a major task, and I would say probably it's easy to be alarmist and scary, but it's also important to keep a sense of proportion about winners, as well as losers.

And secondly, this re-importation of goods, I might just say, in the French case where they've actually got figures that separate the re-import of goods from French investments abroad, as opposed to French companies servicing developing markets. Last year, I think 4 percent of jobs lost in France, 4 percent of the total was due to what they call delocalization, which is very small. Family breakdowns in family businesses are bigger in France, and other things like new technology changing consumer tastes are much bigger.

So having said that, it's still the number one concern, and the threat of it is very much in French minds at the moment. We know from some figures that we've had from a survey done by Cornell University in the States, that in something like 50 percent of collective bargaining negotiations, the threat of “if you don't agree to this concession, we are going somewhere else cheaper, probably China,” is there. So psychologically it's very important, even if the threats are not as common as perhaps sometimes we assume that they might be, and that's not to say, of course, that things won't get worse in the future.

So what should we do about it? That's what you're really here for. We notice some differences perhaps with American labor, that our instinct is not to be protectionist if we can help it. We do recognize free trade does bring significant benefits for workers generally, for economic growth. The casualties are very visible and very noisy, and rightly so, the beneficiaries are often much quieter. But free trade generally is done well. Protectionism is not done well, and has led to international tensions. And if you go through the history of this continent, in the 1920s and 1930s, protectionism was a major contributor to World War II and the tensions between European countries.

And in a sense, putting all that behind us is our culture and our tradition. We are very aware of that. But so if we're not protectionist and we probably think we can't build walls high enough in terms of tariffs to keep out the—certainly on non-strategically important areas anyway—we can't, given the difference in wage levels, the Chinese efficiency levels are such that we couldn't price them out of our markets very easily anyway, except with very, very restrictive policy.

So what can we do? We're looking—and I don't think there's any agreement in Europe about this yet—but we're looking at what obligations we put on companies to, (A) their home area, when they think of leaving, and secondly, when they go to the new location. I was mentioning to the Chairman just before we started that I'm most impressed with a visit I did recently to the textile center in Denmark, a city called Herning, where the city discusses unions, employers, labor market authority, discusses what to do about this on the basis that they're not going to be able to protect themselves, but how can they grow their textile industry in these circumstances. They've actually facilitated, by agreement, the export to cheap locations, some to the Ukraine, some to China, of the spinning, the weaving, the sewing, and those basic sort of things, and they've kept design, brand management, fashion consciousness, bringing in a new generation of workers, and with beneficial effects on the economy of that town.

Whether it's transferable, I don't know, but it's clearly a positive response, and it's not rocket science what they're doing. It's basic textile work. It's not haute couture; it's not just a little niche. This is the stuff that's in the high streets in Brussels and every other city in the West that they're concentrating on. But in a sense, in terms of how companies behave, that seems to me to be a good model. They don't just quit. They've got to think about what they can leave, what their obligations are.

And globalization in a way has been removing that sense of residual loyalty that companies have had to their home base. You've had it in the States. Companies were loyal to where they came from, and they remembered that, and in terms of charitable bequests and so on. The danger of globalization is that mobility becomes everything, and the sense of obligation becomes nothing. And I think that that is the area to tackle. How do we create a sense of obligation? Maybe you can't stop companies going, but the terms on which they go become very important.

Nor would we just rely on some wishy-washy debate on corporate social responsibility in this area. I guess in the European way, we

would be looking for some obligations on companies about information and consultation before decisions are taken, the chance for people to come up with alternatives, a chance to consider what's going to be left, what skills people need maybe to adapt to other challenges, and maybe other jobs in other companies in the locality. But the company, to confuse its life a bit, has got to think about that as well as about the bottom line. And quite a lot of European companies do think about that. Some American companies think about that, by the way. It's not just this side of the Atlantic. The best ones do think about that, and we want to see that good practice generalized.

Secondly, when they get to China or wherever it may be, that they behave like companies from democratic countries, who respect human rights and labor rights, and they don't just suddenly go local and say, "Oh, we can plan with the lure of wherever we are and the practice of wherever we are." They've got a job to export our values, to uphold our values in terms of democracy and human rights and labor rights.

So we've got something we call the open social model, which is the market, big market, single market balanced by a sense of social obligations, and we want European countries to export that social model as far as they can when they go, and don't just join the race to the bottom, because at the end of the day if China is like a big Japan—I mean 20 years ago we would have been talking about Japan just as we talk about China—but today we don't talk about Japan like that. Japan's wage levels are comparable. Living standards are comparable in many respects, and it's been a successful transition, and we need to see China, India and the others go through that same transition.

And that will be done by trade unions, free trade unions getting their share of the growth for the general population, not just being kept by some elites paying coolie wages out.

So I would say, Chairman, that's very much our approach. We do feel vulnerable. A lot of workers feel vulnerable. But we're looking to be positive and to be practical.

Chairman D'AMATO. Thank you very much, Mr. Monks, very insightful. You teed up many of the issues that we've been concerned about. I know we're going to have a number of questions of the panel and with you to further explore some of these concepts that you raised.

I'd like to move to Mr. Peter Nightingale. He's the Chairman of the Euro-China Business Association. Thank you, Mr. Nightingale.

**STATEMENT OF PETER NIGHTINGALE, CHAIRMAN
EURO-CHINA BUSINESS ASSOCIATION**

Mr. NIGHTINGALE. Thank you, Chairman.

As you said, I'm the Chairman of the Euro-China Business Association, which is the business association that brings together all the China business associations of European Union member states. I have to say that we're still looking for these associations in the newly joining states, but we have to find them. The old 15, of course, we represent.

My real job, I suppose, is running the China-Britain Business Council, and the Chair of the Euro-China Business Association.

The Business Association rotates between the different members, and I hold it at the moment. We represent companies in Europe that are interested in doing business in China, and we do that, of course, because there is such a huge interest in China, the Chinese economy is growing so quickly, and the opportunities for business amongst European companies is vast, of course, and yet it is a distant country, it is a difficult country in which to do business. It's changing very quickly. Twenty-five years ago it was a completely closed totalitarian state, and since then it's opened up into what many people would say is a much more mixed economy. But nevertheless, companies need help in finding their way through the maze of Chinese bureaucracy and the Chinese economic environment, and that's why our association exists, to give practical help to businesses, to lobby on behalf of businesses, and of course, to work with the European Commission here and the European Union Chamber of Commerce in China to make sure that the various requirements for a free-flowing trade and investment environment are developed in China.

The Chinese economy, of course, has grown very fast this year. In fact, many have feared that it is overheating, and that includes the Chinese government, which has taken some measures to cool down the economy. I think that it is having some success insofar as the racing growth has been slowed to some extent, and has certainly been slowed I think in those areas where the Chinese government identified severe overheating, such as infrastructure, where clearly there was a boom on which was not very healthy.

The prospects for European business in China are obviously very good under these circumstances. There are risks. There is of course political risk, and I guess the panel will be discussing that later on today, and it will be interesting to hear what conclusions you reach, but on the whole, as far as the economy is concerned, I think the general consensus of European business is that the Chinese have made reasonable progress in implementing the obligations that they undertook when they signed up to join the WTO, and that the senior leaders in China have identified problems in the economy and are addressing those problems reasonably carefully, cautiously, but nevertheless with some effect. And therefore I think that companies generally feel that the environment for doing business in China for foreign companies is reasonably healthy and has a fairly good outlook.

The European Union Chamber of Commerce undertook a survey of its members earlier this year, and on the whole there was an optimistic feel amongst European companies in China about the medium-term future for their businesses, and over 60 percent of them said that they would make a profit this year, which is quite a big change I think from about five years ago when companies from overseas generally found the conditions in China very difficult, and I think on the whole were not making profit.

I think another indication of the buoyancy of China's economy for foreign companies is the number of small- or medium-sized European companies that are now invested in China. These are companies which could not afford to undergo years of loss or breakeven, unlike the big multi-nationals, and they would not be there unless they were making profits. Of course, the fact that they don't shout

about their profit making is due to the slightly underdeveloped nature of Chinese regulation. I think people are frightened of announcing that they've made decent profits in China because the next thing that would happen would be the call from the tax man, the Chinese tax man, to suggest that there were various taxes that the company had not paid, and very likely the company would never have heard of these taxes, and they might even have been invented on the day, because the Chinese tax bureau is targeted to raise tax, and it is in a sense incentivized to raise tax. And if you talk to Chinese companies, particularly the state-owned enterprise companies, very often one of the first things they will say, rather than saying, "We made a profit last year," is "We contributed so much tax last year." I don't think European companies would have the same sort of frame of mind.

But this brings me to the big point really about the Chinese economic environment, and that is the fact that it is still developing. If you consider the ground that it has made over the last 20 years, it is astonishing, I think, that it has achieved so much with so little obvious problems. But it is still developing. So we have various real points of difficulty in China—the Chairman's already referred to the protection of intellectual property. The rules and regulations in China I think are second to none probably anywhere in the world, but it's the way those rules and regulations are implemented across an enormous country which still lacks really enough educated people in some ways to make sure that the regulations are understood, and then of course, enough political will to make sure that the regulations are implemented fairly and transparently.

There is progress being made and some of that progress is undoubtedly due to the fact that there are now Chinese companies which have intellectual property to protect, and they themselves are putting pressure on their own government to make the necessary moves to ensure that there is better protection of intellectual property.

There is also of course a very underdeveloped legal framework. The laws and regulations are still being made, and in some cases they're being made with a lot of international advice and assistance, which is a good thing. But nevertheless, although it is now possible to win a commercial case in a Chinese court, it is much more difficult to get a judgment enforced if it's in your favor as a foreign company. And that's also a problem.

But again, I think our contact with the senior leaders in China indicates that they know that this is a major problem. And of course, the Chinese economic boom could not ever have happened without the enormous inflow of foreign investment, and China knows that in order to keep its economy growing at a speed necessary to absorb the surplus labor that is being created as the result of the reform of the state-owned enterprise system, it needs to continue to attract foreign investment. And in order to attract foreign investment, it must of course have an economic and commercial environment that is attractive to foreign investors. So there is a huge amount of willpower at the top of China to make the environment right for foreign investors, but of course, in that process there's a lot of nationalism that creeps in. There's a lot of what

they call local protectionism that creeps in, which sometimes distorts the intentions of the senior leaders.

Returning to compliance with WTO, I think on the whole European businesses are quite pleased with the way that China has complied, but there are issues that nevertheless concern us, and we call those non-tariff barriers, which are being raised in sectors that are theoretically being opened to international business. But as the opening occurs, a non-tariff barrier is raised, which negotiations to enter the WTO had never even anticipated. So that there are certain problems in certain sectors. I would quote the financial services sector, the automobile sector, to a certain extent the pharmaceutical sector, about where these barriers are being raised, and therefore thwarting the opening up that was envisaged under WTO.

Now, we then as an association work closely with the European Trade Director which negotiates trade policy on behalf of all European Union member states, and I have to say that in some cases there has been success in reversing some of these non-tariff barriers, which is good news, and I think that probably the line that we are taking or that the Commission takes, which is quite hard bargaining in these areas, is the right line, backed up of course by strong business representation. And I think that there is at least the prospect of progress in dismantling some of these barriers, but it needs perseverance and it needs a coalition of European business to make sure that the point is made.

And again referring to a remark that the Chairman made, I think there is a great deal to be gained by the EU and the U.S.A. coordinating their approaches on these matters, because the more that we can speak with the same voice, I think the more likely it is that China will listen. Because of course, China is a past master at dividing and ruling. It used to try that amongst the individual European Union member states, it would come to each of us individually and say, "Well, don't you agree to this, don't you agree to that?" And then try to make its case to the European Union on the basis that a number of states said that they did agree with a certain point. I think they now realize that actually they must negotiate with the Union at the Commission level, rather than trying to wheedle concessions out of individual states. So the more that we can work together, I think the better.

Just one last point I'd like to make, referring to something that John Monks said, which is of course the balance of interest between a flow of jobs to China, a flow of imports back to us from China, an unbalanced trade. I think this is a problem. I think in the UK, as John will know, where we are not any longer such a strong manufacturing country, we don't suffer to quite the same degree as other European countries may be suffering which have a bigger manufacturing base. In a way, those countries without such a big manufacturing base are benefiting, because I think in our non-visible trade with China, for example, in the UK, we do very well. Our invisible exports to China, financial services, professional services, education, are very strong, and to some extent redresses the imbalance of visible trade, not completely I don't think, but to some extent. And across the European Union of course you can see that other states are more in balance. Germany is in balance really

in its trade with China. The UK is a particular example that is out of balance. Holland is a particular example that is badly out of balance. But as I say, on invisibles I think sometimes there is a positive balance in favor of Europe.

I think also there is absolutely no doubt that the huge investment by western companies in China has assisted the Chinese government to liberalize China in a way that could never have happened without it. I think that big European companies, and small ones actually, responsible companies, take with them to China the sort of standards that they operate in this country. I've been around many European company plants in China. Some of them are merely replicas of the plants that they have in Europe, and they really try to apply the sort of terms and conditions that they apply in Europe. They can't afford not to do it, because they can't afford to be criticized at their annual general meeting by shareholders who accuse them of profiteering out of investing overseas. So I think there is a strain of responsibility that has helped China to liberalize in a way that would never have been possible unless they had opened up to foreign investment.

I'll leave it there.

[The statement follows:]

**Prepared Statement of Peter Nightingale
Chairman, Euro-China Business Association**

1. The Chinese Economy

The Chinese report GDP growth for the first nine months of 2004 at +9.1%. At the end of September 2004, China's foreign exchange reserves stood at US\$514.5 billion. At the end of October 2004 direct foreign investment for 2004 had reached US\$53.8 billion (exceeding the record total of the whole of 2003). At end of September 2004 annual price inflation measured +5.2%. Overall Chinese statistics show China's imports and exports at end of 3rd quarter 2004 to be +38% and +35% respectively, compared with same period last year (2003), and almost balanced.

Reacting to concerns that the economy is overheating in certain sectors, the government has taken measures to slow growth in these sectors (e.g. infrastructure, property). There has been some scepticism in the international financial community as to whether this can be achieved, but the signs are that the policy is working through a combination of administrative direction and monetary policy instruments (including an increase in interest rates).

There remain major challenges, such as the reform of China's banking structure, and movement towards freeing exchange rates. On the latter, the authorities have made it clear that they intend to make changes, but only when they deem conditions to have reached an appropriate stage. On the former there is evidence that China's Banking Regulatory Commission is seriously pursuing reform although a shortage of sufficient skilled personnel across the sector continues to be an impediment.

Overall, however, there are grounds for optimism that China's economic environment will remain stable and conducive to foreign participation.

2. Trade Policy Issues

On the whole China's compliance with obligations undertaken when it joined the World Trade Organisation has generally been satisfactory. Large numbers of laws have been changed and new regulations have been introduced. Generally, sectors have been opened to foreign participation in line with the timetables agreed with WTO.

The major problems currently encountered are:

- Poor protection of intellectual property. Sound regulations are in place, but at best, they are ineffectively applied and, at worst, openly flouted. The Chinese authorities say they are taking steps to improve matters; some foreign companies have succeeded in obtaining redress; and it is the case that there is now a growing number of local companies that realise they have intellectual property to be protected and thus, they themselves are beginning to urge reform.
- Erection of non-tariff barriers for foreign firms entering sectors, which, under WTO obligations, are otherwise opening up. Examples of this have been experi-

enced in financial, automotive, construction and other sectors. Foreign trade policy negotiators have had some success in persuading China to dismantle such obstructions, but the “level playing” field envisaged by WTO is by no means yet universal.

- Inability, for foreign companies in particular, to get favourable legal judgements enforced.

Much improvement is still required, but considering the progress, which has been made, particularly since China joined the WTO, the positive balance is impressive.

Earlier this year the European Union Chamber of Commerce in China, in a survey of its members, found 90% of respondents were “optimistic” or “cautiously optimistic” about prospects for their business in China. Sixty-four percent of responding companies expected to be profitable in 2004. Similar findings had been obtained in an American Chamber of Commerce survey in 2003.

3. EU-China Trade

The current status of EU-China (15 member states) visible trade (as reported by China) is shown on the attached chart.

Overall, there is a significant trade balance in China’s favour, but there are considerable variations between the performances of different member states.

The EU would like to see a more balanced trade, but current exchange rates are likely to lead to an increasing gap in China’s favour.

EU investment in China (at end 2003) is also shown on the attached chart. The UK is the largest EU investor in China followed by Germany and France.

There are no figures for Chinese investment in the EU but, given the Chinese government’s policy towards encouraging outward investment, this is seen to have a growing potential. A number of EU member states (e.g. the UK) are putting extra resources in to attracting Chinese investment.

Following its enlargement in May 2004, the EU has become China’s largest trading partner. China has shown increasing interest in its bilateral ties (particularly business) with the EU. Premier Wen Jiabao visited the EU Commission on 9.5.04 and addressed a well-attended EU business symposium in Brussels. He is due to repeat the exercise at a large business gathering to be held in The Hague, in conjunction with the annual EU-China Summit on 8–9 December 2004.

4. The Euro-China Business Association (ECBA)

ECBA is an association the members of which are the China business associations of each EU member state. It’s objective is to undertake China related business activities at the EU level, which enhance, rather than duplicate, the activities of individual member states’ China business associations.

ECBA liaises closely with the EU Chamber of Commerce in China and the EU Commission on trade policy issues regarding China.

The Chair of ECBA rotates, being held by one of the ECBA’s member organisations. It is currently held by the China-Britain Business Council.

European FDI in China Cumulatively to end of 2003 and in 2003

Unit: US\$ Billion

	Accumulative Total at end of 2003		Jan-Dec 2003	
	Contractual	Actual	Contractual	Actual
China Total	943.13	501.47	115.07	53.50
EU Total	65.94	37.87	5.85	3.93
UK	20.84	11.44	1.21	0.74
Germany	15.71	8.85	1.39	0.86
France	7.91	6.15	0.72	0.60
Italy	3.81	2.55	0.62	0.32
Netherlands	9.93	5.06	0.95	0.73
Spain	1.36	0.45	0.32	0.09
Sweden	1.27	0.93	0.11	0.12
Austria	1.04	0.44	0.13	0.09
Belgium	1.08	0.67	0.17	0.11
Denmark	1.41	0.52	0.08	0.04
Finland	0.61	0.39	0.07	0.03
Luxembourg	0.60	0.28	0.05	0.18
Portugal	0.13	0.07	0.02	0.00
Ireland	0.13	0.05	0.02	0.02
Greece	0.11	0.02	0.00	0.00

Source: Chinese Embassy 2004

EU15 export/import to/from China 2003

Millions of US Dollars

Rank	Country	Exports to China 2003	Year to date Sept 2004	Imports from China 2003	Year to date Sept 2004
	EU	53,061.87	52,635.11	72,154.86	75,384.89
1	Germany	24,340.51	23,058.79	17,535.74	16,382.79
2	France	6,097.67	5,738.20	7,293.70	7,142.28
3	Italy	5,080.21	4,772.15	6,653.16	6,761.38
4	United Kingdom	3,570.47	3,537.78	10,823.88	10,569.51
5	Belgium	2,768.19	2,555.57	3,934.38	4,088.08
6	Sweden	2,716.09	2,571.63	1,452.93	1,343.11
7	Netherlands	1,933.83	2,274.42	13,504.89	12,461.52
8	Finland	1,788.16	2,059.00	1,673.84	1,703.87
9	Spain	1,361.36	1,362.12	3,890.98	3,910.88
10	Austria	1,104.81	1,121.78	673.84	560.86
11	Denmark	964.17	882.68	1,494.33	1,341.41
12	Ireland*				
13	Portugal*				
14	Greece*				
15	Luxembourg*				

Not listed in China Customs Statistics Monthly
Source of Data: China Customs Statistics 2003/2004

Chairman D'AMATO. Thank you very much, Mr. Nightingale. I know we are going to want to pursue a lot of your comments with you. It was a very, very provocative and interesting presentation.

I would like to move on to Mr. Francesco Marchi, Director of Economic Affairs of the European Apparel and Textile Organization.

**STATEMENT OF FRANCESCO MARCHI
DIRECTOR OF ECONOMIC AFFAIRS
EUROPEAN APPAREL AND TEXTILE ORGANIZATION**

Mr. MARCHI. Thank you for giving EURATEX the opportunity to present, before your Commission, the European textile and clothing industry's point of view on today's subject.

First of all, who is EURATEX, by the way? Well, we defend the interests of the textile and clothing industry in the enlarged European Union, and in our partners of the pan Euro Mediterranean rim. Our members are all the 25 EU member states, plus other countries, plus Turkey, plus Morocco, plus Tunisia, and maybe others coming from the pan Euro Mediterranean rim.

As of May 1, the EU-25 textile and clothing industry reached a turnover of roughly 213 billions of Euros, employing 2.5 million of workers in over 170,000 companies. So our problem is [inaudible].

While close to 25 percent of our turnover is exported outside the EU, China is clearly EU's first textile and clothing supplier with a global share of 17.5 percent in value, and the trade deficit is mounting to minus 11, minus 12 billion of euros, which represents roughly 40 percent of the overall textile and clothing deficit with the rest of the world.

The accession of China to the WTO brought a giant economy into the rules-based international trading system, and it opened the market to exports, and thus offered a genuine growth potential for EU companies. These exports in 2003 have reached and grown roughly to a level of more than 683 million of euros. This is encouraging even if China represents only 1.7 percent of the total EU value of exports.

Nevertheless, EU companies are determined to increase their exports to this very promising, fast-growing, but difficult market. This explains why for us it is crucial that for our industry that China fully implement its commitments in joining the WTO, where tariff reductions and removal of non-tariff barriers are concerned. China has to date clearly respected its commitments in respect of tariff reductions, but a number of further barriers still exist today.

Some examples: lengthy custom clearance procedures; lack of transparency; costly and complex standards in quality controls; exports and other subsidies; problems in distribution; and on protectional investment for textiles and clothing companies. And we expect the EU Commission and the WTO member states, and mainly the U.S., could help us ensure that trade barriers are permanently removed as rapidly as possible.

It is just as important that the Chinese authorities should themselves take all the appropriate action to stamp out any breach of intellectual property rights in their country. Not only is it essential that Chinese legislation should conform to Article 25, Paragraph 2 of the TRIPs agreement, relating to textile designs and models, and which they have denied since 2001, but at the same time there should be in China a genuine will to apply such legislation everywhere. Infringements in the recent past which EURATEX has been called upon to deal with have demonstrated that this is far from being the case.

Since 2002 China has completely distorted the ATC agreement on textiles and clothing dismantling process. Price cuts in 2002–2004 periods have been impressive. Liberalized categories, average prices have been cut up to minus 75 percent. As a result, this country has consolidated its focus on the EU market with exports that by the end of 2003 were more than 12 billion euros, and continue to grow at the two-digit rhythm.

I find it difficult to believe that all of that growth can be ascribed alone to the disappearance of the quota rents, as important as they have undoubtedly been, otherwise India or Taiwan or others would have benefited also to a similar extent.

We have already as an industry, stressed in 2001–2002 that the renminbi is vastly undervalued, but it is not enough to explain the China mystery price, identified also by the U.S. industry and by the Peruvian government recently.

Definitely, the non-respect of minimal labor conditions has impacted negatively the overall competitiveness of the world sector, but also the inability to price correctly their price.

Bank lending rates too are a problem, and I won't spend too much time on that. But we have been able to determine to what extent the banks themselves are solvent in certain cases, and what the role of the state is. But as China has invested the most in the most modern textile machinery in recent years within the world, one may ask how it is being paid for. That's a big question.

What is clear is that at the end of this year the remaining 24 categories will be integrated under the normal rules of the WTO, and those represent roughly 36 percent of the value of their exports to the EU from China, and roughly 22 percent of the volumes in tonnages.

But those categories are mainly apparel products, and 21 of those 34 already are utilized, at means above 90 or 100 percent of the quota. So this means that the boom is there.

If the Chinese production behavior focuses on very high price cutting accompanied by huge increases of volumes, it is evident that one ought to expect a massive impact on overall EU trade to the detriment of all other exporters, as well as to the EU–25 production base, thus reinforcing and China's leadership.

In addition, U.S. industry and authorities have launched a raft of safeguard requests and/or measures, based for the most part on the threat of injury. Not only will we in Europe face, in 2005, the risk of massive increases of absurdly priced goods from China when the quota will expire, but in addition, we will have to shoulder the added burden of additional quantities that would normally have found a home in the U.S.

This will occur at the moment when the industry is facing one of its most difficult periods over the last 20 years, as the EU market has not shown improvements since 2001. The real expenses are decreasing in clothing and textiles, and the exports are hampered in its most natural markets, and it's not a question of exchange rates.

To prevent such additional negative impact, clearly, we as the association have launched a political dialogue with the Commission and the member states to obtain first of all an effective and timely monitoring system to cover both quantities and prices first of all

for China, but, also for other dominant suppliers. India, Pakistan may be the next problems tomorrow. Also to obtain clear guidelines on criteria for specific textile safeguards to enable us to determine under what conditions and with whom action can be taken.

Finally, EURATEX, as do the rest of the EU manufacturing industries, opposes the request to grant China the market economy status. Indeed, in our sector the role of the state remains important as only 34 percent of the 38,000 Chinese companies are truly privatized.

Besides those more defensive elements, we are promoting more offensive actions. Special studies have been launched to assess the real impact of both non-tariff barriers and government practices in the financial sectors and in the environmental area on the Chinese textile and clothing companies' competitiveness. And clearly from there we will act upon and support our exports that remain important for us.

Finally, the EU and China launched a political trade dialogue on textiles and clothing in May 2004, both between the administrations and the representatives of the industry. This complemented clearly a more technical discussion on standards and technical barriers that had been launched 18 months ago. But we have to witness one thing; results are far from being tangible, and particularly in trade.

In conclusion, times ahead will be tremendously difficult and challenging for our companies. But one thing is sure, China should obey and implement WTO rules to allow our industry the freedom to develop and prosper within the commonly agreed multilateral framework. Competition is not a problem for us, but what we want is not a free-for-all. We surely have a right for a fair-for-all, and we will duel for it.

Thank you.

[The statement follows:]

**Prepared Statement of Francesco Marchi
Director of Economic Affairs
European Apparel and Textile Organization**

Thank you for giving EURATEX the opportunity to present before your Commission the European textile and clothing industry point of view on today's subject.

I do wish to point out first of all what EURATEX represents. Our mission is to defend the interests of the textile and clothing industry in the European Union, in the new member-states and in our partner-countries of the Pan Euro Mediterranean rim, of which Turkey is by far the largest. I think that it is worthwhile noting that as of May 1st 2004 the EU-25 textile and clothing industry has a turnover of some € 213.4 billion (-6.0%), employing more than 2.570 million workers (-5.6%) across the 25 member-states of the enlarged Union and over 170,000 companies. Interestingly EU companies exported outside the EU-25 close to 25% of the overall turnover.

China is EU's first textile and clothing supplier with a global share of 17.5% in value and the trade deficit reached € -11.6 billion or 40% of the overall EU-15 textile and clothing trade deficit.

1. Chinese WTO compliance

The accession of China to WTO was by definition an important event. It brought a giant economy of the near future and today's largest textile and clothing manufacturer into the rules-based international trading system. It opened the Chinese market to exports from other countries, and thus offered genuine growth potential for EU exporters of textiles and clothing products. These exports already amounted to € 593 million in 2002 and for the whole of 2003 that amount has grown to € 683 million. This is encouraging even if China represents only 1.7% of Extra-EU-15 ex-

ports in value. Most of these exports are concentrated in high end semi finished textile products (representing 90% of EU exports to China) while direct exports of household linen and of apparel remains at desperately very low levels (€ 71 million only). For 2004 the prospects are less positive partially due to the Euro/\$ exchange rate.

EU companies are determined to increase their exports to this very promising fast-growing, but difficult market. This explains why it is crucial for our industry that WTO and the EU ensure that China fully implements its commitments in joining WTO where tariff reductions and the removal of non-tariff barriers are concerned. China has to date respected its commitments in respect of tariff reductions. But a number of other barriers still exist today.

For example, members have reported lengthy customs clearance procedures, lacking in transparency that translates sometimes into high reference prices for imported goods which arbitrarily increase the duty to be paid; costly and complex standards and quality controls which are more stringent than for domestic products; export and other subsidies; problems in distributing goods around the country; reluctance of foreign companies to take part in investment projects for fear of lack of protection of their investment. We expect the EU Commission and WTO member-states to ensure that these barriers are permanently removed as rapidly as possible.

It is just as important that the Chinese authorities should themselves take all appropriate action to stamp out any breaches of intellectual property rights in the country. Not only is it essential that Chinese legislation should conform to Article 25.2 of the TRIPs agreement, relating to textile designs and models, but at the same time there should be in China a genuine will to apply such legislation everywhere. Infringements in the recent past which EURATEX has been called upon to deal with have demonstrated that this is far from being the case.

2. The year end reduction of textile quotas and the effect on industry of Chinese exports

Even without taking into consideration the €/ \$ exchange rate (which makes Asian export prices correspondingly lower) China has completely unbalanced the ATC dismantling process as the 2002 ATC integration has proven.

What is clear is that at the end of this year the remaining 34 categories will be integrated under the normal rules of WTO representing in trade terms for 2003, a little bit more than 22% of the volumes imported from China and 36% of the value. Those categories are mainly apparel product categories of which most of them (21) are already highly utilised (> 90% of the quota level) despite quota increases enshrined in the ATC.

This will occur at a moment where the industry is facing one of its most difficult periods of the last 20 years as the EU market is not showing improvement since 2001: the final consumption is decreasing in real terms and the exports, one of the driving forces of our industry, is hampered by slowing down consumption in his most important markets, increased competition and a disastrous €/ \$ exchange rate.

There is a clear risk that if the Chinese producer behaviour is the same as the one observed during the 3rd ATC phase—very high price cutting accompanied by huge increases of volumes—one might expect a massive impact on overall EU trade to the detriment of other exporters as well as to the EU-25 production base. This country will consolidate its leadership on the EU market with exports which already by the end of 2003 amounted to € 12.3 billion. This is 18 times greater than European exports to China.

3. Chinese textile “dumping”

Price cuts in the 2002–2004 periods have been impressive either in Euro terms or in USD. Elements are showing that in the liberalised categories average prices have been cut up to 75%.

What then are the elements which have contributed so much to the success of China as an exporter of manufactured goods? I find it difficult to believe that all of this growth can be ascribed alone to the disappearance of quota rents important as they have undoubtedly been, otherwise India and others would have benefited to a similar extent. This being said, EURATEX already stressed in 2001/2002 that the renmimbi is vastly undervalued but this is not enough to explain the “China mystery price” dilemma also identified by the U.S. industry as well as by the Peruvian government in its recent safeguard clause on specific apparel products.

Bank lending rates too are understood to be as low as 1.1%, at least in those cases where the borrowed money is ever likely to need to be reimbursed. We have been unable to determine to what extent the banks themselves are solvent, and what the role of the state is. There can however be no dispute as to the fact that in many areas of spinning and weaving machinery China has invested the most in the most

modern machinery in recent years. The % of total world investments by China in 2000, 2001 and 2002 is impressive to say the least. One may however ask how it is being paid for.

4. How the EU is responding to your industry's concerns in connection with China

As you know, our American colleagues and their authorities have launched a raft of safeguard requests and/or measures, based for the most part on threat of injury while in the EU the industry is still expecting clarifications on the procedures.

Not only then will we face in 2005 the risk of massive increases of absurdly priced goods from China when the quotas expire, as we already did in certain categories after January 2002, but in addition we may have to shoulder the added burden of additional quantities which would normally have found a home in the United States. Such a state of affairs would be intolerable.

To prevent such additional negative impact, EURATEX launched a political dialogue with the Commission to obtain:

1. Firstly an effective and timely monitoring system to cover both quantities and prices first of all for China, but also for other dominant suppliers.
2. Second, clear guidelines and criteria for specific textile safeguards are needed to enable us to determine under what conditions and with whom action can be taken.

Besides those more defensive elements, due to the size of the market and the natural behaviour of EU companies to export, EURATEX promotes more offensive actions:

1. Special studies funded by the Commission have been launched to assess with great care and in details the real impact of nontariff barriers and of government practices in the financial sector and in the environmental areas on Chinese textile and clothing companies' competitiveness. Those studies are on the verge to finish and from their analysis several actions may be launched to force a better market access to EU products directly to the final Chinese consumer.
2. The EU and China launched a political trade dialogue on textile and clothing from May 2004 both between the administrations and the representatives of the industries. This complemented a more technical discussion on standards and technical barriers to trade experienced while entering both the EU or China markets that were launched 18 month ago. Results are far from being tangible particularly as far as "the trade dialogue is concerned."

5. Debate regarding whether to grant China "market economy" status

As far as China "market economy" status is concerned EURATEX position do not divert from the one expressed publicly by the EU manufacturing industry as a whole. EURATEX does not see any reason why we should accept the request to grant China "market economy status" in a sector where the role of the state remains still important. Only 34% of the 38,000 companies are truly privatised, the remaining companies being or mixed joint-ventures (foreign capital and local municipalities) or 100% state owned (13.4% of the total). Moreover, for the Chinese government textile and clothing is the sector out of which the country expects to drag out positive results from its membership to the WTO as in the other areas; they consider that this has represented an additional burden with "few immediate results."

6. Areas of cooperation between the U.S. and Europe in this area

EU companies have since had long very tight relationships with their subsidiaries in the U.S. or with customers of suppliers of high value added textile products. This explains why the U.S. is our first customer with € 4.5 billion exports, despite lengthy customs procedures, and European companies realised a trade balance surplus of € 3.2 billion in 2003.

As a natural consequence, EURATEX has regular exchange of information with the U.S. textile and clothing industry associations mainly on international issues, such as WTO negotiations, China impact, etc., while attempting as much as possible to minimise the negative impact of possible trade wars between EU and the U.S. (i.e. Byrd amendment, etc.).

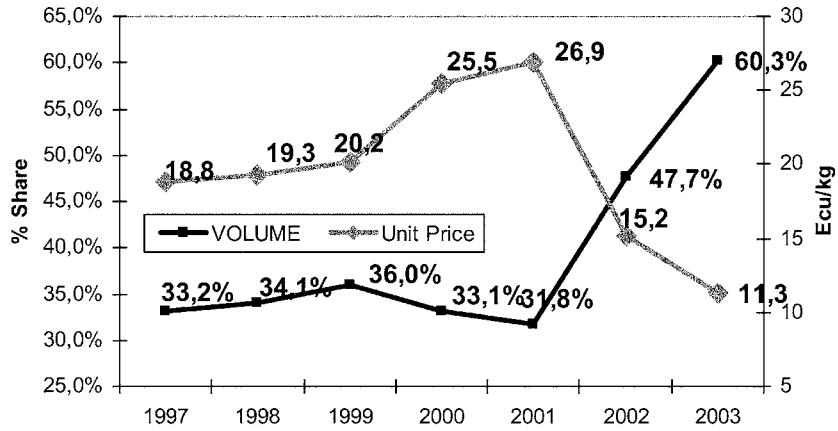
7. Conclusions

I am sorry for having spoken longer than allowed, but the complexities of our relationships with China deserve a little more time.

One thing is sure China should obey to and implement WTO rules so to allow our industry the freedom to develop and prosper within a commonly agreed multilateral framework—we do not want a free-for-all, but we surely have a right to a fair-for-all.

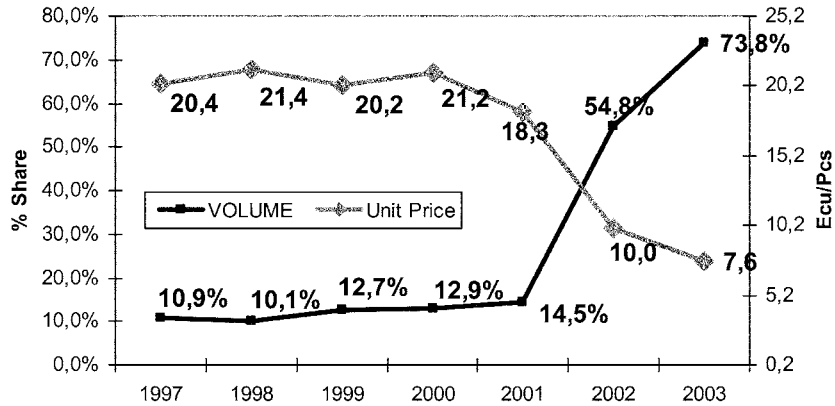
**EU Market share evolution of Chinese Exports
Cat 68 (volume)—Babies' garments and clothing accessories**

EU's imports from China increased 108% in 2002 and 44% in 2003.



**EU Market share evolution of Chinese Exports
Cat 21 (volume)—Parkas, Anorak ... Other than knitted/crocheted**

EU's imports from China increased 451% in 2002 and 87% in 2003.



Abstract from EURATEX Bulletin 2–2003 June 2003 (pg 60 to 65)

“V. A few remarks on China after the liberalisation of quotas from which it benefited in 2002

It no longer astonishes anyone when someone says that, in 2002, Chinese firms showed an amazing ability to resist to the prevailing crisis and even to take advantage of it to secure a growing number of market shares on all the markets of industrialised countries. This also proved to be true in the European Union for which the analysis of data shows that it is mainly—but not only—thanks to the categories of products which were liberalised following the accession of China to WTO that Chinese firms were able to gain such a foothold on the Community market.

When we compare the trends of Chinese trade with those of the rest of the world, for all the textile and clothing products exported to the EU (table 1), we note the following changes:

- In value terms, imports of textile products from the rest of the world recorded a setback in 2002 (–6.2%), while Chinese sales were increasing by +8.5%. On the other hand, purchases of clothing articles from the rest of the world stagnated overall in euros (–0.8%) while, in 2002, imports of clothing articles from China grew very rapidly (+10.5%). Thus, for the whole sector, China gained market shares (+10.0%) to the detriment of the rest of the world (–2.3%). What is however more astonishing is that practically all of the growth in value terms of Chinese imports is only ascribable to the liberalised categories:¹ 96.4%!
- A similar trend was noted in volume terms: imports of textile products from the rest of the world stagnated in 2002 (–0.2%), while Chinese sales grew very rapidly (+21%). On the other hand, purchases of clothing products from the rest of the world also stagnated in value terms (+0.4%) while, in 2002, clothing imports from China reached an all-time high with a growth of +35.6%. For the whole sector, China gained market shares in value terms (+29.6%) to the detriment of the rest of the world (–2.4%). However, only 61.2% (?) of the increases in the volumes imported from China are ascribable to the liberalised categories.
- At the end of this crazy year, China has supplied 19% of the volumes (instead of 15.1% in 2001) and accounted for 16.4% (as compared with 14.8% in 2001) of the products in value terms purchased by the EU-15 from the rest of the world!

The most alarming consequence of these trends is the “price effect,” especially for the categories of liberalised products. An analysis of the table 2 shows that:

- For those categories for which Chinese prices were lower than world prices, Chinese prices tended to remain low in 2002 (Cat. 37, 76) or increased slightly (Cat. 19, 33) while maintaining the same difference vis-à-vis world import prices into the EU.
- On the other hand, for the categories of products for which Chinese prices were by far superior to the reference prices in the rest of the world in 2001, import prices declined strongly in 2002 to reach or fall much below the level of the prices of the rest of the world. This is more particularly the case for categories: 10, 18, 21, 24, 32, 68, 73 and 76 (see description in table 2).

On the other hand, when we compare the trends of average prices and of market shares, we note that, in most cases, there is a direct link between the liberalisation, the slump in prices and the gains of market shares from which Chinese producers benefited (with the sole exception of categories 19 and 33) as demonstrated by the table hereunder:

A brief look at the table 3 enables us to draw some conclusions: first of all, the growth of market shares in imports is very high in terms of volume: most of the time, this share doubled in 2002. Secondly, the explosion is more obvious for clothing products, even if, overall, all performances are remarkable. Finally, for those categories for which China already had a dominant position in Community imports before the liberalisation, the growth is not so clear cut and seems to be stabilising (?) around 40% in value terms and 50% in volume terms.

Which conclusions can we draw from this? These upheavals, on the eve of the full liberalisation of the textile and clothing markets in accordance with the ATC, are the consequence of a combination of elements which EURATEX tried to isolate and which only enable to explain in part the scope of the phenomenon witnessed in 2002:

¹ Categories: 10, 18, 19, 21, 24, 32, 33, 37, 68, 73, 76

- The price of the quota: in China and elsewhere, it is common practice to buy export quotas to the U.S.A., Canada and the EU. The available information analysed by EURATEX shows that the impact of the purchase of quotas can only account for 20% of the slump in prices recorded in 2002.
- The volume effect: for all the products for which Chinese producers were controlling a high share of the market of Community imports (close to 50% in 2001), growths in volume terms were comparatively less for the period 1997–2002. On the other hand, it is obvious that for textile products (e.g. category 32), Chinese producers seem to have deliberately reduced their prices to exclude other world competitors.
- The exchange rate effect: of course, one cannot go without mentioning the trends of exchange rates since 2001: the relative devaluation of the dollar against the euro makes imports more attractive, especially if, as some pretend, the Chinese authorities have deliberately reduced the value of their currency in relation to the dollar. This being said, when we “sterilise” prices by using, e.g. the average euro/U.S. dollar exchange rate of 1997, we realise that, over the last five years, Chinese prices, expressed in U.S. dollars of 1997, have always been inferior to the world reference prices and that this had been concealed by the very relative weakness of the euro until 2002.
- Effects of productive capacity: at the end of the nineties, the industrial restructuring effected by the Chinese authorities to endow State enterprises with a certain degree of competitiveness was much talked about. This modernisation was coupled, especially in the private sector—but not only there—with an unprecedented growth of investment in the latest technologies by attracting investment from big Japanese, South Korean and Taiwanese groups, among others. These groups started their quest for the Grail and invested heavily in China, thus increasing productive capacity at the same time, and staking on the huge consumption potential of that market. But, as Chinese household consumption cannot currently absorb these quantities, the latter flow on world markets, thus impacting prices.
- Impact of purchasing methods: the buyers of the big central purchasing units, but not only they, have started to rationalise their supplies and take advantage of the increase in available volumes to intensify competition between suppliers, forcing a deflation of selling prices, a situation from which Western consumers do not seem to benefit in the end.
- Incapability of other suppliers to face this competition, especially “small suppliers” or “specialised” suppliers. To cope with this situation, several countries: [a] asked for a relaxation of the privileged commercial rules that tie them to industrialised countries to facilitate their access to the consumers of those markets; and/or [b] have embarked on programmes to improve quality, have moved upmarket, choosing products with a higher added value, etc. ... Now, an enormous amount of time will be necessary to effect this change and to position themselves on markets with more limited growth rates, at least in volume terms; it will inevitably increase competition in these market niches and, in the long run, it will once again bring prices down. This being said, these two behaviours will not be sufficient to rise to the challenge launched by China. Indeed, so far as making-up is concerned, Chinese firms have quality labour at their disposal in quantity and at low costs. Thus, these firms are unavoidable for mass production.

Of course, these elements only provide a part answer to the Chinese challenge and the shadow of this industrial power will still be felt for a long time by the sector, except if: [a] the Chinese authorities succeed in bringing some discipline into their industry and in strengthening their negotiating power vis-à-vis world buyers; [b] the Doha Development Agenda guarantees a concrete improvement of access to world markets which will enable to reduce the pressure on the markets of industrialised countries and probably guarantee a better match between supply and demand, thus also promoting a stabilisation of prices ... provided world growth can resume its course.

See appendix tables.

**Appendix to
"Abstract from EURATEX Bulletin 2-2003 June 2003 (pg 60 to 65)"**

Table 1 : EU Imports from PR China in 2002

	China		World without China		World		Share (China on World) % in 1000 Eur
	1000 EUR	02/01	1000 EUR	02/01	1000 EUR	02/01	
Total Textiles	2,219,779	8.5%	15,939,683	-6.2%	18,159,462	-4.7%	12.2%
Total Apparel	9,186,474	10.5%	42,149,474	-0.8%	51,335,948	1.1%	17.9%
Total Text+ Cloth	11,406,253	10.1%	58,089,157	-2.3%	69,495,410	-0.5%	16.4%

	TONs		TONs		TONs		% in Tons
	TONs	02/01	TONs	TONs	TONs	02/01	
Total Textiles	446,597	21.0%	3,552,856	-0.2%	3,999,453	1.8%	11.2%
Total Apparel	721,471	35.6%	2,537,137	0.4%	3,258,808	6.6%	22.1%
Total Text+ Cloth	1,168,068	29.6%	4,964,291	-2.4%	6,132,359	2.4%	19.0%

Importance of liberalised categories

	1000 Euros			Tons		
	All products increases 2002/2001	Liberalised categories increases	Share of liberalised Chinese categories growth on total Chinese growth	All products increases 2002/2001	Liberalised categories increases	Share of liberalised Chinese categories growth on total Chinese growth
Total Textiles	174,298	145,689	83.6%	77,441	40,737	52.6%
Total Apparel	873,199	864,072	99.0%	189,228	122,476	64.7%
Total Text+ Cloth	1,047,497	1,009,761	96.4%	266,669	163,213	61.2%

Table 2: China price evolutions for liberalised categories - 2002

Liberalised Categories	Chinese Price on world price* December 2001	Chinese Price on world price* December 2002
10 - Gloves	1,79	1,08
18 - Underwear knitted	1,96	0,95
19 - Handkerchiefs	0,39	0,41
21 - Anoraks	1,18	0,66
24 - Pyjamas knitted	1,01	0,87
32 - Woven pile fabrics	1,24	0,72
33 - Woven fabrics polyethylene-polypropylene	0,76	0,79
37 - Woven fabrics of artificial fibres	0,60	0,53
68 - Babies garment s	1,39	0,84
73 - Tracksuits	1,50	0,77
76 - Work wear	0,61	0,43

*World Price = 1,00

Source: CITH

Table 3: China : Market shares of the liberalised categories in EU-15 imports

Liberalised Categ.	Market Share in EURs		Market Share in Volume or Pieces	
	December 2001	December 2002	December 2001	December 2002
10 - Gloves	26,4%	36,4%	16,7%	34,7%
18 - Underwear knitted	26,4%	31,6%	15,5%	32,8%
19 - Handkerchiefs	34,5%	33,1%	57,6%	55,0%
21 - Anoraks	16,7%	44,5%	14,5%	54,9%
24 - Pyjamas knitted	20,1%	22,3%	20,0%	24,7%
32 - Woven pile fabrics	25,5%	47,2%	21,5%	55,5%
33 - Woven fabrics polyethylene- polypropylene	4,7%	4,3%	6,0%	5,4%
37 - Woven fabrics of artificial fibres	12,9%	17,2%	19,8%	28,3%
68 - Babies garment s	39,4%	45,5%	31,8%	49,8%
73 - Tracksuits	25,3%	44,5%	18,4%	51,1%
76 - Work wear	11,3%	13,7%	17,2%	26,9%

Source: CITH

Abstract from EURATEX Bulletin 2-2004 June 2004 (pg 57 to 67)

“V. A few remarks on China after the liberalisation of quotas from which they benefited in 2002

China consolidates year after year an unstoppable performance, which is “stealing” market shares from all other major world partners, even within the INTRA-EU market itself. It comes now as no wonder why China takes day after day new front pages in all major journals as to how this Chinese miracle is being achieved.

With regards to the EU, China is today both the major supplier of Textiles (2.4 billion EUR) and Apparel (10.8 billion EUR), recording increases of circa +10%. This is even more striking if one should bear in mind the overall economic slowdown and slow recovery still under way. China seems not to be affected by world economic patterns, but rather by “China” patterns.

The analysis of data proves that it is mainly—but not only—thanks to the categories of products which were liberalised following the accession of China to the WTO that Chinese firms were able to gain such foothold on the Community market.

When comparing the trends of Chinese trade with those of the rest of the world, for all the textile and clothing products exported to the EU (table 1), we note the following changes:

- In value terms, imports of textile products from the rest of the world recorded a similar setback as the one experienced during 2002 (−6.5%), while Chinese sales increased by +6%. Similarly, purchases of Apparel from the rest of the world decreased (−2.2%) while China observed an evolution of sheer size (+9.2%). Thus, for the whole sector, China gained market shares (+8.5%) to the detriment of the rest of the world (−2.3%). Clearly, the bulk of the growth of Chinese TC articles in the EU market is chiefly ascribable to the striking development of the already liberalised categories. Indeed 72% of the total increase was recorded by the above categories. Admittedly, this is particularly the case with regards to Apparel, which remain the most protected categories whereas Textiles protection remains rather limited.
- In volume terms, the Chinese pattern accentuates whereas the picture of the rest of the world remains unchanged. If EU imports from China increased by circa +10% in value; when regarded in volume, imports of China recorded an even stronger evolution (+21% in Textiles and +26% in Apparel). Once again, this intuitively points to a further drop in prices. As a result the part taken by China on the total EXTRA-EU imports of TC products is now 19%! Interestingly, the weight of the liberalised categories on the total increase is again lower when accounted for in tons.
- This fabulous trend has led China to gain an impressive foothold of the EU TC market. While in 1995, China accounted for 7.9% and 12.8% of the total EU15 imports, for Textiles and Apparel respectively; China today represents 13.9% and 20.4%. What’s more, while EU world imports of Textiles increased (between 1995 and 2003) by 35%, China increased by 138%. In Apparel EU imports rose by 83% whereas imports from China rose by 191%.

The most alarming consequence of this trend remains the “price effect,” especially for the categories of liberalised products. The analyses of the table 2 leads to the following conclusions:

- For those categories for which Chinese prices were lower than world prices, Chinese prices have stabilised. This is the case of woven fabrics of polyethylene-polypropylene (Cat. 33) and handkerchiefs (Cat. 19).
- For the rest, categories for which Chinese prices were above the world price in 2001, awesome drops in prices could be perceived during the year 2002, placing them always below the world price. Evolution which came to a halt for some categories (gloves, anoraks or woven fabrics of artificial fibres), but accentuated for the rest. This is, Chinese operators have placed most of these products at a price circa 20% (sometimes even more) lower than all other EU suppliers.

Most alarmingly, when one puts into perspective the trend of the average prices with that of market shares, one notes that, in most cases, there is a direct cause-effect link between the liberalisation, the slump in prices and the gains of market shares from which Chinese producers benefited.

Clearly, the analysis of the table 3 pinpoints the huge potential of China to cut prices and take outstanding market shares in view of the forthcoming quota phase out on January 1, 2005. Market shares shot up in all cases (with the only exception of Cat. 33) during the first year of liberalisation, reaching market shares of 30% or even 40% of the EU market. This is not all, during the second year of liberalisation (2003) practically all market shares showed no intention to stabilise or even de-

crease, but rather accentuate further, to the point that China has over 50% market share of the EU market! (Cat. 21, 68 and 73). In volume terms this trend is even more marked. Market shares of China attain ridiculous levels such as 75% for Parkas (Cat. 21), 67% for Tracksuits (Cat. 73) or 60% for baby garments (Cat. 68) and woven pile fabrics (Cat. 32).

Analysis of CHINESE exports to the World—HS 2-digit chapters—Value (table 4, table 5)

Further to the previous chapter particularly focused on the Chinese impact on the EU15 TC market following accession to the WTO and the resulting quota phase-out, EURATEX has taken the approach to look at the perspective of trade from the Chinese side. Baring this in mind, EURATEX has been in a position to obtain Chinese trade data allowing EURATEX to put itself in Chinese' shoes to better understand their market strategy and positioning.

Chinese exports of TC to the World (in value) are concentrated in articles of Apparel (HS62) and Knitted and Crocheted Apparel (HS61). Together they cover over 60% of the total TC exports. Household linen (HS63) comes next in importance, representing 8.4% of total TC exports. Clearly, China's competitive advantage in Clothing is pricing out other world suppliers and gaining rapid ground on all world markets, particularly in industrialized countries. Chinese specialization in Textiles is less patent, at least from the export perspective and because 30% of exports are sent to Hong Kong (see next paragraph). Cotton exports and Man-made filaments exports represent together almost 50% of total exports of Textiles; although from every 3 US\$ exported by China, 1 is Textiles and 2 are Apparel.

Interestingly, Hong Kong appears as the China's major client in TC products in 2003 having recorded a total of 15 billion US\$ of imports. Admittedly, Hong Kong represents a port for re-exportation which makes it unclear what the ultimate consumption market is. This is the major explanation, other than the FOB and CIF one, for the apparent incomprehensible difference between official EU imports from China (in US\$) and official exports from China to the EU (in US\$). The reason lies on the fact that while Chinese Customs Statistics measure direct trade only, Eurostat² includes the flow goods via third countries as well, and thus covering also Hong Kong or other intermediate countries' trade, not taken into consideration in Chinese official data.

This reality generates a major gap between both statistical offices' figures, and particularly in the case of Apparel. This can clearly be perceived by the fact that the EU15 declares imports of 2.7 and 9.6 billion EUR of TC from China in 2003, this is, 3.1 and 10.9 billion US\$, whereas China declares having exported to the EU15 2.7 and 5.0 billion US\$.

After Hong Kong, Japan, to which China has exported 14.5 billion US\$ worth of TC products in 2003, represents the largest client of Chinese TC manufacturers, and particularly in Apparel. Indeed, Japan was flooded in 2003 with 12.1 billion US\$ worth garments (HS61–62) and 1.3 billion US\$ Household linen (HS63), far more than all other industrialized markets like the U.S. or the EU. Japan alone accounts for 1/4 of Chinese Apparel exports to the world.

The EU15 is the third largest client for Chinese TC products,³ with imports totaling 7.7 billion US\$ in 2003 or 9.4 billion US\$ for the EU25. This accounts for 10.4% and 12.9% of Chinese total exports to the world, respectively. The EU15 dependency on Chinese imports lies on Garments, not knitted or crocheted (HS62), representing over 40% of total Chinese exports of TC to the EU15 or 7 billion US\$. In this aspect, the EU15 is more dependent from the Chinese supply than the U.S.A. Knitted and crocheted garments come second with 21% or 1.6 billion US\$, although here, the EU15 dependency is less marked than in the U.S.A. In Textiles, the EU15 is mostly dependent upon Household linen (HS63) and Man-made filaments imports (HS54).

Finally, the U.S. position is characterized by a similar concentration of cheap imports of garments from China, representing together 2/3 of total exports into the U.S., whereas U.S. dependency in Textiles is far less marked. However, one chapter stands out for the sheer size of U.S. dependency upon the Chinese market, Household Linen (HS63). The U.S. imported in 2003 1.8 billion US\$ worth of Household Linen, 30% more than Japan or 100% than the EU15. Indeed, Chinese exports of Household Linen to the world totaled 6.2 billion US\$ in 2003, and those to the U.S. alone amounted to 1.8 billion US\$, this is, 29% of Chinese total exports!

Generally, China opts for exporting the bulk of its Textiles to Hong Kong, where they will be further re-exported to the world. This is typically the case of "Other vegetable textile fibres; paper yarn and woven fabrics of paper yarn" (HS53) or Knit-

²European Commission Statistical Office.

³Second if one disregards Hong Kong.

ted and Crocheted Fabrics (HS60), which represent nearly 60% of Chinese exports to the world. Other headings are lower although still paramount, Cotton, Wool, Man-made staple fibres, etc. Contrarily, Apparel exports tend to go directly to their final market, with Japan as the top world importer of Chinese garments as already mentioned above. When it comes to the EU15, the largest dependency on the Chinese market stands out in terms of Silk (HS50), Wool (HS51), Man-made filaments (HS54) and carpets (HS57). Although in this latter case, U.S. and to a lesser extent Japanese, dependence is even larger.

See appendix tables.

**Appendix to
“Abstract from EURATEX Bulletin 2–2004 June 2004 (pg 57 to 67)”**

Table 1: EU Imports from PR China in 2003

	China		World without China		World		Share (China on World)
	1000 EUR	03/02	1000 EUR	03/02	1000 EUR	03/02	
Value							% in 1000 Eur
Total Textiles	2.699.336	5.9%	17.351.503	-6.5%	20.050.839	-5.0%	13.5%
Total Apparel	9.636.681	9.2%	40.585.140	-2.2%	50.221.821	-0.2%	19.2%
Total Text+ Cloth	12.336.017	8.5%	57.936.643	-3.5%	70.272.660	-1.6%	17.6%

	TONs		TONs		TONs		% in Tons
	03/02	03/02	03/02	03/02	03/02		
Volume							
Total Textiles	614.819	25.2%	5.072.384	-2.7%	5.687.203	-0.3%	10.8%
Total Apparel	931.586	33.8%	2.538.393	6.6%	3.469.979	12.8%	26.8%
Total Text+ Cloth	1.546.405	30.3%	7.610.777	0.2%	9.157.182	4.3%	16.9%

Importance of liberalised categories

	1000 Euros			Tons		
	All products increases 2003/2002	Liberalised categories increases	Share of liberalised Chinese categories growth on total Chinese growth	All products increases 2003/2002	Liberalised categories increases	Share of liberalised Chinese categories growth on total Chinese growth
Total Textiles	150.070	47.588	31.7%	123.482	25.046	20.3%
Total Apparel	815.118	646.581	79.3%	235.416	107.529	45.7%
Total Text+ Cloth	965.188	694.169	71.9%	358.898	132.575	36.9%

Table 2: China price evolutions for liberalised categories - 2003

Liberalised Categories	Chinese Price on world price*	Chinese Price on world price*	Chinese Price on world price*
	December 2001 Revised data	December 2002 Revised data	December 2003
10 - Gloves	1.27	0.80	0.88
18 - Underwear knitted	1.72	0.97	0.85
19 - Handkerchiefs	0.71	0.72	0.70
21 - Anoraks	1.13	0.73	0.78
24 - Pyjamas knitted	1.03	0.94	0.78
32 - Woven pile fabrics	1.19	0.85	0.80
33 - Woven fabrics polyethylene-polypropylene	0.77	0.80	0.73
37 - Woven fabrics of artificial fibres	1.29	0.61	0.66
68 - Babies garments	1.24	0.96	0.85
73 - Tracksuits	1.05	0.86	0.81
76 - Work wear	1.02	0.66	0.65

*World Price = 1,00

Source: CITH

Table 3: China : Market shares of the liberalised categories in EU-15 imports

Liberalised Categories	Market Share in EURs			Market Share in Volume or Pieces		
	December 2001	December 2002 (*)	December 2003	December 2001	December 2002	December 2003
10 - Gloves	26,2%	36,4%	39,5%	20,6%	45,6%	44,7%
18 - Underwear knitted	26,5%	31,6%	35,4%	15,5%	32,7%	41,4%
19 - Handkerchiefs	34,6%	33,9%	43,6%	49,0%	47,1%	62,6%
21 - Anoraks	16,7%	44,6%	58,9%	14,7%	61,1%	75,4%
24 - Pyjamas knitted	20,2%	22,3%	28,2%	19,7%	23,7%	36,0%
32 - Woven pile fabrics	25,3%	47,3%	48,1%	21,3%	55,7%	60,0%
33 - Woven fabrics polyethylene-polypropylene	4,8%	4,3%	4,5%	6,1%	5,4%	6,2%
37 - Woven fabrics of artificial fibres	12,8%	17,2%	23,7%	9,9%	28,3%	35,9%
68 - Babies garments	39,4%	45,9%	51,4%	31,8%	47,7%	60,2%
73 - Tracksuits	24,4%	44,7%	54,5%	23,2%	52,2%	67,2%
76 - Work wear	11,2%	13,6%	19,6%	10,9%	20,8%	30,0%

(*) Revised data , where necessary

Source: CITH

Table 5: CHINESE EXPORTS to WORLD - YEAR 2003 - US\$

Heads	World	Distribution per country					
		Hong Kong	USA	Japan	EU15	EU25	
50	823.944.723	111.755.887	27.237.260	103.679.316	147.674.962	148.244.265	18,0%
51	1.318.302.370	372.668.607	4.302.696	225.745.206	287.893.745	291.509.349	22,1%
52	6.222.732.605	2.612.420.619	128.973.655	244.211.998	137.176.694	176.360.967	2,8%
53	525.656.826	314.032.109	13.174.777	14.462.435	21.392.317	33.311.311	6,3%
54	3.753.431.111	364.375.663	27.205.241	62.297.262	583.998.061	634.559.379	16,9%
55	2.788.980.214	612.783.744	76.135.230	95.086.534	139.601.678	157.893.969	5,7%
56	469.268.338	75.580.466	20.116.509	50.376.688	38.208.582	40.847.765	8,7%
57	638.073.184	17.872.270	274.755.099	130.296.280	113.772.754	115.359.257	18,1%
58	1.555.368.028	413.704.149	72.599.806	54.900.237	177.885.097	193.052.307	12,4%
59	826.141.210	174.517.755	42.709.072	39.720.255	55.576.708	69.658.365	8,4%
60	2.508.654.113	1.468.108.597	39.741.842	11.989.491	44.297.076	50.129.501	2,0%
61	20.686.781.323	3.907.238.652	1.835.641.273	5.146.171.152	1.620.100.732	2.432.262.130	11,8%
62	25.085.274.948	4.101.910.388	2.855.949.735	6.940.747.507	3.339.264.129	4.056.184.928	16,2%
63	6.172.059.698	303.184.686	1.775.364.079	1.342.837.287	951.410.663	1.050.567.038	17,0%
Total countries	73.374.668.691	14.850.153.592	7.193.906.274	14.462.521.648	7.658.253.218	9.449.940.531	12,9%

Nota bene : Data on the absolute volume of trade between the EU and China, differ dramatically, depending on the source. While the different application of FOB and CIF concepts explains a small part of the difference, it is mainly the different statistical approach that is responsible for the differences. While Chinese Customs Statistics measure direct trade only, Eurostat includes the flow of goods via third countries as well.

Source : GTIS

Abstract from EURATEX information letter November 2004

“China external trade (until September 2004)

EURATEX has analyzed both export and import figures of China into and from the World so as to better comprehend their perspective. This is, using Chinese official data, and not EUROSTAT data. Since this is the first time we engage in such exercise, we have opted to split the analysis in three.

1. Chinese exports to the World of all T&C products, compressed into 10 categories

You will find in Table 1 a summary table of the Chinese exports to the World, broken into 10 very broad types of categories. This quick overview table below may give the reader the importance of the European market for the Chinese manufacturers of T&C. All in all the EU25 represents one of the major clients for these. The EU25 represents the second biggest client for Chinese garments, only after Japan. In Textiles the picture is slightly more varied although one should notice that the EU25 is in all circumstances among its top 5 clients, particularly in natural fibers, man-made fibers and carpets where the EU25 represents 35% to 18% of all Chinese exports to the World in value!

Also to be noticed is the fact that China declares having exported to the World 72.9 billion USD worth of Textiles and Apparel during 2003. Similarly, China declares exports to the EU25 worth 8.4 billion USD and 6.9 billion USD to the EU15. (As such, the EU25 represents 11% of total Chinese T&C exports to the world. The EU15 represents 9%). This is, taken the ECB exchange rate EUR/US\$ for the year 2003 (1 EUR = 1.1312 US\$), one would conclude that China declares exports of T&C to the EU15 worth 6.1 billion EUR. The EU15 declares, however, having imported 12.3 billion EUR worth of T&C from China.

As such, the next question appears obvious, why do we find a gap of 6.2 billion EUR? The possible explanation could be that China records the first destination of its products as the final destination, whereas the EU records the origin of the products where they were manufactured and not transitory ports. As such, Hong Kong could be part of the answer. Being used as a transitory port, Hong Kong deviates the attention of both EU importers and Chinese exporters misleading the operators and decisionmakers. However, Hong Kong is not likely to be the unique solution to this disconcerting question since the EU declares T&C imports from Hong Kong worth 2.1 billion EUR, far apart the 6.2 billion EUR that appear to be missing. The analysis of Hong Kong figures along with Chinese figures would however be desirable.

2. Chinese exports to the World of some major T&C categories

We have realized a further breakdown so as to better comprehend the importance of some specific products within the categories above. We have selected those categories displaying particularly strong performances into the EU market (page 50 of Bulletin 2004/5).

The table 2 gives us a clear picture of what the weight of the EU25 is like with regards to Chinese manufacturers and its position as a major client. Both in Textiles and Clothing, the EU25 represent a major export market for all the products below. In Textiles, the most striking development is that of the woven fabrics of synthetic filament yarns, for which the EU25 signify the first client with a 17% share. Its price, however, is not lower than the average Chinese export to the World of such product. This must necessarily mean that China is exporting to other third markets at a price lower than that destined to the EU. Indeed, and except for the case of man-made filament yarn, the Chinese price into the EU25 of the below products, in US\$ and from their perspective, is higher than the average product destined to the World. Another Textile product of major importance in absolute terms is cotton fabrics. The EU25 imported 169 million US\$ of these in 2003. However it only represents 4% of the total Chinese exports to the world of such product.

For the selected Clothing categories, the EU25 represents a particular important client for China with regards to Overcoats and Babies garments, holding a market share between 34% and 29%. Here again we find that the prices of the products the Chinese destine to our market is higher than the average export to the world. What's more, Chinese babies garments destined to Europe are of a much higher price (+37%) than those exported to other markets. Some other major Clothing categories in absolute terms are the trousers or the jerseys. China declares exports of these into the EU25 of 259 and 87 million pieces, respectively, during 2003. (The EU15 declares imports from China of 276 and 63 million pieces respectively).

Admittedly, the introduction in this analysis of the variable exchange rate would certainly change the above conclusions.

3. Analysis of Chinese exports to the EU25 of some of the most sensitive MFA categories today (table 3 & table 4)

Far from the intention of trying to complicate matters and with the unique intention to facilitate the task of decisionmakers in the T&C world today some 80 days before the historic end of the ATC; we have opted to put into perspective the Chinese export situation of some of the most sensitive categories here in Europe and this for the most updated period possible, September 2004.

For such reason, you will find here below a similar table for the following soon-to-be-dismantled MFA categories: Shirts and T-shirts (Cat. 4), Trousers (Cat. 6), Women's blouses (Cat. 7), Men's shirts (Cat. 8), Bed linen (Cat. 20) and Women's dresses (Cat. 26). One should first note that during the first three quarters of 2004 and in value, Chinese exports of most of these products into the EU25 have recorded double-digit increases, despite being still under quota. Only the Chinese exports of men's shirts stagnated. However, among these 6 categories, two display very large amounts, T-shirts and trousers, which both exceed the 6.5 billion US\$.

Generally, the EU25 is one major client for these Chinese products, but it tends to be so only after Japan and the U.S.A., which rank generally first and second respectively (disregarding Hong Kong). However two main points should be stressed here:

- The prices of these products into the EU25 display a higher price in US\$ as compared to the price of exports to the world of these same products during the first 3 quarters of 2004. The only exceptions to this are the women's dresses whose price is lower and the bed linen which is similar. However, one should note that the prices of these products into the other two major clients systematically present higher prices. This is, the prices of these products into the EU25 are always lower than those destined to Japan or the U.S.A. Among these, the difference is shocking with regards to the women's dresses, whose price into the EU25 is only of 3.8 US\$/piece, whereas the price of this same product in Japan attains 6.6 US\$ in Japan and 12.4 US\$ in the U.S.A.!
- Chinese exports of most of these products to the World (except women's blouses and dresses) are growing at a higher pace than those destined to the EU. One should however remember that this fact may be only explained by the fact that they remain still under quota. This fact could be very possibly reversed as soon as quotas are lifted. The evolution of exports into Japan and the U.S.A. does not allow us to draw a unique conclusion. Data have to be regarded on a product-by-product basis. In any case, it appears obvious that the exports of Chinese bed linen and women's dresses into the EU25 are recording outstanding double-digit increases, well above the average. Only exports of bed linen to the U.S.A. have overtaken these developments, nearly doubling in only 9 months!

See appendix tables.

Appendix to "Abstract from EURATEX information letter November 2004"

Table 1: Chinese exports of T&C to selected European markets - 2003

		000 USD	Share on world (by product)	Unit	Volume	Share on world (by product)	Unit	Price	Ranking (value) (Note 1)	Ranking (value) (Note 2)
Natural Fibers	World	767.936			184.467			4,2		
	EU25	268.389	35%	T	21.207	11%	US\$/KG	12,7	1	1
	EU15	268.242	35%		21.069	11%		12,7	1	1
	NEW10	147	0%		138	0%		1,1	42	41
Man-made fibres	World	72.736			47.155			1,5		
	EU25	19.741	27%	T	10.348	22%	US\$/KG	1,9	1	1
	EU15	19.557	27%		10.247	22%		1,9	1	1
	NEW10	184	0%		101	0%		1,8	31	30
Yarns and threads	World	3.680.512			1.125.178			3,3		
	EU25	207.882	6%	T	48.299	4%	US\$/KG	4,3	4	3
	EU15	181.912	5%		39.285	3%		4,6	4	3
	NEW10	25.970	1%		9.014	1%		2,9	16	15
Knitted fabrics	World	2.508.654			701.342			3,6		
	EU25	50.130	2%	T	13.299	2%	US\$/KG	3,8	6	5
	EU15	44.297	2%		11.680	2%		3,8	6	5
	NEW10	5.832	0%		1.619	0%		3,6	36	35
Carpets	World	638.342			99.109			6,4		
	EU25	115.535	18%	000 M ²	16.761	17%	US\$/M ²	6,9	3	3
	EU15	113.948	18%		16.386	17%		7,0	3	3
	NEW10	1.587	0%		376	0%		4,2	27	26
Home Textiles	World	4.199.403			4.569.429			0,9		
	EU25	587.238	14%	000 UNIT	466.419	10%	US\$/Unit	1,3	3	3
	EU15	512.208	12%		365.848	8%		1,4	3	3
	NEW10	75.029	2%		100.571	2%		0,7	7	6
Other Textiles	World	2.917.698			(Note 3)	(Note 3)		n.a.		
	EU25	220.612	8%	000 UNIT	613.651	(Note 3)	US\$/Unit	0,4	1	1
	EU15	207.172	7%		481.396	(Note 3)		0,4	1	1
	NEW10	13.440	0%		132.256	(Note 3)		0,1	13	12
Woven Fabrics	World	12.366.644			(Note 3)	(Note 3)		n.a.		
	EU25	1.050.266	8%	000 M ²	993.657	(Note 3)	US\$/UNIT	1,1	2	1
	EU15	943.531	8%		879.387	(Note 3)		1,1	2	1
	NEW10	106.735	1%		114.270	(Note 3)		0,9	29	28
Knitted garments	World	20.686.781			(Note 3)	(Note 3)		n.a.		
	EU25	2.000.610	10%	000 UNIT	1.189.087	(Note 3)	US\$/UNIT	1,7	3	2
	EU15	1.254.983	6%		546.441	(Note 3)		2,3	4	3
	NEW10	745.627	4%		642.646	(Note 3)		1,2	5	4
Woven garments	World	25.085.275			(Note 3)	(Note 3)		n.a.		
	EU25	3.847.814	15%	000 UNIT	1.202.395	(Note 3)	US\$/UNIT	3,2	3	2
	EU15	3.141.516	13%		958.214	(Note 3)		3,3	3	2
	NEW10	706.297	3%		244.180	(Note 3)		2,9	5	4

To follow

Table 1: Chinese exports of T&C to selected European markets - 2003

		000 USD	Share on world (by product)	Unit	Volume	Share on world (by product)	Unit	Price	Ranking (value) (Note 1)	Ranking (value) (Note 2)
Total Textiles	World	27.151.925		(Note 3)	(Note 3)	(Note 3)	(Note 3)	n.a.		
	EU25	2.519.793	9%		(Note 3)	(Note 3)		n.a.	2	1
	EU15	2.290.869	8%		(Note 3)	(Note 3)		n.a.	3	2
	NEW10	228.924	1%		(Note 3)	(Note 3)		n.a.	25	24
Total Clothing	World	47.070.770		000 UNIT	(Note 3)	(Note 3)	US\$/UNIT	n.a.		
	EU25	5.848.424	13%		2.391.481	(Note 3)		2,4	3	2
	EU15	4.396.500	10%		1.504.655	(Note 3)		2,9	4	3
	NEW10	1.451.924	3%		886.827	(Note 3)		1,6	7	6

Source: Chinese Customs data

Note 1: This ranking includes individual Member States

Note 2: This ranking disregards Hong Kong and includes individual Member States

Note 3: These very large categories generate problems in terms of secondary units since Chinese data only report one secondary unit, and thus tons are not always available. As such, EURATEX has not been able to get to aggregate volume figures for these products.

Table 2: Chinese exports of some very significant T&C products into the EU-25 - 2003

		000 USD	Share on world (by product)	Unit	Volume	Share on world (by product)	Unit	Price	Ranking (value) (Note 1)	Ranking (value) (Note 2)
Man-made filament yarn	World	560.726		Tons	185.892		US\$/Kg	3,0		
	EU25	57.994	10%		26.786	14%		2,2	3	2
Cotton fabrics	World	4.709.637		000 M ²	5.036.105		US\$/M ²	0,9		
	EU25	168.684	4%		166.427	3%		1,0	6	5
Woven fabrics synthetic filament yarns	World	3.143.346		000 M ²	4.179.744		US\$/M ²	0,8		
	EU25	548.231	17%		573.728	14%		1,0	1	1
Nonwovens	World	178.433		Tons	80.873		US\$/Kg	2,2		
	EU25	13.696	8%		5.661	7%		2,4	4	3
Textile fibres impregnated	World	577.861		Tons	255.770		US\$/Kg	2,3		
	EU25	45.436	8%		19.297	8%		2,4	3	2
Overcoats	World	4.735.071		000 Units	636.818		US\$/Unit	7,4		
	EU25	1.596.023	34%		212.550	33%		7,5	1	1
Shirts	World	3.330.289		000 Units	1.059.469		US\$/Unit	3,1		
	EU25	282.130	8%		79.645	8%		3,5	4	3
T-Shirts	World	3.001.748		000 Units	2.253.849		US\$/Unit	1,3		
	EU25	267.033	9%		171.171	8%		1,6	2	1
Jerseys	World	5.846.935		000 Units	1.996.914		US\$/Unit	2,9		
	EU25	397.047	7%		87.031	4%		4,6	5	4
Babies garments	World	1.353.843		Tons	159.198		US\$/Kg	8,5		
	EU25	389.600	29%		33.418	21%		11,7	2	2
Ensembles	World	2.012.314		000 Units	520.822		US\$/Unit	3,9		
	EU25	283.221	14%		58.135	11%		4,9	2	2
Trousers	World	7.998.674		000 Units	2.929.211		US\$/Unit	2,7		
	EU25	719.555	9%		258.822	9%		2,8	3	2

Source: Chinese Customs data

Note 1: This ranking includes individual Member States

Note 2: This ranking disregards Hong Kong and includes individual Member States

Table 3: Chinese exports to the world of selected MFA categories – 2003
Selected product categories

		000 USD				Volume				Price per Unit sept-04	Ranking		
		sept-03	sept-04	Chg.	Share on world sept-04	Unit	sept-03	sept-04	Evol.		Share on world sept-04	(value	(value
												Note 1)	Note 2)
Cat. 4 - Shirts and T-shirts	World	5.238.869	6.540.481	25%		2.956.860	3.417.155	16%		1,9 \$			
	EU25	385.384	433.520	12%	7%	000 Units	190.161	180.894	-5%	5%	2,4 \$	4 3	
Cat. 6 - Trousers	World	5.709.751	6.523.345	14%		000 Units	1.661.216	1.837.016	11%		3,6 \$		
	EU25	547.775	589.485	8%	9%	000 Units	139.364	147.683	6%	8%	4,0 \$	4 3	
Cat. 7 - Women's blouses	World	688.180	708.271	3%		000 Units	219.384	218.121	-1%		3,2 \$		
	EU25	36.035	39.568	10%	6%	000 Units	10.022	9.123	-9%	4%	4,3 \$	4 3	
Cat. 8 - Men's shirts	World	1.141.203	1.290.267	13%		000 Units	399.527	424.403	6%		3,0 \$		
	EU25	91.010	90.742	0%	7%	000 Units	32.218	25.301	-21%	6%	3,6 \$	3 2	
Cat. 20 - Bedlinen	World	695.885	804.901	16%		000 Units	357.860	404.916	13%		2,0 \$		
	EU25	70.767	80.938	14%	10%	000 Units	29.982	39.747	33%	10%	2,0 \$	3 3	
Cat. 26 - Women's dresses	World	295.917	313.447	6%		000 Units	72.777	77.210	6%		4,1 \$		
	EU25	15.120	20.403	35%	7%	000 Units	4.189	5.434	30%	7%	3,8 \$	4 3	

Source: Chinese Customs data

Note 1: This ranking includes individual Member States.
Note 2: This ranking disregards Hong Kong and includes individual Member States

Table 4: Evolution of Chinese exports into the EU-25, USA and Japan
Selected product categories

	Evolution Chinese exports into the EU25 Sept 2003 – Sept 2004 (volumes)				Price Sept 2004 – US\$/Unit			
	Japan	USA	EU25	World	Japan	USA	EU25	World
	Cat. 4 - Shirts and T-shirts	+12%	-7%	-5%	+16%	2.4	3.6	2.4
Cat. 6 - Trousers	+3%	+34%	+6%	+11%	5.7	5.2	4.0	3.6
Cat. 7 - Women's blouses	-8%	-18%	-9%	-1%	5.3	5.5	4.3	3.2
Cat. 8 - Men's shirts	+6%	+4%	-21%	+6%	5.0	4.4	3.6	3.0
Cat. 20 - Bedlinen	-12%	+92%	+33%	+13%	2.5	2.3	2.0	2.0
Cat. 26 - Women's dresses	-9%	-1%	+30%	+6%	6.6	12.4	3.8	4.1

Source: Chinese Customs data

Panel I: Discussion, Questions and Answers

Chairman D'AMATO. Thank you very much for that interesting statement.

Let me just lead off the questions with this one. I think it was Mr. Monks who mentioned the study done by Cornell this year. This was a study that was commissioned by this Commission, and that study was, and has been, the only study, interestingly enough, conducted in the United States that tries to quantify the outsourcing issue. No Federal Government work has been done in the United States whatsoever to try and quantify this issue, so we had the very peculiar situation of having a few researchers at Cornell and Amherst for the first time trying to quantify this issue. So, we're at the very early stages of really understanding the actual scope of these flows, which leads me to a couple of questions, the first to Mr. Nightingale.

You identified that 60 percent of the companies say they're going to be profitable. I wonder how much of that profitability as a result of their selling in the Chinese market, versus selling back to their home countries in the export trade? That would be the one question.

The second question I have for you is on non-tariff barriers, whether your association has actually developed any kind of a scorecard? The market becomes open and then it becomes closed again. Are we winning or losing in terms of the flow of fairness in trade?

Mr. NIGHTINGALE. To answer your first question about the percentage of profit, I don't have a figure for that, and I don't know that one exists. All one does know is that quite a large number of particularly the bigger investors in China of course are interested in selling in the Chinese market, particularly if they're obviously in the consumer goods side, and that is becoming more possible as the WTO obligations are undertaken by China. There are of course still some closed sectors or some sectors that are restricted, and financial services is one of them, where the opening up won't be completed until 2006. So in those sectors, of course, profitability probably comes from trade that really comes from outside China.

But I think more and more companies are looking at the local market. Of course, a lot of the exporting that comes out of China is done by non-European and non-U.S. companies. It's either Hong Kong companies or Taiwanese companies that are invested there because they moved there, previously exporting production from Hong Kong or Taiwan into China. So there's a huge amount of exports that come from those sorts of companies, or indeed, Chinese companies themselves.

On the question of non-tariff barriers, I don't have a scorecard. I think that the individual sectors tend to take a step-by-step process. The sector opens up or is due to open up on a certain date and duly does open up, but some unexpected barrier is raised, which then hinders the freedom of that opening up. Again, I refer to the financial services sector in banking where it's now possible to open branches of foreign banks in more than a certain number of Chinese cities. Banks are much freer now to open in other cities. However, the capital deposit required for each bank branch if you are a foreign bank is five times the amount that is required by a Chinese bank. Now, that was not anticipated when the WTO entry was being negotiated, so that it then sets off another train of negotiation to try to get the Chinese authorities to see that this is not creating a level playing field, and would they please therefore reverse that regulation so a level playing field is created.

There is some evidence that this negotiation does result in a positive result. In the automotive trade, there were restrictions on distributing—for foreign companies to distribute their imported cars through the same distributor as locally made cars. You had to have different distributors. Now, again, this was not anticipated from the WTO. Negotiations have taken place and now they are allowed to have one distributor for both. So that is progress.

Chairman D'AMATO. Thank you very much.

I have one additional question. You talked about something that we are very concerned about, and that is the question of companies' perspective when they decide to go overseas, their decisionmaking process. What does loyalty to the home country play here? We're very concerned about that. In your work have you come across any kind of systematic kind of a scorecard or code that some companies may have addressed or outside groups or NGOs put together that

would be a checklist as to what a company ought to do in terms of trying to make it back in its home market before it goes abroad. Is there any kind of a patriotic code of conduct or something of that kind? Are you aware of that kind of development anywhere in Europe?

Mr. MONKS. Not precisely in those terms, no. Europe of course is very diverse; as there are some things it does in common and some things, which you notice, the differences more than you notice the similarities. I was in Paris last week discussing this issue with a group of French trade unionist and business people, and I think there's this certain generally understood obligations in France that the—and I'm not quite sure how much of this is custom, how much of it is code, how much of it is regulation.

For example, if any company is in receipt of a regional grant and then decides to go offshore, there's an obligation to pay that back, which is not the case in a lot of European countries. So if there's an area of high unemployment, which is seeking to attract inward investment, in my guess, some French government support for that, there's an obligation to pay back.

Secondly, France is particularly interesting because I think it's the only country in Europe that actually does try to keep figures on this issue of reimportation that you mentioned, what's for the local market and what's for bringing back into France. I think they are particularly keen to try and make that distinction. There are certain national pressures which are evident on companies to keep the reimportation figures quite low, more probably than in some of the other countries. I don't know, textiles I guess not, but in certain other areas which might be regarded as high-tech, strategic and so on it might be a bit different.

I'm sorry, this is more impressionist than precise, but there are certain government pressures on companies that they should remember their home base, and I would say that's a stronger cultural factor than it probably is over the European Union countries.

Chairman D'AMATO. So France you would say—

Mr. MONKS. France is an interesting case, yes.

Chairman D'AMATO. Well, we would be interested in learning of any kind of creation of some kind of a code of conduct or set of principles. For example, in the American market we think that in terms of importation from China, certainly a majority of the goods that comes into the United States comes back from companies that have relocated into China, not Chinese companies, but American companies. Fifty-eight percent of that trade, of course, is coming back to us that was originally produced where we were, so that's a kind of a disturbing factor in many respects for some of us.

Mr. MONKS. Right.

Chairman D'AMATO. Does anybody have a question?

Commissioner MULLOY. Yes. First a question for Mr. Marchi. In your testimony you say that China wants to be designated a market economy, and the question is "why?" When they got into the WTO they had special requirements put on them because they were not a market economy, like the annual Transitional Review Mechanism, special China safeguards, special textile safeguards. This was because they got a waiver to get into the WTO because

they didn't fit the criteria that you had to fit in order to get into the WTO.

Recently, the President of China was in Brazil and Argentina, and both of those countries have now declared that China is a market economy. This is a political effort on the part of the Chinese to get that designation. You mention it in your testimony. Can you help us understand what is the economic significance for Europe or for the United States? They have requested that from us as well, and we haven't given it to them, and neither have you. What is the economic significance for us if we gave them that status?

Mr. MARCHI. It's easy, it's anti-dumping. I guess that you have the answer by the way.

In reality there's a point. Giving them the market economy status, clearly we are forced to follow letter by letter the law, while not giving them the market economy status we can take other countries as models. In the EU, we have a specific anti-dumping legislation for China, and you may not be aware of it, which is that a company which is under an anti-dumping complaint could claim that he's acting as a market economy status company, and he has to prove it. If he succeeds to prove it, then he will be treated within the general anti-dumping as a market economy.

What we believe this means, clearly, is that you need to have balance sheet accountability in all [inaudible]. And what we have seen is that very few companies ask for it, and the only ones asking for it are all China or Taiwanese-based, home-based companies, or South Korean home-based companies or American-based companies or EU-based companies, and no more. So it means clearly that 100 percent owned or dominantly owned Chinese companies are still not acting today as market economy companies.

We have said 38,000 companies is quite a lot. Now, when you see arriving on your market the final product, which costs less than the raw materials, I have a problem there. And generally we have seen that they are pricing at any costs without taking into account the full accounts, so sometimes they are only covering the raw materials but not the manpower, nor the energy, nor whatever. This is possible simply because part of the semi-joint ventures in China have been sold at very advantageous prices, which means that companies could afford not to finance. They have very low credit in reality in terms of their balance sheets so they can do what they want.

And as the banks are not asking for the lendings, we go back to square one. And I think that our sector is not unique compared to others. What is unique is the fact that for China, clearly, our sector is the sector which China hopes to drag out as the biggest positive results of their accession to the WTO, and immediate results, while for other sectors, they will have to wait at least to 2013 [inaudible], the end of the specific treatment. That makes our life difficult simply because to get them in we have paid a high price despite all the efforts that we have made to try to convince our constituency that this was dangerous in that, well, they get, in terms of ATC dismantling, everything on day one of [inaudible]. While the other countries will have to wait 10 years, the Chinese will get the full dismantling of their quotas between 2001 and 2005, so four years. So it's really a big gift that has been given.

The bargain there was, well, “you will open the market and you will export this.” It’s true that we are exporting a lot, more than before, but it’s still unsatisfactory. To give an example, over the 680 whatever millions of euros, only 71 are composed of home textiles and apparel going directly to the final consumer. So this gives you the big in imbalance what they’re buying, buying value-added products to transform them, and most of them are re-exported outside simply because most of the companies buying those products are only in free export zones. So if they have to enter China, they have to pay a double penalty, which is dangerous, so you see double [inaudible].

Chairman D’AMATO. Let me just summarize what I think you’ve said; which I think is quite important. That the train wreck that is coming in textiles, is not a result of marketplace economics at all. That two-thirds of the companies in China are not privatized, which means that there’s state involvement in the companies, and that the pricing is not marketplace pricing. Now, let me ask you, when we decided that we would remove these textile quotas, was the assumption that the marketplace in economics would have been taking place at that point? What was the underlying rationale?

Mr. MARCHI. When China entered the WTO, we were in a different economic situation. The gambling was the following of one another. China is an important market, particularly for exporting high-valued products, and we see it now today, the demand is quite important for high-value-added products, including clothing, textiles, whatever. There’s not a problem there. The problem is that the Chinese have, while respecting the tariff dismantling—this was a clear commitment by them. And by the way, their tariffs are lower than the Indian ones, which is to take the other big giant—they have added up NTBs, non-tariff barriers, and also administrative practices, and that’s typical of the Asian behavior. It’s not a criticism. It’s the way they are acting. And by the way, probably in the 20th century our countries have done the same thing. But this is something else, this is history.

The companies’ exports will grow, and we know the proximity effect. It means the Mediterranean rim—as in the U.S., it’s CBI in Mexico—will maintain the balance. Now, the big buyers, despite all their efforts, have completely changed their minds once they realized that the Euro was over evaluated. And what we see now is an overheating of buying there. What is blocking a little bit of the system is the risk of safeguards, but even if you take a safeguard, by the way, you will not stop them. You will only cap for one year by the end. That’s due to the economic impact will be just to limit the steam.

I think that the Chinese government now have understood the danger of repeating next year what happened in 2002. And I don’t know what they will do. They have to save their face, but they are clearly—and the Commission last week, no, two weeks ago, we were in Beijing with the Commission, and the Commission clearly stated, “If you don’t respect [inaudible] and if you don’t follow carefully the situation and avoid your repeating of the 2002 situation [inaudible], and then we will act.” It means safeguards. It means other problems.

Now, clearly this is the Commission. We will have to also convince all 25 member states, and you know that in the EU it is a little bit more difficult, having liberal countries and more restrictive ones.

But nevertheless, the social impact will be terrible, but it is not nothing new under the sun in the way that we knew, since 1995 when we signed the ATC agreement, the quota will go away, and we will have to restructure, and we have done the work, and our companies are doing this on a daily basis. What is terrible is that in the—when a small company is—and our sectors employ roughly per company 19 employees—when a company's closing, nobody cares about it, contrary to the U.S., where in South Carolina when a big company is closing thousands of people out.

Chairman D'AMATO. Right.

Mr. MARCHI. And secondly, don't forget that MEPs are not, excepting the UK, regional based, but are national. It means their constituency, except in the UK, is not regional, is national. So you have to convince the MEPs that they have big interests and political, to spend in political terms, to work for our sector also. But the gambling was that more exports—we know that the prices will go down, but roughly of 20 percent, which was affordable, not 75 percent. And that's the point.

Commissioner MULLOY. I think it's very important to realize that the textile quota phase out was done as part of the Uruguay Round Agreement in 1994. At that point China wasn't the WTO. They came in six, seven years later, so the process was already going on, and suddenly there was a whole new factor thrown into the process. And you talk about the exchange rate differentials, the fact that you have these loans that are made by these state banks, which may be a hidden subsidy of some sort, because they're not paid back. So there are a lot of things that go on here that have changed the original rationale for phasing out the textile quotas.

My understanding is that there have been a number of industry groups, the Istanbul Group, which has talked about—"can we have a little more time?" Of course that would require unanimous agreement, and my understanding is the Chinese aren't eager to give more time. Is that correct?

Mr. MARCHI. Well, you are referring to what we call the Istanbul Declaration or whatever. There has been a number of national associations from all over the world, the U.S. and the EU and Africa, and even in Asia, asking for a little bit more time in dismantling or better control of what will happen at least for two or three years to allow those countries, and particularly less-developed countries to adapt or to implement, say, their structural revision or structural changes within the industry. Clearly India and China have resisted, and only even last week the [inaudible] there was no agreement. What developing countries, certain developing countries will get is simply an additional IMF funding, and this is it. It was written in the sky. And by the way, to be frank, even though they don't deny the danger, a certain number of lesser developed countries should have been better advised to think a little bit more in 1994 when signing, who are now shouting because they are facing a completely different situation.

This being said, and for rationale, in the textile and clothing industry in Europe, when we import, roughly half of the imports are entering duty free. That's a big difference compared to the U.S. Rather 20 to 30 percent are entering to a reduced rate of duties on the GSP, General System of Preferences that U.S. is not giving on textiles. And the rest is mainly, I would say, OECD countries are paying for duty. So at the end, even if our duties are lower than yours in the U.S., but higher compared to the Japanese, in reality the impact for developing countries is very low, including for India, by the way, whose tariffs today are unbound, and they are around 20, 25 percent unbound. It means that if you take a few bound lines, they are around 70, 80, 100 percent. So, come on, this worries the DDA there, but this is another subject.

Chairman D'AMATO. Thank you very much. Commissioner Dreyer?

Commissioner DREYER. This Commission holds most of its hearings in Washington, D.C. We decided it would be a good idea to hold field hearings because of the truth of the old saying that Washington is a small island surrounded by a sea of reality. Field hearings were held in Akron, Ohio and Columbia, South Carolina, as Mr. Marchi mentioned. We heard from textile manufacturers and tile manufacturers and candle manufacturers, who told the same story. That is what I would call predatory pricing. I remember the candle manufacturer specifically saying that Chinese candles were being offered for sale for less than the price of the paraffin that went into the candles. The tile manufacturer told a story of being desperate because his was a family-owned company that had been in business for 150 years. They had very loyal employees, and they sat down with their bank creditors and their employees, and decided that if everyone took a big financial hit, they could offer a lower price than the purchasing company had said the Chinese had quoted to them. They managed to do this. The Chinese company then came back with a price, which was still lower. So that is what I regard as predatory pricing.

This is really not the sort of situation one can compete in no matter what one does, for reasons that Commissioner Mulloy was mentioning—the loans that don't have to be paid back, et cetera.

I wonder if Europeans have seen any evidence of that in your dealings with the Chinese. Mr. Monks mentioned the efficiency of the Chinese worker. Again, I don't know what the standard of comparison is, but a study funded by the Commission that includes people at Cornell, Kate Bronfenbrenner, et al., that shows the American worker is actually much more efficient than the Chinese worker. So it is not productivity, at least in the estimation of these people we deal with. Again, I don't know what the efficiency of the European worker is like.

Do you want to try that? Then I have another question. Have you seen these predatory prices? Is there any way you can compete with such practices? You can't become more efficient. You're already more efficient than the Chinese worker.

Mr. MONKS. Well, I can't really comment on the predatory pricing. I think maybe my two colleagues here know more about that than I do, but certainly, just to say I accept exactly what you say about the efficiency thing. I mean French, German, core European

economy productivity rates per hour are similar to the United States. Americans do work longer than Western Europeans. And some other countries, Britain included, have got lower productivity per hour than France and Germany, but also work longer, and so living standards are roughly comparable. When I mentioned efficiency with the Chinese, I think where the Chinese score is logistical efficiency, transportation. So when I started out in the States people were saying, in textiles, for example, an order from via Shanghai comes a lot quicker than one via Mexico. So the comparison is less with the American worker and American business than perhaps with some of their competitors who are competing on low wages around. They've got this very, very effective logistical system, ports, transportation and so on, which are somewhere in the top lead.

Commissioner DREYER. Does anyone else want to speak on predatory pricing?

Mr. NIGHTINGALE. Of course, our organization mainly is looking at companies that want to do business in China. We're not so much concerned with importers. But where we do come into contact with companies that are looking at this issue is where a company may find that it's manufacturing a product, some of the components of which can be manufactured in China apparently much more cheaply. And they will therefore look for sources of supply in China in order to source that component more cheaply, in order to remain competitive overall as far as their general output is concerned.

To put it very broadly, in order to remain competitive in the European homeland, whichever state that happens to be, they've got to source products from overseas, they've got to source products maybe from China where it's cheapest, in order to stay in business in, let us say the UK or France or wherever, in order to maintain competitiveness. The alternative is to carry on working as they have been working, and find them becoming more and more uncompetitive in terms of their pricing, and eventually they go out of business all together, but undoubtedly there have been companies in Europe that have outsourced everything to China because it's much, much more cheap to procure that product in China. What they end up with in Europe is a shell company or a small administrative company that is doing the distribution and so forth. So that certainly happens.

As far as China's is concerned, I think I would agree, of course. The Chinese are not as efficient as Americans. But what the Chinese have is numbers. They've got unlimited numbers of labor, so that if you have to carry something to the port of Shanghai and you haven't got a lorry, you can literally do it by hand, because there are just numbers of people there and their wages are not very high. Of course the wages are going up, and I think in the south of China particularly now, they say that they are having problems in terms of sourcing enough labor at prices that are competitive with their current practices, which means of course that the labor rates are going to have to rise, as they have risen in many other parts of the country already, and that will gradually of course be reflected in prices.

I think one must not forget that a lot of these companies that are exporting from China are doing so, particularly in consumer

goods, at very, very low margins, so very slight movements in terms of labor cost or the exchange rate, for example, will have an effect.

Commissioner MULLOY. Yes.

Mr. MARCHI. If I may, I think that when you are looking to the Chinese official statistics there is no predatory pricing. When we are looking to our statistics, we are importing roughly 12 billion euros. For the Chinese government they are exporting only 6 billion dollars. So where are the rest going, is coming from, because we are looking to the real origin of the products, while they are looking only to destination countries and the U.S., by the way, while [inaudible] is a part of the answer, but not only.

Efficiency. Clearly now as a sector we can speak, particularly on the clothing side, we should present that with 90 percent of the imports, there is inefficiency. Otherwise this cannot explain why investments have been done so quickly and so vastly in China in our sector. Certain people are expecting an increase of their capacities in trying to do 40 percent in less than one year, so it means that there will be an overcapacity worldwide even in terms of clothing.

Logistical, yes, may be an answer, but not enough. More and more companies are now displacing their production, particularly in clothing, in the inner China, which is much more distant, and nevertheless they continue to price low.

Now, if I want to be nasty, I will say that it is simply the buyer, which is pushing the prices down including its own margin, and I do not want to point to any company because this is not the place to do it. But we have witnessed an increase of imports for such a number of important distribution or retailing companies, accompanied with a very high increase of the profits, and all the financials, and when you're looking at whatever, IFT or whatever, everyone is saying, well, this company is fantastic, thanks a lot. To the detriment of whom? The manufacturing bases in Europe? So we are entering a sort of discussion that is dangerous.

By the way, if I have to come to the Commission saying there is predatory pricing, then it's said, you don't need to have a safeguard, you have to do anti-dumping. And doing anti-dumping for a small and medium company, waiting 18 months for results—

Commissioner DREYER. At least.

Mr. MARCHI. Yes. You bury them, so that is not the answer. So that's why we have accepted to embark upon this political dialogue even if we were very conscious that the results would take time to be seen. But that's the only way. It's a part of the answer, not the answer. And I think the Chinese are beginning to understand slowly that if they continue like that, they would kill their, I would say, the golden egg, and the golden egg is our consumers, it means us.

But put the question to a young [inaudible], and you say, well, if they buy, they are able to buy a computer, very cheap labor that is being produced by an international company in China, they are expecting the same treatment on clothing or shoes and ties, whatever. So there is sort of a perversion of the system, but this is it. This is the market economy. And I don't know, I think that it is depending—if you are very liberal, it's a market economy.

If you want to be really a bit more, I would say, based on the people on the ground say if to be liberal you need to produce in Eu-

rope and to get wages to be able to consume, then we should have a better managed—

Commissioner DREYER. Market?

Mr. MARCHI. Marketplace. That's what I'm saying. And maybe China today is showing us today what was maybe the capitalism at the beginning of the 17th, 18th or 19th century.

Chairman D'AMATO. Commissioner Wortzel.

Commissioner WORTZEL. Thank you very much, gentlemen. I have one short point of clarification I hope I can get from someone on the manufacturing side. But I hear the term "state ownership," and I have heard it throughout the testimony, and the problems that that create both for market a economy and for WTO compliance and negotiation with state entities in China. But do you distinguish between local or city or county ownership of a Chinese company, or provincial ownership and national ownership? And then if you do, how does that effect with whom you negotiate about WTO compliance?

Second, another very short question. Mr. Monks, on the 5th of February 2004 in your remarks to the European Trade Union Confederation, you complain that the United States Administration has committed massive breaches of fundamental international standards such as freedom of association. I don't see any comments in here on the freedom of association in China. How does your trade union association address that, and I guess are American breaches more egregious than Chinese breaches?

Mr. MONKS. Maybe I should go first on that. Can I just say that American unions shout a lot louder about it than anybody in China does.

Commissioner WORTZEL. That's because they get shot in China.

Mr. MONKS. No, no, no. You've come off the bat of a recent Presidential election where American labor was very vocal on the American sins of omission and commission as far as labor standards were concerned. I'm not making any opportunity to balance that comparison between American democracy and Chinese democracy for sure. And we do insult those nearest and closest to us perhaps rather more unfairly than we should from time to time.

But the China thing is uniquely difficult. If we were having this six, seven years ago, we were against them coming into the WTO; we said they don't comply with ILO conventions on labor standards, the fundamental ones, right to organize, right to strike, and so on, and keep them out. Anyway, we lost the argument. It's moved on. China is now a significant player in the world economy, and the question is, not to replay the old arguments, but to say how are we going to find some leaders to influence China for the better; is it possible? Is that the right way to proceed? At the moment we don't see an alternative.

To push China back into some—almost an attack from the rest of the world, the European Union, the United States, NAFTA, somehow, is that going to work? I don't think we think it is. What would the steel workers of Pittsburgh be saying about that, the ones that are left, and depending on China as well. The interlinks now are very, very substantial. And raising living standards, raising human rights issues, raising trade union freedom issues, yes. My old organization, the TUC, was in China doing this recently,

and has been asked to help with trade union training and stuff. Whether these are straws in the wind or whether these are substantial changes, we can't yet assess, but we are giving them a bit of a chance rather than being totally suspicious and so on.

I've had complaints about the American administration from time to time both on trade and on labor standards, but I take this opportunity to say that I'm not bracketing it with China.

Mr. NIGHTINGALE. I endorse what John Monks has said. I think the Chinese are very interested to learn from overseas practices in all sorts of different areas, and John is right. Our UK Secretary of Trade Ministry went to China last month with a posse of British trade unionists to talk about exactly this particular issue. Now, of course, the Chinese are not going to change their ways overnight, and they may well not adopt the sort of practices that we have in the UK or in Europe. But what they are interested in doing I think is generally finding out which practices might suit China, and where they might take ideas. I think they do this in other areas as well.

They do it in the law. In the UK, we have numerous Chinese judges coming for training in the UK, and I'm sure this happens in the U.S. as well. It's a huge problem. The majority of Chinese judges, the older ones who were appointed during the Cultural Revolution, and they have no education whatsoever. So the idea of actually having a legal education or legal training and being legally independent is totally alien, and they are beginning to recognize that that may not be the right way to go about running their judicial system. On the other hand, you must never forget that it's a one-party state. It's run by the Communist Party. Every company in China has a Communist Party member looking after the Communist political side of that company, which of course is completely different to anything we have in the West. Sometimes, of course, that party member may take the role of a trade unionist. They may take the role of looking after workers' interests in a company.

So I think one just has to recognize that there are whole systems in China that are completely different from the ones that we in the West have. But on the other hand, the Chinese are very interested in looking at our systems to see how some of them might adapt to being suitable for China. Just going back to the state-owned enterprise question, which is a very good question, because it's very difficult to tell in China whether a company is still owned by the state or not, because of course they've been through this period of transition. Some companies are very clearly still state owned, absolutely no question about it. Some companies, however, are partly state-owned. Some companies are run by people from the Ministry that used to own the company that have left the Ministry and now run the company. Is that still a state-owned company? It's difficult to tell. Some companies, of course, are properly private companies because you can easily tell then they're private entrepreneurs that have come into business in the last five or ten years. So I think this is still a big question, and I think when one's negotiating with China at the policy level about how the state should go about procurement, for example, it's still quite difficult to draw the line between where the state ends and where the private sector begins. And of course, that's going to be a question for quite a long time.

Chairman D'AMATO. Thank you. We have one more question from our Vice Chairman—

Mr. MARCHI. If I might react, because clearly even if I can accept part of your comments, in our sector, I have told you roughly 34 percent, whatever, are truly privatized with mainly clothing people, not only. You have roughly 10 to 15 percent of the companies that still are state owned, and generally those are [inaudible] the ones which will be apt to disappear, but they are having a lot of tax but continue to produce, and they have a lot of workers. And then you have the rest, and the rest aren't [inaudible].

At the first meeting that I had with the Chinese, I have [inaudible] old country, old city, so this is clearly a problem for us. When the Chinese told us, well, if we are able to, and what we will do is to control implementation of the new legislation terms on environment and financial, we will control the industry, you have understood. They are still not at full control, but at very high control in our sector at least, simply because it is a central piece in their strategy.

I would like to add something, and I maybe sounding trade unionist, but this is dangerous. China's perversion is perverting the system in the rest of Asia. I've learned yesterday or two days ago that the Philippines will dismantle minimum wages.

Commissioner DREYER. Really?

Mr. MARCHI. Simply because they have to compete with China in our sector, and this is where we begin with. It has been stated by the government, so textiles and other exposed sectors, companies, may ask not to apply the local legislation. So the perversion is there. And in Europe we won't be able to do it, by the by, and we don't want to do it.

Chairman D'AMATO. Let me just say we're going to have the floor opened for questions, but Vice Chairman Robinson has a question before we start.

Vice Chairman ROBINSON. I have one. This is a very important point. Our Chairman has been concerned that China is in a sense perverting globalization itself at some level. It's such a large player, such a force. And obviously the predatory nature of some of its practices are creating this kind of undesirable ripple effect, and hence the need to come to terms with some of these issues as quickly as we can.

I was pleased that Mr. Nightingale acknowledged the 800-kilo gorilla in the middle of the room, which is authoritarian one-party rule in China which colors so much of this discussion. I mean this unspoken, almost impolite fact of life that is a common challenge for us. In the United States we have a peculiar set of circumstances because we have forward-deployed forces, unlike yourselves, in the region. We will likely be the first respondent to a conflict in the Taiwan Strait. We have to worry about China's missile buildup and a host of other security issues.

We also have, perhaps regrettably, an inordinate share of the world policing responsibilities concerning the proliferation of weapons of mass destruction and ballistic missiles. We have more robust export controls. Neither the U.S.-China business counsel nor is the business community at large very enamored with human rights-

related measures or national security-related sanctions in response to proliferation-related abuses or any other reason.

So we have political human rights and national security issues colliding with business interests to a greater extent than Europe. We also have more legislation dealing with forced labor-related abuses.

Do any of the panelists have any thoughts about the fact that the U.S. gets involved in an awful lot of what could be deemed from a business perspective unwanted unilateral actions? Others would argue, particularly those of us who have served in the national security community and elsewhere, that security concerns must trump profits and commercial activities because of the need to preserve regional stability, discipline and prudence. I won't belabor the point, but I just wondered if you had any observations about the fact that the U.S. is considerably more activist on national security and human rights issues than Europe as it pertains to our trade relations.

The Chairman, by the way, offers a valid correction. It may well be the case that Europe is more active on the human rights front than we are. So upon reflection, I think this is more a national security-related question.

Mr. MONKS. I was just going to echo what the Chairman just said in terms of your analysis on the human rights side. Some of the criticisms of American trade negotiators are they've not given enough attention to human rights. Negotiators have been more active. Pascal Lamey, the outgoing Commissioner, was very active on that, and that was one area. Although they acted together quite often on things with the States, there was a problem there. And there's a degree of carelessness, which I think was affecting my remarks about American policy on labor rights as well.

National security is a completely different matter, and of course we're all assuming, I guess, in this debate until now, that the relatively peaceful climate will continue. I mean I was wondering the other day that if things turn nasty in the Ukraine, just what that might do for the European/United States divisions in the Middle East at the moment, for example. It might put them in a different perspective. And similarly, if there's trouble between China and Taiwan, all those people who have rushed to invest in China will be looking pretty sick and so on.

Of course, one of the reasons perhaps there's not more trouble in Taiwan is the sheer economic interdependence that has been built up, and at the end of the day do you think trade is an assist to the maintenance of security and peace or not, and, well, I think mostly in history it has been. Certainly protectionism and isolationism has been an assist to war and to increased tensions. So I mean I think at the moment we are, without being naive in any way—and I often caution major inward investors into China with this—what happens if there is an incident as there have been in the past, and they haven't even thought about it, some of them, not even crossed their radar screens. This is still an area of instability in world terms, and I'd think you'd do well to remind people of that, that there are issues. But to isolate China somehow as a result of that—taking it to a logical conclusion I suspect is not the right way, and we are looking to—you find levers all the time to

improve some of these things that we—all these actually that we've been talking about this morning.

Chairman D'AMATO. Thank you very much.

I'm actually going to open the floor up. If anyone has any questions, we wanted to give you an opportunity to ask questions of the Commissioners or the panel.

Open Microphone

Mr. FOUQUET. Well, I think this kind of crosschecking is extremely useful because I think we've been operating in some of these areas kind of blindly. You mentioned that Cornell University was perhaps the first to undertake some detailed studies, and outside of the textile sector I'm really not very much aware in Europe that we've done a great deal of evaluation about the loss of jobs. We hear about Siemens, Volkswagen, a number of companies outsourcing, but we never really added it up, nor do we add up the supposed benefits that flow back in higher purchasing power in Europe because of cheaper goods, et cetera. These are often cited as arguments why we on the whole benefit. But we're still operating without data, which seems extremely strange, especially coming as I do. I'm—

Chairman D'AMATO. Can you identify yourself?

Mr. FOUQUET. Yes. David Fouquet from the Asia-Europe Project. It's a small NGO organization here.

Chairman D'AMATO. I think that you're right. The data issue has become an extremely difficult issue we don't really understand. When we have to go to researchers in a couple of universities to understand what's happening in the country in terms of loss of jobs from outsourcing, we don't have in place the kind of analysis at the Federal level that we need to, and we're recommending that that analysis start to be done immediately and be done regularly by the Federal Government. About the only entity that can do it effectively is the Federal Government.

Mr. FOUQUET. The other thing, I wanted to pose a question, because as an outsider non-expert, I'm more involved in the security dimension, where we do a lot of bean counting, incidentally, which sometimes is full of myth and exaggeration too.

But I was interested in Commissioner Mulloy's question regarding market status. Now, I believe that the EU, and the U.S., also has granted market status to Russia, which is not a member of the WTO. What is Russia? Is it better as a market economy than China, or less? Again, are we operating kind of on an impression or are we operating on political—

Commissioner DREYER. Or a double standard.

Mr. FOUQUET. Yes.

Chairman D'AMATO. They're not part of the WTO, but the definition of market status with regard to the Chinese is very specific in the WTO. I mean we have specific guidelines to identify market status, but Russia's not in the WTO.

Commissioner DREYER. I think that we do give Russia certain advantages. Now, I don't know that much about the trade situation, but there was no earthly reason why the G-7 should have become the G-8 with Russia's inclusion, particularly at the time at which

it occurred, Russia having been an economic basket case in that year. It was done, of course, because we wanted to assuage hurt feelings when several former Soviet client states were admitted into NATO. So we do economic things for political reasons.

It's easy for me to sit here and judge that this is a foolish thing for my government to have done, but I am unfortunately not in the position of being the decisionmaker. I would like to think there's some information I'm not party to that makes the decision on Russia seem more rational, but since I don't have that information it doesn't seem very rational to me.

Commissioner MULLOY. We have a statutory test under a certain criteria you have to meet in order to be—one of the problems with the Chinese is you have to have a currency that's market based. So for us, that's a real problem if you want to deal with the Chinese because they're currency is not market based. As one of our witnesses, Mr. Marchi, pointed out, it is tremendously undervalued. It's tied to the dollar, and as the dollar is falling against the euro, so the Chinese currency is falling against the euro. You think you have trade problems now with China, let's look at your figures a year from now. I think you're going to be more concerned than you are now. You've got a trade deficit of about 60 billion now. I expect that will be quite higher.

For me, the phenomenon to watch here—and again, I love the Chinese. They had a bad 200 years. But they're a great civilization. They're very organized people. They hit upon a strategy. Why did they want the WTO? They wanted in the WTO to lock markets open, and then the investment flows—capital has no conscience—the investment flows moving to China. You can make stuff in China, ship it back here and make a lot. And so our own companies are part of the agents of moving China forward technologically and economically. Good, bad, whatever, but that's what's going on.

And then you've got to say, is this good, bad, or indifferent? And if you understand that, then you've got to figure out, well, if you don't want it happening and you don't want tremendous downward pressure on your own standard of living, what do you do about it? That's what we're really trying to understand.

When you begin to have R&D movement, significant high-tech R&D moving out of America, and I think out of Europe, to China, what does that mean for yourself? What does that mean for your national security, the future standard of living of your children? All of these are important issues, and that's one of the reasons we came over here to talk and learn what you're thinking about.

Chairman D'AMATO. We're running a little bit late, but we'll have time for one more question. I think you had your hand up.

Mr. HERVERGT. Thank you, Mr. Chairman. Philippe Hervergt. I belong to the Ministry of Urban Affairs, but I speak in my personal name. I have two questions. The first is, I noticed regional integration which is something relatively new in Asia because I see that China [inaudible] we are committed and are committed to [inaudible] terrorism, but Japan has begun [inaudible] was reciting French agreements to conclude with some other Asian countries. China seems to do the same with Asian countries. Do you see some concerns in this integration?

I had a second question that is outside the debate, but I cannot attend the second panel. Do you really believe in the cooling down of the Chinese economy? Are there real signs? The hard landing seems to me a very [inaudible] but the soft landing would have some positive consequences as the pressures will diminish on some markets. What is your opinion about this [inaudible] of soft landing? Would that happen? Thank you.

Commissioner DREYER. I think that China may have said it's committed to multilateralism, but I don't actually believe that it is committed. I found it amusing that for years the Chinese would refuse to negotiate multilaterally with the Southeast Asian claimants to the Spratly Islands. Finally, China agreed to deal multilaterally, but at the same time its diplomats were working on the Filipinos who about three weeks ago agreed to negotiate unilaterally. So I find this commitment to multilateralism to be more rhetorical than in actuality.

Chairman D'AMATO. We're going to take a five-minute break and start the next panel. And those people who did not have an opportunity to ask their questions might in this little informal period ask the panelists or the members of the Commission, your questions.

Thank you.

[Recess.]

PANEL II: TRENDS IN EU-CHINA ECONOMIC RELATIONS

Vice Chairman ROBINSON. We would like to continue at this juncture. I think that everyone participating would agree that that was an extraordinarily useful first panel, and we're very grateful to the participants. We're now delighted to welcome Professor Peter Ferdinand of the University of Warwick, as well as Dr. Bernhard Speyer from Deutsche Bank.

Dr. Lemoine, who is with the Centre D'Etudes Prospectives Et D'Informations Internationales is still to join us, but we hope that she'll be with us shortly, and of course, we'll be pleased to hear her remarks as well.

[Note: Dr. Lemoine was unable to appear in person. Her written remarks are included in this transcript.]

That said, we might just begin with Professor Ferdinand.

STATEMENT OF PETER FERDINAND DIRECTOR, CENTRE FOR STUDIES IN DEMOCRATISATION DEPARTMENT OF POLITICS AND INTERNATIONAL STUDIES UNIVERSITY OF WARWICK, COVENTRY, UNITED KINGDOM

Prof. FERDINAND. Thank you very much for the invitation to come and make a few remarks here today.

I have to say that when I read through one of the faxes that I got from your organizers, it did seem to me that the Commission was inventing a new kind of Chinese torture, at least for academics, because one of the things I noticed about the supposed ground rules for presentations was that they were supposed to last for 7 minutes.

I'm an academic, and I think in terms of 50 to 55 minutes as the minimum contribution.

And on a bad day it could be two hours. So I will try to keep my remarks brief, but I hope you will understand if I don't quite manage it.

I also have not had the opportunity to consult with the other presenters today for this panel, and would hope that we will focus upon some different things, but I can't guarantee that that will be the case. However, if I'm going first, that gives me a head start.

There are really six things, six points that I want to make in the presentation now. The first, fairly obviously, is to restate the general fact of the large and growing EU trade deficit with China and Hong Kong. It is now the country or territory with which the EU has the largest trade deficit, and so that makes it potentially a matter of significant concern for the EU Commission as well as for individual member states.

Although, if you look at the brief statistics that I produced, the two tables that are on here, one of the things that I notice came out of the first session was—this is a thing to warm academics' hearts—the idea of further research that could be done.

One of the things that I was struck by when looking at the statistics on trade between the EU and China and Hong Kong was the disparity between the figures for the trade surplus from the Chinese side as opposed to the EU side. And although I was using figures on the one hand from Eurostat and on the other hand from the IMF direction of trade statistics, when you find that there is a disparity of three to one in terms of the trade balance, I am struck by that apparent anomaly. Is it all transport and insurance cost? Is that the only thing that makes a difference? But if the two sides have such a different perspective on where they stand, let alone what should be done about it in the future, then there is the possibility for a great deal of further confusion.

So one of the things that at least I would hope might come out of your work would be a further examination about what the common ground for these statistics might be, and where the differences might lie. I'm not an expert in this field, but I am struck by the disparity. But it doesn't really matter. In one sense the trade deficit between the EU and China and Hong Kong certainly does exist, it is growing and it's significant. And only one country in the EU—15 currently enjoys a trade surplus with China and Hong Kong combined, and that's Finland. Sweden is basically in balance. It's got a slight trade deficit, but \$58 million is neither here nor there, and it did have a trade surplus in 2000 and 2001, but all other EU countries have deficits with China and Hong Kong combined. So it ought to be important for them as well. That's how the overall cumulative deficit was built up.

So it ought to be important, and yet at the same time, the second point, I don't think that there is the same sense of impending crises yet in terms of EU-China relations that there is in China-U.S. relations over trade. That's partly because the actual size of the deficit with the EU, as opposed to the fact of it, is lower than with the U.S. So it's not surprising that the U.S. would feel more worried about that. But most of the rest of my presentation would be about trying to explain why the impact of the deficit varies from one EU country to another, and that explains why it's much more difficult to have a common sense of a unified threat or challenge.

I think that it's important to distinguish, when looking at the figures for individual EU member states, between their trade position with the EU and with the rest of the world because these are different circumstances.

Let me just draw your attention to the statistics that are there in the data, that section at the end, table for individual countries. I haven't done the whole of the 15 EU member states, just those that have the larger trade with China. I think it's important to distinguish between, for instance, on the one hand Germany, which does have a trade imbalance with China and Hong Kong, but has a trade surplus with the world with the EU and with non-EU countries. So they're not going to be especially worried about the size of the deficit, I don't assume.

And France and Italy have substantial trade surpluses with the rest of the world, but deficits with the EU, so to some extent, when China and Hong Kong are part of that picture, then it doesn't really matter so much to them because looking at the relations with the rest of the world, then the picture is relatively reassuring.

Spain is probably the EU country that comes closest to the American position in that it has a trade deficit with the world, with the EU and with China, and it also has a growing trade deficit with China and Hong Kong, and so in 2003 it represented about 23 percent of its total non-EU trade deficit, the equivalent of that. And there have been demonstrations in Spain over Chinese imports, so there is something of a political issue there, and that might impact more strongly upon the new socialist government.

There are the two countries which have the largest trade deficits with China and Hong Kong, firstly, the Netherlands, and secondly, the United Kingdom. Now, in the case of the Netherlands, which has the largest trade deficit with China and Hong Kong—in 2003 it was \$14.9 billion. That's 23.5 percent of its total non-EU trade deficit. This is to some extent compensated by the fact that the Netherlands runs a very large trade surplus with the rest of the EU, and since quite a lot of the things that are imported into the Netherlands probably are going to be re-exported into other countries in the EU, then it won't seem to the Dutch government as much of an issue, and in any case, they are running an overall trade surplus, as well as with the EU, so therefore, it won't be perceived as being especially threatening.

And lastly, you have the United Kingdom, where of course the trade deficit with the world is going up, with the EU is going up, with the non-EU is going up, and with the China in Hong Kong is going up as well, and in 2003 it represented 37 percent of British trade deficit with non-EU countries. So that's gone up from 22 percent in the year 2000, so it's gone up pretty quickly, at least in 2003.

But there, too, are some things that I think need to be borne in mind. The first is that while the trade deficit with China and Hong Kong and Britain has gone up significantly over the years 2000 and 2003, the trade deficit as a whole with non-EU countries has remained pretty static. So what you've effectively had, what it looks like is trade diversion. Things are coming from China that were previously coming from other parts of the world. So that doesn't give you the sense that there is a mounting threat as well as every-

thing else is becoming threatening. It's simply that the United Kingdom is buying more from China.

And the second thing that in a sense consoles the British government about its trade relations with China and Hong Kong is that it expects that it will run—Peter Nightingale also referred to this—a significant trade surplus in invisibles of one kind or another, services over all the British government, because the data aren't especially robust, but it guesses that Britain has a surplus in invisible trade which is equivalent to roughly 60 percent of its deficit in visible trade, largely financial services, though also educational, tourism and so on. Probably the surplus on invisible services and trade with China and Hong Kong is not as great as yet in some other parts of the world, but nonetheless, there is the prospect as China becomes a fuller partner of the WTO and the transitional arrangements come to an end, that there will be opportunities for British companies and British service providers to take advantage of that in the future, in the not-too-distant future.

So for all of those reasons the picture overall is fairly homogenous as far as most of the EU countries are concerned, the specific circumstances of each country needs to be factored in to explain why it is that, as yet, there isn't the same sense of mounting overwhelming challenge.

In addition—this is the fourth point—a number of EU countries do expect that they will be able to take advantage of infrastructure development in China, which China will need to engage in to maintain its economic growth, and where they think that European companies may have a significant advantage, especially for instance in transport, railways, things like that. I won't raise the question about Airbus versus Boeing, but that could come back as an issue at some point in the future.

And so the prospect of that taking place in the fairly near future is also a source of some reassurance to EU governments. There is the new agreement that simplified tourism arrangements for groups of tourists from China to the EU in 2004, and some EU officials have talked about an expectation that five or six hundred thousand Chinese tourists might come to Europe in 2005. Who knows whether they will, and who knows whether they'll stay. There is the prospect of the buildup of educational services as well. The British Council says that not only have Chinese students in British universities gone up from 10,000 to 40,000 over the period 2000 to 2004, they think it might go—but this is of course seat-of-the-pants calculations—it might go up to 130,000 by the year 2020.

Were that to happen, or anything like that to happen, it would make a significant difference to trading relationships between Britain and China, and other EU countries would also hope to benefit from that tide of the internationalization of higher education.

And thus, there is the possibility, although it's still not very much of a reality, but again, not much research has been done on this to my knowledge, the possibility of Chinese foreign direct investment in European countries, which may become more important in the future, and I'm reminded of the potential significance of the fact by the announcement in the last two weeks, that the last remaining British independent car manufacturer, Rover, is going to be taken over by Shanghai Automotive, with the prospect

of investments of something like a billion pounds or 1.4 billion euros.

Now, I'm not unduly cynical if I suggest that 1 billion pounds is an awfully round figure. I bet it isn't really a serious business plan if it came up with that kind of sum, but even if the actual details may vary, the idea that Chinese companies might also become investors in European countries is also a source of mild comfort for European governments, because after all, the British government has made a big thing about attracting FDI from East Asia since the 1980s. And the only reason why Britain has a viable automobile manufacturing sector as a whole at the moment, which is a net export, is because of Japanese investments. So if Chinese companies might do something for Rover, which BMW failed to do, then it would be striking.

So it seems to me that European countries, at least for the moment, have a somewhat more relaxed view about the deficit that they run. It means that they would be, I guess, prepared to wait and see how far China does implement all of the commitments that it undertook when it joined the WTO, and that means then that there are two, three, four years to assess that seriously.

European governments will certainly want to make sure that that takes place. And in that there is obviously a lot of opportunity for cooperation with the United States in trying to make sure that that happens fairly because European governments are as aware as American governments about the pitfalls for trade in China, and the ways in which what seemed to be successful deals turned wrong for reasons that nobody can quite confound.

The last point then is something that in a sense Commissioner, Mr. Mulloy made in the previous session, was there may be a more relaxed view in EU countries about trade relations with China and Hong Kong. That doesn't mean to say that it's complacent about it. The term that I've used off the top of my head to try to characterize it is wherein [inaudible] equanimity. We can accept it sort of at the moment, but it doesn't mean to say that the European governments or the European Commission is complacent about what this might lead to in the future, because as Mr. Mulloy said, one can think of one scenario or rather two scenarios when combined, which could change the picture quite dramatically. And that would be if not only the U.S. dollar sank significantly, but the renminbi would remain tied to it, so that trade surpluses for China with the EU went up dramatically. And if at the same time this would be a very cunning strategy on the part of the People's Bank of China, if they transferred a lot of their reserves into euros as well, making sure that the euro also remained much higher than it would otherwise be. You would have in the phrase of Chris Patton, the double whammy, which would both hit the European Union quite badly, and that could make relations with China turn somewhat more acrimonious in the fairly short term. But who am I to suggest that that scenario is necessarily what is going to happen, but it's certainly something I'm sure that European governments are looking at very closely.

[The statement follows:]

**Prepared Statement of Peter Ferdinand
Director, Centre for Studies in Democratisation
Department of Politics and International Studies
University of Warwick, Coventry, United Kingdom**

Recent Trends in EU-China Trade: Anxiety or Equanimity?

Since China began its economic reform programme at the end of 1978, it has become a major international trader. Its relations with the EU have steadily thickened. By the end of 2003 it had become the second greatest trading partner with the EU after the U.S. By the end of 2004 it may have become number one.

China's entry into the WTO in 2001 excited hopes around the world of a dramatic increase in trade, from which all should benefit. The EU was no exception.

Yet in recent years the EU has witnessed an increasing deficit in its visible trade with the PRC. This can be seen from Table 1. In 2001 the EU's collective trade deficit with China and Hong Kong at 45.82 billion Euros was almost identical to the EU's total trade deficit with non-EU countries at 45.38 Euros. Nevertheless as Table 1 shows, the year-on-year growth of the deficit has been modest.

When viewed from the Chinese side, the trend is the same—see Table 2 for the combined trade of the PRC and Hong Kong with the EU.

This comes at a time when growth in the Eurozone has been disappointing. Insofar as trade with the rest of the world contributes to that poor performance, it can exacerbate the problem. The Chinese trade surplus with the EU as a whole grew by 66.4 percent between 2000 and 2003. This is only slightly less than the 73.2 percent by which the joint surplus of the PRC and Hong Kong increased with the U.S. over the same period. Yet whilst the adverse trade balance with China does provoke political attention in European countries, it does not at the moment excite the same passion as in the U.S. The main purpose of this submission is to illuminate some of the reasons for that.

First of all, there is the obvious fact that the trade surplus of the PRC and Hong Kong with the EU is significantly smaller than that with the U.S. In 2003 it was only 33.6 percent of the surplus with the U.S. So in gross terms it does not seem to represent such an immediate challenge to EU countries.

Secondly, it is important to factor in the impact of Chinese trade upon individual EU member countries. Here the picture is quite variegated. Some countries are much more heavily affected than others. The ways in which they are affected vary too. That fact in itself reduces the sense of a common and equally shared challenge.

The rest of this submission will focus upon the perception of different groups of countries. It will concentrate upon the position of the largest European economies, which do the greatest trade with China. In most cases it is important to distinguish between member countries' trade balance with the rest of the EU and their trade balance with the rest of the world.

First of all only one EU country enjoys a trade surplus with China and Hong Kong combined and has done so throughout the period since 2000, i.e. Finland. It also enjoys a trade surplus with the rest of the world. In 2003 its surplus on trade with the Chinas was equivalent to roughly 4.9 percent of its total foreign trade surplus. In addition Sweden enjoyed small trade surpluses with the Chinas in 2000 and 2001. In 2002 and 2003 it registered trade deficits of US\$58 and \$56 million. It too enjoys trade surpluses with the rest of the world as a whole. Neither of these countries has reason to be anxious about their trade with the Chinas.

Secondly there is Germany, which has a large trade surplus with the world and also with the EU, as can be seen from Table 3. Although this shows a trade deficit with the Chinas, it is more than compensated by trade surpluses elsewhere.

Thirdly there are the countries like France and Italy that have positive trade balances with the rest of the world, but negative ones with the EU. This can be seen from Tables 4 and 5. Italy has a small overall trade balance, whilst France on the whole a modest trade deficit. But even though both of them have significant trade deficits with the Chinas, these are more than compensated by significant trade surpluses with countries outside the EU. For both of these countries a bigger problem is trade deficits with the rest of the EU.

Fourthly there is Spain which has trade deficits with the Chinas, with the EU and with the world as a whole, as can be seen from Table 6. Here is a country that has been affected by imports from China and there have been workers' protests over factories that have been forced to close because of cheaper imports from East Asia, most obviously from China. The deficit on trade with the Chinas is equivalent to around one-fifth of the total Spanish trade deficit with non-EU countries. Conceivably the new Socialist government in Spain will be more sympathetic to complaints from organized labour over cheap imports. Nevertheless the Spanish government

will find it difficult to make a big issue out of this unless it can find other countries willing to support it.

Finally there are the two EU countries that have the largest deficits on trade with the Chinas: the Netherlands and the UK. Yet neither government seems especially agitated by that. The reasons are different, but again they have to do with each country's trade with the EU when separated from their trade with the rest of the world.

The Netherlands has the highest deficit with China, as can be seen from Table 7. It also has a significant deficit with countries outside the EU. As in the case of Spain, the deficit with China represents about one-fifth of Holland's total trade deficit with countries outside the EU. Nevertheless Holland has a quite large surplus with the world as a whole, and that means that it has a large surplus with the EU. The deficit with China is in part caused by the attraction of the sophisticated port infrastructure that the Netherlands have built to serve as a gateway to the European continent, not just to Holland. In any case the trade deficit with the Chinas seems fairly stable and certainly manageable.

Finally there is the UK. Here, as can be seen from Table 8, the deficit with the Chinas has grown rapidly over the period 2000–2003. And the UK has a large deficit on the trade in goods with both the rest of the EU and also the rest of the world. The deficit on visible trade with China is a significant factor in that. Nevertheless Table 8 shows that the British deficit with non-EU countries has remained very stable over this period. So even if the deficit with China has grown, this has displaced trade with other non-EU countries. The overall picture of trade outside the EU is not so worrying. For the British government the adverse trend of trade within the EU is a greater cause for concern.

In addition the British government places great emphasis upon the country's exports of services. Although data in this respect are less robust, the UK government assumes that its surplus on trade in 'invisibles' is equivalent to around 60 percent of its deficit on visible trade. In large part financial services account for this. No doubt at present the British surplus on services sold to China will be less than in other parts of the world. Nevertheless the British government has high hopes of increased penetration of the Chinese market as the period for China's transitional arrangements for entry into the WTO comes to an end. And there are other compensating factors too, e.g. the dramatic increase in Chinese students in UK universities—now over 40,000 per year where there were only 10,000 in 2000. The British Council estimates that numbers could rise to 130,000 by 2020. The possibility is even emerging of Chinese companies investing in the UK—viz the recent announcement of a merger between Britain's last major independent automobile manufacturer, Rover, with a Chinese partner, Shanghai Automotive, that plans to invest up to 1.4 billion Euros. Since the 1980s the British government has achieved considerable success in attracting FDI from East Asia and hopes to do the same from China in due course.

Does Equanimity Equal Complacency?

All of this has suggested reasons why EU member states are alert to, but not unduly concerned by, the challenges of a growing trade deficit with China and Hong Kong. There is no sense of the need for a major campaign against Chinese exports—not yet at any rate. In the UK, for instance, the transfer of call centres and IT-related jobs to the Indian sub-continent receives much greater political and media attention at present than the trade deficit with China. The mood is quite different from the late 1980s when Japanese exports were perceived to be flooding into Europe unfairly and when the French government in particular took unilateral action.

Whilst the deficit on the trade in goods is certainly growing, European countries are consoled by the prospect of countervailing trade in the fairly near future. Some, especially France and Germany, have high hopes of signing major contracts to develop the infrastructure that China will have to develop or upgrade, e.g. transport systems and equipment, if it is to keep up its economic momentum. Then too there was the agreement between the EU and China earlier this year to simplify arrangements for groups of tourists to visit the EU. European officials have looked forward to 500–600,000 Chinese tourists visiting various European countries per year.

None of this means that EU countries are complacent. They will be vigilant in monitoring the ways in which China lives up to the commitments that it undertook when joining the WTO as the transitional period comes to an end. Several are counting on much greater success in penetrating Chinese markets for services, as well as manufactured goods. European companies and governments are aware of myriad obstacles to business success for outsiders in China. But they know that it will be a few years before a clear picture emerges of the impact of the WTO. For the moment they can focus on the medium term of 3–4 years, whilst reassuring

themselves that in the longer term an increasingly prosperous China will be in the interests of the EU.

It is, however, possible to envisage two scenarios that could raise European emotions in the near future. The first is a dramatic fall in the value of the U.S. dollar with the RMB remaining pegged to it. If that led to a further significant increase in the Chinese trade surplus with individual EU countries and more manufacturers going out of business as a consequence, that would raise the political stakes.

The second would be the PRC switching a large proportion of its foreign exchange reserves from dollars into Euros. Whilst some European leaders would appreciate the implicit show of confidence in the Euro, if this kept the Euro's value up against other currencies, it would damage European exporters. That could have political consequences.

For the moment, though, European attitudes towards trade with China would seem to be characterized by wary equanimity.

Table 1. EU Trade Balance with China and Hong Kong

(in millions of Euros)

2000	2001	2002	2003
-44780	-45800	-47600	-54900

Source: Eurostat

Table 2. Combined China and Hong Kong Trade Balance with the EU

(in millions of U.S. Dollars)

2000	2001	2002	2003
19538	13226	18525	29444

Source: IMF, Direction of Trade Statistics (various years)

Table 3. German Trade Balances

(in millions of U.S. Dollars)

	2000	2001	2002	2003
With world	54770	83997	120694	149659
With EU	50948	58026	80680	110999
Non-EU	3822	25971	40014	38660
With China & Hong Kong	-6746	-5254	-4240	-5484

Source: IMF, Direction of Trade Statistics (various years)

Table 4. French Trade Balances

(in millions of U.S. Dollars)

	2000	2001	2002	2003
With world	-10694	-2954	1542	-4846
With EU	-15842	-17764	-14208	-20408
Non-EU	5148	14810	12666	15562
With China & Hong Kong	-2713	-1209	-2373	-3425

Source: IMF, Direction of Trade Statistics (various years)

Table 5. Italian Trade Balances

(in millions of U.S. Dollars)

	2000	2001	2002	2003
With world	1863	8746	9050	1321
With EU	-2607	-1929	-4971	-9484
Non-EU	4470	10675	14021	10805
With China & Hong Kong	-1631	-1198	-1504	-3918

Source: IMF, Direction of Trade Statistics (various years)

Table 6. Spanish Trade Balances

(in millions of U.S. Dollars)

	2000	2001	2002	2003
With world	-30911	-37715	-39994	-52558
With EU	-18407	-16840	-18885	-26365
Non-EU	-12504	-20875	-21109	-26193
With China & Hong Kong	-3031	-3157	-3531	-5960
As percentage of total non-EU balance	24.2	15.1	16.7	22.8

Source: IMF, Direction of Trade Statistics (various years)

Table 7. Netherlands Trade Balances

(in millions of U.S. Dollars)

	2000	2001	2002	2003
With world	11317	41210	28712	26208
With EU	70954	77381	74813	89674
Non-EU	-59637	-36171	-46101	-63466
With China & Hong Kong	-7816	-8720	10052	-14926
As percentage of total non-EU balance	13.1	24.1	21.8	23.5

Source: IMF, Direction of Trade Statistics (various years)

Table 8. UK Trade Balances

(in millions of U.S. Dollars)

	2000	2001	2002	2003
With world	- 52832	- 53624	- 59139	- 76527
With EU	- 5623	- 5915	- 12805	- 33335
Non-EU	- 47209	- 47709	- 46384	- 43192
With China & Hong Kong	- 10529	- 10840	- 13166	- 16011
As percentage of total non- EU balance	22.3	21.9	28.4	37.1

Source: IMF, Direction of Trade Statistics (various years)

Vice Chairman ROBINSON. Thank you very much. That was a very interesting presentation indeed, and I'm sure there will be comment on it.

Dr. Bernhard Speyer, please.

**STATEMENT OF BERNHARD SPEYER, DIRECTOR
HEAD OF BANKING, FINANCIAL MARKETS, REGULATION
DEUTSCHE BANK RESEARCH/ECONOMICS, FRANKFURT, GERMANY**

Dr. SPEYER. Thank you, Mr. Vice Chairman.

Of course people in the financial industry are known to have an attention span of 30 seconds, so presumably expect me to have finished my talk quite quickly. I'm not quite sure whether I can comply with that.

Let me start by pointing out that in our view—and I think this is a view widely shared in the financial industry—China has actually complied with its WTO commitments as far as financial services are concerned, to the extent that they have committed to, and the industry's expecting that it will continue to do so going forward until the end of the compliance period in 2006.

There have, of course, been other regulatory action by the Chinese authorities, some of which have raised some concerns. However, the view is, perhaps with one possible exception, that most of these measures have been taken in response to and in an effort to manage the Chinese economy rather than in an effort to discriminate against foreign services suppliers.

The time market opening philosophy that the Chinese authorities have followed for financial services, of course follows the philosophy of gradualism that has been a hallmark of the Chinese liberalization processes, and this gradualism certainly has been very useful and sensible, given the precarious state of the Chinese financial system.

Having said this though, there are obviously a great extent of problems in the Chinese financial system, and we in the financial industry are convinced that a more vigorous offensive approach in terms of liberalization, beyond the commitment that China undertook in the WTO would actually be fruitful and in the interest not only of the financial industry, but also in China's interest.

Let me stress this final point. We really feel that this is an area, whether it's the mutual interest of the Chinese authorities as well as the financial industry, because what's the interest of China in further opening its financial markets? Well, first of all, of course, there is the greater expertise that foreign financial services providers have in many fields and products, not least of all amongst those areas of expertise is risk management, which is something that is sorely lacking in Chinese financial institutions, and in fairly good supply in foreign financial institutions. It's also the case that participation of foreign industry would add to the liquidity of the Chinese market, which is actually fairly poor, and would also help to improve the infrastructure of Chinese financial markets, for example by building the security settlement structure and rating agencies and the like.

Where do we stand currently in terms of numbers? Well, foreign banks, securities houses, fund managers and the like, have actually made quite an effort to get into the Chinese market. We had at the end of 2003, 62 foreign banks from 19 countries, with 191 operational units. Amongst those were 56 European funded banks with 55 branches, and those 55 branches are actually a third of the entire population of foreign branches in China. Total assets were approximately \$400 billion renminbi, which is quite a significant amount, up almost a fifth from 2002, but still represents less than 2 percent of total assets in the Chinese banking system.

One has to consider though that in certain market segments, and certainly the foreign currency business is one here. The market share of foreign institutions is a lot higher, stands officially at 9.9 percent, some (?) and some market segments go as high as 20 to 30 percent.

Importantly, there's now been by now 21 European branches that have been approved to conduct renminbi business, and this is actually quite an increase, more than a doubling from 2001. So progress has actually been quite good, but where are areas where we feel that further progress can be made?

Now, let me divide those into points, one really three areas of more general liberalization, and secondly, areas which are more of concern to the foreign financial industry. Starting with the first three points, those are first of all, the liberalization of interest rates; secondly, the creation of a derivatives market; and thirdly, improvements in corporate governance, and there is actually a fourth one, which is broadening the range of assets.

Starting with the liberalization of interest rates, up until the end of last month, end of October, there was very limited possibilities for Chinese banks to actually vary the rates of interest both on deposit and the lending side. Now, of course, that not only impeded the profitability, but more importantly, it impeded their ability to actually do a proper risk management, because the pricing of loans is obviously a very important tool for structuring your risks properly.

For foreign banks it actually also is an impediment to entering the Chinese markets, because if you have caps on the deposit side, you cannot attract customers by offering them higher deposit rates. It's also been a concern lately for the Chinese institutions as well, because given the low deposit rates, which in some cases are even

falling below the inflation rate, there has been an outflow of deposits out from the banking system and into the gray market, which of course is a concern for the Chinese banks, which see their funding base eroded.

More generally, the ability of the Chinese authorities to conduct macroeconomic policy is severely circumscribed by caps on interest rates. Now, as I said, there has been lifting at least on the side of the lending rates at the end of October. However, what we find is that this has not yet been translated into the markets, and banks do not actually use that freedom that they have.

Second point, derivatives. Derivatives markets, in particular futures, are current very limited. Again, this is extremely unfortunate because derivatives really are a key factor for banks to manage their credit risk and other related risks such as market risk in particular. Again, this extends actually beyond the banking sector and into the general economic environment because the lack of in particular foreign exchange derivatives has been one of the factors why the Chinese government has always maintained that it cannot yet liberalize its exchange rate regime because companies and the financial institutions cannot hedge themselves against possible changes in the exchange rate. So those two are actually inter-related. There have been moves lately to open up the derivatives market, but these are still very much in the infant stages.

Third point, broadening the range of assets. The key factor here really is developing bond markets. The Chinese financial system is very much a bank-based system, and again, this has led to a culmination and concentration of financial risk in the banking system rather than spreading the risk to the entire financial market. This is one of the reasons why the Chinese banking market is so crippled with nonperforming loans.

Certainly a more balanced funding structure would be desirable, and the development of market segments, especially securitizations, asset-backed securities and the like is very important, not the least as an instrument for dealing with the nonperforming loans problem.

Fourth point, improvements in corporate governance. Investor confidence certainly is still a problem in the Chinese markets. There are still a lot of reports on insider trading, other scandals. The Chinese authorities have actually been very active in that, and put out a number of regulations concerning outside board members, protecting the right of minority shareholders and the like, but the challenge of course is to put this actually into implementation and into enforcement, something that's similar to what was mentioned earlier on on the problem of IPR.

The industry is actually very much into that topic as well. There has been a report by the Washington-based Institute of International Finance recently on corporate governance in China, which has actually received a very warm reception by the Chinese authorities, who fully stood behind that, and again, this is something I would stress, that in the Chinese authorities, in the regulatory community, you have a strong commitment to adhering to internationally accepted standards.

Let me now turn to the second part, which is the specific requests by Europe's financial industry, and let me start by men-

tioning something that has already been raised by Mr. Nightingale earlier on, which is the minimum capital requirements for branches. As he pointed rightly out, those are actually five times as high as those for the domestic institutions, so this is actually the one instance where one would arguably could say that this might be in violation of the principle of national treatment under the WTO rules. Those amounts in any case are very high by international standards, and on top of that the problem is that those actually apply to each and every branch individually, so every time you'd want to open a new branch you would have additional minimum capital requirements.

In economic terms, this is actually not a very sensible arrangement because a branch, after all, is fully guaranteed by the parent institution, and is not a separate legal entity. There is actually no economic rationale for that high minimum capital requirements. And hence, the European financial ministry is convinced that those should be brought into line with domestic institutions.

The same thing is compounded by the fact that there are actually high-reserve requirements, meaning that 30 percent of that working capital has to be put aside into Chinese financial institutions designated by the government, mostly these companies, or put into government bonds. Now again, this reduces the return on equity on the branches and limits their development.

The third point, limits on foreign ownership. The maximum equity stake that individual foreign banks can take in a Chinese financial institution now stands at 20 percent. There's an overall cap of 25 percent for foreign participations, and the problem is, once you exceed that threshold, the institution in question loses its status as a domestic financial institution. It becomes a joint venture institution with a far more restrictive regulatory environment.

Now again, this is certainly a critical point because it's customary international practice that the regulatory regime for a financial institution should be really tied to its financial status, its liquidity, the quality of risk management, but not to the type of ownership. Obviously, there has to be ownership control. We all have that in our respective countries, but the regulatory environment certainly should not be tied to the nationality of the owner.

The next point is what is commonly called the foreign debt policy. There has been an administrative measure issued in May this year, becoming effective in June of this year, that actually no longer allows foreign currency loans of foreign financial institutions to be converted into renminbi by their local customers. This, of course, is a very important point for the multi-national enterprises that operate in China and have domestic counter-parties that they're able to pay those in renminbi. There used to be a way around that which was employed by foreign financial institutions, and that was to grant them by letters of credit to Chinese financial institutions, which would then lend renminbi loans to the multi-national enterprise. However, this loophole has now also been closed, which makes it very difficult for firms to service their natural customer base, i.e., the foreign enterprises.

Last point that I want to mention is the awarding of a renminbi license. Again, this is a fairly restrictive regime because you only can get a renminbi license after having had the branch license for

at least three years, and after two years of uninterrupted profitability of your existing branches. Now, again, this doesn't make a lot of economic sense, given that a branch is not a separate legal entity, and is actually the fourth committed guarantee of its parent company. And of course, it does put a severe brake to the expansion in China because you can roughly calculate the number of Chinese provinces and multiply that by three and you end up by 150 years until you have at least one branch in every Chinese province.

Let me stop here and refer you to our website of Deutsche Bank Research, which incidentally I should mention is the think tank of Deutsche Bank Group. We have actually made China one of our major research topics about two years ago, and have put out a number of publications, which I forwarded to Josh Eisenman. We'll certainly make them available to you, but for you and everybody else they are available at www.dbresearch.com.

Thank you.

[The statement follows:]

**Prepared Statement of Bernhard Speyer
Director, Head of Banking, Financial Markets, Regulation
Deutsche Bank Research/Economics, Frankfurt, Germany**

The Liberalisation of China's Financial Markets

1. Compliance With WTO Commitments

As regards banking and securities services, China has so far complied with the commitments made upon accession to the WTO—and, in our view, can be expected to do so looking forward. Other subsequent regulatory action by the Chinese authorities have not put the commitment into question, but have nonetheless been the source of some concern as regards the principle of national treatment (see below, section 4).

The gradual market opening in financial services that China committed to in its WTO accession protocol is in line with the cautious policy of market liberalisation which the PRC has applied to other markets, too. This gradualism certainly has helped to avoid disruption in financial markets. However, given the extent of problems in the Chinese financial system, making more use of the expertise of foreign institutions and advancing more boldly on financial sector reform might be wise, though. Hence, Deutsche Bank—along with many other foreign financial services providers—is convinced that a more vigorous market opening—including an acceleration of the time-table agreed in the WTO protocol—would be in the interest not only of foreign financial institutions, but also in China's interest.

2. Further Liberalisation in Mutual Interest

For the PRC, there are large potential benefits to be gained from greater participation of foreign institutions in the People's Republic: additional products; stronger ties between China and the global economy; and, above all, access to expertise, not least in risk management. Greater room for foreign institutions to invest in the stock and bond markets should improve liquidity. Foreign financial institutions can also play a role to help China develop a supporting infrastructure for bond markets by partnering with domestic brokers and rating agencies. In the longer-term perspective, demographics should be kept in mind. There is a need for Chinese individuals to increase their provisioning for old age—and again, firms from "greying markets" bring expertise.

Foreign banks, securities houses, fund managers and insurance companies want to participate in China's development and ascendancy. High growth potential and, so far, vastly under-served financial needs combine into a compelling business case. At end 2003, 62 foreign banks from 19 countries had set up 191 operational units in China. This group includes 56 European-funded banks with 55 branches, the latter being more than a third of the total number of branches (156). Total assets of foreign financial institutions amounted to nearly RMB 400bn, up 21.5% from 2002, but nonetheless representing only 1.4% of total bank assets. However, the market share of foreign funded banks in foreign currency loans stood at 9.9%. Twenty-one European branches had been approved at end-2003 to conduct RMB business, compared to 19 in 2002 and 10 in 2001.

3. Areas for Further Liberalisation in General

Liberalisation of interest rates

Currently, banks operating in China have only limited possibilities to vary interest rates in the deposit as well as in the lending business. State-imposed rules for setting interest rates do not only distort the allocation of financial resources, but also impede the development of financial markets. The lack of differentiation on the lending side, in particular, is a major obstacle to controlling credit risk adequately. Lack of competition on the deposit side leads to outflows of deposits from the banking system into the informal credit markets and reduces the chances of foreign institutions to compensate for their lack of branch networks by offering higher interest rates. More generally, it also impedes the ability of the Chinese authorities to manage the macro economy by means of conventional policy instruments, such as monetary policy.

It is therefore welcome that the Chinese authorities are in the process of lifting these rules. The authorities consider, for instance, using Shanghai as a test ground for the liberalisation of interest rates. While country-wide financial institutions have been permitted, since the start of 2004, to extend loans with lending rates 1.7 times as high as or 10% lower than the central bank's guiding rate, banks in Shanghai would be allowed to ignore the upper ceiling.

Derivatives

Derivatives markets, in particular futures, are currently limited. This is unfortunate for two reasons: (a) derivatives are important if financial institutions are to prudently and actively manage their portfolios and the risk contained therein; (b) financial derivatives have been the fastest-growing segment of financial markets and offer higher margins than standard products. Again, the importance of this gap in the product range extends beyond financial markets: One of the reasons why China delays an adjustment of its exchange rate is that companies cannot hedge effectively against a change in the official rate, let alone a more flexible exchange rate regime.

There have been some encouraging signs that the Chinese authorities will gradually liberalise this market segment, too. In February 2004 the China Banking Regulatory Commission (CBRC) introduced the first set of rules governing derivatives activity by banks and other financial institutions; derivatives trading is to be allowed for both commercial and hedging purposes. In March 2004 there was an initiative by the People's Congress to allow an equity futures market. The Chicago Mercantile Exchange (CME) announced in May that it wants to develop a range of financial futures together with the Shanghai Futures Exchange, to be ready whenever the Chinese government opens the door for financial futures trading. Over and beyond the immediate issue of financial derivatives, teaming up with other global exchanges to develop new market segments is certainly a sensible course because markets are standardising and consolidating to meet users' and intermediaries' demands for lower operational costs and greater capital efficiencies.

Broadening the range of assets

The Chinese bond market is small (volume outstanding around 34%/GDP, 2002) and dominated by public issuers so far (approx. 86% of volume outstanding). There is enormous growth potential in the commercial bond market. The current underdevelopment of this market segment reflects the dominance of bank lending, of course: In H1/2004 82.7% of the financing of the non-financial domestic sector was funded by bank loans, 4.6% by equity and only 0.6% in the corporate bond market (data by PBoC; the balance is issuance of government bonds). Given the enduring problem of non-performing loans in banks' portfolios, a more balanced funding structure for the Chinese economy and a broader spreading of risk across the financial system would certainly be desirable. A broader product range would include covered and securitised fixed income products, such as *Pfandbriefe*, mortgage-backed securities and other asset-backed securities as well as a broadening of the maturity range.

Improvements in corporate governance

Investor confidence is a major issue in China's financial markets. This refers, on the one hand, to market supervision in the narrow sense: Reports of allegations of insider trading and other scandals still surface occasionally. More especially, though, it has to do with overall financial regulation and corporate governance, in particular. The China Securities Regulatory Commission (CSRC) has issued a number of regulations relating to investor confidence. These include proposals to increase the proportion of outside board members, to make it easier for minority shareholders to sue management, to encourage institutional investors, and for compulsory delistings for loss-making firms. The challenge will be to follow through on

these proposals. Similarly, earlier this year, the Institute of International Finance (IIF) published a report on corporate governance reforms in China. The IIF notes that rising portfolio equity investments in China are, in part, due to improvements in corporate governance, but that nonetheless more needs to be done to improve the environment for foreign investors. This would include, *inter alia*, improving information disclosure, upgrading auditing standards, introducing stricter rules against market manipulation, and strengthening the role of independent directors. Needless to say, a further reduction in state ownership would also reduce a major obstacle to good corporate governance.

The tradable portion of state companies' shares listed on the stock exchange is generally rather limited as the majority of shares remain under government control. In other words, the stock market is not yet used primarily as a vehicle for privatisation with some critics saying that it is more of a capital-raising tool. This also raises concerns over the protection of outside (private) minority shareholders. Also, with high state ownership, share prices inevitably reflect government policy as much as corporate fundamentals.

4. Specific Requests by Europe's Financial Industry

Working capital requirements

Issue:

There are working capital requirements for foreign institutions which depend on the range of activities and range from RMB 100m to RMB 500m per branch to potentially carry out the full range of banking services currently allowed (both in domestic and foreign currency). Specifically, for foreign banks seeking a corporate banking license RMB 300m is needed and for a retail banking license a further RMB 200m. These amounts are many times higher than international standards, including those in the EU (where a working capital of EUR 5m is the minimum). In addition, these capital requirements are applied for any additional branch of one and the same foreign bank.

These dotational capital requirements were introduced after China's accession to the WTO. Chinese institutions do only have to satisfy overall capital requirements and those—unlike for foreign institutions—are not tied to the number of institutions and the range of customer segments served. Hence, the provisions may be considered as violating the principle of national treatment, as laid down in the WTO agreement.

Assessment:

Separate working capital requirements for each branch ignore the fact that these branches are part of a single legal entity supported by its total capital base. Essentially, the new regulation requires branches of foreign banks to be capitalised like subsidiaries, although branches are not separate legal entities.

Recommendation:

Reduce working capital requirements in line with internationally prevailing practice or, at least, reduce the level from up to RMB 500m to RMB 100m, which applies to branches of domestic banks. In addition, any dotational capital requirement should, in conformity with international standards, apply on a consolidated basis to all Chinese branches of a foreign bank, reflecting that banks are supervised on a consolidated basis at home.

High reserve requirements

Concern:

30% of the working capital of each branch has at any time to be deposited at a local bank approved by PBoC, or alternatively in government bonds.

Assessment:

This reserve capital requirement renders a large part of the very high capital injections into each branch useless for commercial purposes. It significantly reduces the return on equity and limits the development of the branches. Again, these reserve requirements ignore that branches are not a separate legal entity and that their liabilities are fully guaranteed by their respective head offices.

Recommendation:

Abolish the mandatory deposit of 30% of working capital.

Limits to foreign ownership in domestic institutions

Concern:

The maximum equity stake that an individual foreign bank is permitted to take in a Chinese bank was raised from 15% to 20% in December 2003, with a total for-

own ownership of 25% being allowed. If this threshold is exceeded, the institution in question loses domestic PRC status and needs to operate henceforth under the more restrictive license of a JV company.

Assessment:

The legal and supervisory regime for a financial institution should be based on the nature of its business activities and the risks it takes—not on the nationality of its ownership. In addition, limits on foreign ownership are problematic, if corporate governance laws and practices do not sufficiently guarantee the rights of minority shareholders. This in turn will reduce the willingness of foreign owners to transfer best practices, such as those in risk management, to the Chinese institution.

Recommendation:

Foreign ownership in Chinese financial banks should be allowed beyond the current 25% limit.

Foreign debt policy

Concerns:

- First, the “Administrative Measures on Foreign Debt of Foreign Banks in China” issued on 25 May 2004 and effective as of 26 Jun 2004 stipulate that foreign currency loans of foreign financial institutions cannot be converted into RMB by local customers.
- Second, foreign banks are no longer allowed to issue Standby Letters of Credit in favour of Chinese banks to secure RMB loans for their customers.
- Third, there are fixed quotas for the amount of refinancing that can be secured from abroad by Chinese branches of foreign banks. These quotas include capital flows from the parent institution to the branch. Moreover, the quotas are calculated based on an arithmetic average of the last term.

Assessment:

While Chinese banks are subject to similar regulations, the impact on them is considerably smaller, as they have a virtually unlimited access to funding in RMB deposits. Foreign financial firms are disadvantaged because of the gradual opening of China’s financial markets, which entails that they gain access to a RMB deposit base only slowly. Foreign-owned enterprises are the core customers of foreign financial institutions; before the above-mentioned regulations came into force, these banks could offer them all kind of foreign currency services. Now, they find themselves at risk to be unable to support their customer base.

Recommendation:

Allow foreign financial institutions to engage in RMB activities with foreign and Chinese enterprises without any preconditions. Allow the issuance of standby Letters of Credit by foreign banks in favour of Chinese banks as well as a high flexibility in the “quota” allocation.

Award of RMB license

Concern:

Foreign banks can only receive a RMB licence after having had a branch licence for at least three years and after two years of uninterrupted profitability of the branch. Applicants must have had a representative office in the relevant province for at least two years and may only open a branch in that given province.

Assessment:

The regulation limits the pace of expansion of foreign financial institutions. The range of activities an institution is permitted to pursue should be guided exclusively by the quality of the risk management and the capital strength of that institution. Moreover, to tie awarding a RMB to two years of profitability again ignores the fact that branches are not separate legal entities and that branches operate under a full guarantee of the parent institution.

Recommendation:

Awarding a RMB license should be made subject to foreign institutions’ meeting prudential guidelines as regards capital strength and quality of risk management.

Market access for investment banking and fund management

Concern:

Unlike in commercial banking, there is no general time-frame within which regulatory restrictions to domestic investment banking will be loosened. Similarly, the

draft joint venture fund management regulation restricts maximum foreign ownership to 49%. There is no indication if and when this ceiling will be increased. Likewise, there is no indication of whether and when a foreign firm will be allowed to set up a new fund management company in China, independent of a joint venture with a Chinese firm.

Assessment:

As indicated, there is a clear necessity to broaden the financing base of Chinese companies and to develop financial markets in order to spread risk more widely and to gain market signals for the pricing of risk. Similarly, fund management is of great importance in light of the need for reforming China's social security system.

Recommendation:

Chinese authorities should consult on and then publish preconditions and a timetable for opening domestic investment banking business and fund management to foreign institutions.

Panel II: Discussion, Questions and Answers

Vice Chairman ROBINSON. As a former international banker, I was most intrigued by your presentation. We've been looking at China's activities in the capital markets quite extensively over the past two reporting cycles of the Commission. I think we're the only U.S. Government entity anywhere that undertakes this work. We're looking at not just corporate governance-related issues, but also security dimensions, and I was intrigued by what appears to be a good report card from the Institute for International Finance. We're certainly going to get that study and take a look at why Beijing is smiling. It is a little odd seeing that the corporate governance standards of China are woefully below those of their American and European counterparts, particularly in the post-Enron/WorldCom period. You have an inordinate number of state-owned companies in your markets, as well as ours, some 90-plus percent in the United States that are state-owned come to our equity markets. You mentioned in your written presentation minority shareholder rights in China are paltry, at best; independent directors are virtually an unknown; there is inadequate disclosure; uneven accounting practices; and I would add that the risk section of prospectuses aren't nearly what they should be, particularly if you consider the true identities and global activities of the entities that have come to our markets. Some have substantial interests in Sudan, for example, or were recipients of vouchers from Saddam Hussein's Oil for Food Program, of the more corrupt variety. Others have large exposure in Iran, which is deteriorating quickly from a security perspective and could be an issue that investors need to look at.

It appears that nobody's taking a hard, studied look at this matter, and I think you're going to be surprised to find proliferators, arms smugglers, defense-related companies, including ICBM manufacturers, intelligence-related front companies, and entities that have been involved in technology theft. In other words, the question you need to ask, it seems to me, is: Do these activities constitute material risks to investors or not? If somebody's a past proliferator and they don't disclose it in their prospectus or their filings, and that becomes revealed later, is the share value likely to decline? Is corporate reputation damaged?

I would argue that in the United States the answer is definitely yes. You may take a more relaxed attitude here, but I can guar-

antee you that holding the paper of proliferators is sporty, at best, in the United States.

I am curious about your own reaction to some of these observations in terms of the corporate governance.

I was also interested in whether there's a liquidity problem in China, if you wouldn't mind expanding your views there, and your view of the development of their bond market and capital markets, more broadly.

Dr. SPEYER. Thank you. Well, first of all, maybe I should clarify, and excuse me—it must be my lack of English for misinterpreting the IF report. It was actually very critical. What I meant to say is that the Chinese authority actually welcomed that outside report in order to put pressure on their own companies in order to improve their corporate governance structures, so, in fact, as I said, the IF report was highly critical and you find a lot of the issues that you mentioned, especially on minority shareholder rights, confirmed in that.

The point I was trying to make—and, again, I would extend that both to the banking regulators, the CBRC headed by Liu Mingkang, which after all was head of Bank of China, which was a fairly decently run commercial bank, actually, for a state-owned bank, as well as the Chinese Securities Regulatory Commission. They are very keen on improving standards in financial markets in China because they know they have no option given the great problems in the Chinese market. So we are in line on that.

Your second point about the risks posed by the listing of Chinese companies in Western markets, both in terms of investment protection but also related to fund managers who invest in those companies, that is certainly something that is of concern. I think there is a dual responsibility here on two parts—one, on the part of the financial industry that lead managers issues of Chinese companies in Western markets which have to have a very strict due diligence on those companies and insist on high disclosure standards in the prospectuses and especially in the risk section of the prospectuses; and clearly making sure who is standing behind that company, what are the ties of the company to the state system, what have been historic ties of that particular company to the state system, in particular, of course, relations to the army. And at the same time there is a similar burden on the part of investors to make sure which kind of companies they invest in.

In line, I guess, with our usual position, I would assume that we would put a lot of emphasis on disclosure rather than strict regulation of those.

A final point on the development of the markets, I absolutely agree with your assessment that the state of the Chinese financial system, and in particular the banking system, is a fairly [inaudible] one. We have the official figure for NPL numbers, which stands at roughly 15 percent, give or take a bit, which has come down actually over the last 48 months. However, this is probably due to the fact that overall lending volume has gone up rather than NPL figures going down. In fact, mostly. Put it this way: The absolute amount of NPL has actually come down slightly, but certainly not as much as would be warranted. At the same time—

Vice Chairman ROBINSON. You have it at about \$500 billion?

Dr. SPEYER. No, let me just calculate it. I'll let you know.

Vice Chairman ROBINSON. Sorry about that.

Dr. SPEYER. But the problem, of course, is that nobody's really sure about the official figure, and the estimates go up as high as 40 percent, and sometimes even higher, which adds to quite huge numbers if you think that the entire loan-to-GDP ratio in China is 140 percent. So if you take even 20 percent of that and add that maybe to fiscal outlays to the budget, you're certainly talking about large numbers, and a possible crisis to the Chinese budget, actually—which makes it all the more important, to get back to your question, of developing the market segments.

Now, I mentioned briefly that one of the key market segments here really is asset-backed markets, and this is actually something that has now been targeted by a lot of Chinese institutions, as well as the authorities, in order to get NPL figures down. There have already been a number of deals where nonperforming loans have been packaged and sold to outside investors. This is certain to accelerate. It is simply most of all a lack of expertise really to do these deals because the starting point of putting together a securitization in the loan market really is that you have to price that correctly.

Now, the fact is that—and, again, this was mentioned earlier today—the accounting system is really a bit of a mess, and certainly so for most of the domestic institutions. It's getting better for those companies that have international relations, but certainly for the domestic institutions it's still a huge problem. And, how can you repackage that kind of risk and sell it to an outside investor if there is not firm assessment of the actual value of the underlying.

Vice Chairman ROBINSON. And one last quick question. This is more of a yes or no item. Does Deutsche Bank own shares on the A share exchange?

Dr. SPEYER. The Asia exchange?

Vice Chairman ROBINSON. A share.

Dr. SPEYER. A share. Well, yes, we—

Vice Chairman ROBINSON. —qualify foreign institutional—

Dr. SPEYER. We do have a QFII status for US\$200 million, and we're certainly invested in the A share market as well.

Vice Chairman ROBINSON. Thank you.

Chairman D'AMATO. Commissioner Mulloy has a question.

Commissioner MULLOY. I have a quick question for Professor Ferdinand and then another one for Mr. Speyer. On page 3 of the paper that you offered us, you note that in the UK there seems to be more concern about the white-collar jobs going to India than the manufacturing jobs going to China. But what we're trying to understand is how China is part of a larger issue called globalization. Let me read you something. This is from Steve Roach, the chief economist of Morgan Stanley. So this isn't some wacky liberal.

In February of 2004, he's trying to understand why jobs aren't being created in the American economy. He says what's going on here is something called labor arbitrage. Three such forces behind that are the maturation of offshore outsourcing platforms in places such as China and India; the Internet, which is particularly related to India; and the cross-cutting imperatives of a no-pricing-leverage

world. I think he means Carrefour and Wal-Mart, which force companies to move their production facilities to remain suppliers. So he said this is a phenomenon that we have to deal with.

So regardless of whether we're talking China or India, there are factors out there which I think are putting tremendous downward pressure on wages and benefits in our countries, and whether we should be concerned and what we do about this is the issue of the time. And I think it's going to become more apparent as we move ahead in the next couple years. Do you share any of that concern?

Prof. FERDINAND. Sure. Yes, absolutely. I mean, the reason why I think that the outsourcing of IT-related jobs and call centers and so on attracts much more media attention now is because it's new. Britain has been losing industrial workers for decades, if not a century, and so there isn't a sense that there's anything particularly novel about that, though it does continue and the textile workers are one group that will continue to be squeezed by that phenomenon, and there China will attract more attention. But I think it's just because of the novelty of even what used to be thought of as being jobs that could only be handled in the service sector in the country where the customers are that that could now be supplied internationally. That has only recently impinged upon people's consciousness.

Commissioner MULLOY. Mr. Speyer, our Treasury Department has been pushing for the Chinese not to peg their currency to the dollar as they do, but has been advocating that they move to a market-based currency. One of their problems, of course, they have massive problems in their financial system which, if they take off the capital controls, will cause them even more severe problems in their financial system.

This Commission did not endorse what the Treasury endorsed. We said they should re-peg so that they can still keep their capital controls, but give us and you some relief.

Which approach do you think is the most sensible, the push by the U.S. Treasury Department to move China to a market-based currency or the approach we suggest that they re-peg so that they don't have to take off all their capital controls?

Dr. SPEYER. Well, certainly, our feeling is that the Chinese economy is not yet ripe for a completely flexible exchange rate, and I cited the fact that simply the financial instruments that companies need to hedge against foreign exchange rate risk are not available. So that's certainly one important point. The other, you rightly mentioned, was the fragility of the financial system.

If I may, let me add just one point on the terminology. I feel quite uncomfortable with calling a fixed exchange rate not market-based because it's perfectly possible to have a market economy and yet to have a fixed exchange rate. Look at places like Estonia, which certainly is a market economy, but has a completely fixed exchange rate towards the euro. So the two are not necessarily—

Commissioner MULLOY. No, but if you manage the fix, the peg, by massive intervention in currency markets in violation of the IMF guidelines, then you're in a different situation—

Dr. SPEYER. I wasn't defending the currency practice.

Commissioner MULLOY. Good. Thank you. I think that's very helpful because I want to get your judgment as an international

banker on that. I think the Treasury is wrong. And I think it will be a long time before the Chinese are going to move to a market-based exchange rate.

Prof. FERDINAND. Well, there is the kind of—I hope it's not too clever—academic response, which is, both views are compatible. It depends upon your time scale. In the long term, you might want to—

Commissioner MULLOY. Oh, yes, long term.

Prof. FERDINAND. —but in the short term it would be premature.

Commissioner MULLOY. Thank you.

Chairman D'AMATO. We're going to open the floor up to any questions that may be out there, and if anyone does have—I think you have the microphone there.

[No response.]

Chairman D'AMATO. All right. I have a question. You talk about the lack of competition on the deposit side leading to the development of a gray market. We've been reading about this gray market. There's apparently a very large gray market. Can you give us an idea about how large this market is and whether or not they're going to be able to bring it back with this lifting of the rules?

Dr. SPEYER. Well, I'm afraid the only thing that we know about this, we've referred to the same reports that you read which appeared in the international press a couple of weeks ago. It certainly points to the fact that this is a fairly huge market by now, so I haven't got any precise figures for you.

Chairman D'AMATO. You're talking about people running around with wheelbarrows full of money and this sort of thing, not exactly a level of confidence in a sophisticated banking system when you're talking about wheelbarrows.

Dr. SPEYER. Not at all. I'm afraid we don't have that many people running around ourselves on the ground, and certainly not with wheelbarrows.

The thing is probably the recent measures on the exchange rate liberalization will not do the trick because they essentially only concern the lending rates rather than the deposit rates, which have been adjusted slightly but re-pegged at just 27 basis points higher, which doesn't make a lot of difference because they're now at—let me just check—at 2.25, which is not a lot considering the inflation rate, which is at least around that—

Chairman D'AMATO. So you're losing money on deposits?

Dr. SPEYER. Yes.

Chairman D'AMATO. They still have an unresolved issue here.

Dr. SPEYER. Absolutely they do.

Chairman D'AMATO. Commissioner Dreyer?

Commissioner DREYER. I was very interested in what you're saying. You're alluding to the unreliability of Chinese figures, and assessing their validity is practically a cottage industry among economists in the United States who deal with China. I was wondering how Deutsche Bank dealt with this. Do you have people calculating whether the figures reported are higher or lower? Because you can certainly find people in the United States that say, okay, these statistics are inflated because bureaucrats feel they have to come up to quota, so everyone wants to go over quota. Then you also have people saying because of the gray economy that a lot of trans-

actions goes on that never appear in the official figures. So, actually, the Chinese economy is a lot larger than it appears.

How do you at Deutsche Bank stand on that, and what figures are you using inflators or deflators or what?

Dr. SPEYER. Well, the problem really is, as you rightly point out—it's actually a twofold problem because there are, depending on the state of the business cycle, incentives for the officials on the ground in the municipalities to either under-report or over-report. So it's not the uniform trend that you could assume everybody always over reporting rather than doing the opposite thing.

Certainly earlier this year when the central government was trying to clamp down on economic activity, there was a huge incentive for everybody to be seen in compliance with putting the brake on economic activity. So there was probably a tendency to underestimate.

Now, how do we deal with that? Well, the only thing you really can do is—which is what we do—try to give some credence to the figures by running plausibility checks, for example, on, say, energy imports or energy consumption, which is a fairly good proxy for economic activity, and the like, and, B, to work with a certain range of probabilities so that you have a range of possible outcomes that will give you a bit of leeway in your own forecast.

Commissioner DREYER. For Dr. Ferdinand, or actually, Dr. Speyer, if you have any thoughts on this. The problem that was discussed earlier is shortages of skilled labor in certain places, and perhaps also the idea that you need to move inland. The Chinese government has since 1999 been promoting this, a campaign to invest in the West. I know they've brought various investors from Hong Kong in who were delighted to appear to be patriotic, but looked at the West and said "no" and ran off.

Do you have any feelings about this? Obviously there's massive corruption in the investment that's taken place, and the government isn't getting the results it expected. Do you have any thoughts on this? Is it going to solve the problem? Is it working? Please give us any ideas you may have on this.

Prof. FERDINAND. Solve the problem, no. Make a bit of a difference, possibly. Are foreign investors going to want—say from Europe, going to want to take part in that? Not much. A bit to the West, maybe, not just in Guangdong, not just in Shanghai, but Guangxi, I think not—not—

Commissioner DREYER. Guizhou, and definitely not Xinjiang.

Dr. SPEYER. I'd probably concur with that. Actually, one of the publications that I mentioned deals with that, so you might want to look at that.

Commissioner DREYER. Definitely.

Dr. SPEYER. Let me just briefly touch upon that other issue that you raise, the lack of experts. Certainly the financial industry is one of those industries where there isn't a surplus of labor in China. We actually have fairly high wage rates in the financial industry there for the locals because there is a dearth of people who have local knowledge and internationally comparable expertise. They get regularly poached by all the other institutions that now want to enter the Chinese markets, bidding up wages. So, it's certainly not a location for us.

Chairman D'AMATO. Again, if there's anyone out there who's thought of a question.

Mr. NIGHTINGALE. May I refer back to the exchange rate [inaudible, off microphone] by how much which you expect the Chinese currency to appreciate? Obviously there is [inaudible] some relief, the trade imbalance and so forth. On the other hand, it might be [inaudible] actually so great that—

Chairman D'AMATO. Well, we've had testimony by Mr. Bergsten, who is pretty well known in Washington in this area. I think his recommendation was to re-peg the value up about 25 percent. We think that's probably a pretty good solution, although we think it's still undervalued by another 15 percent or so, 10 or 15 percent. But certainly that would be the solution that he's recommending because I think there's general agreement that the system is not ready for any kind of market-oriented free-floating exchange rate, that the banking system would suffer severely if that happened.

Commissioner MULLOY. Well, the thought is—and your point—that if they moved to a market-based, they'd have to take off the capital controls, and they're not sure whether that would really get you a lot of appreciation or cause more problems and maybe a decreased value of the currency. But they are massively intervening to maintain the value of the currency at the peg with the dollar now.

Commissioner DREYER. Would our panelists agree with that?

Dr. SPEYER. Well, taking the risk of being denied the lunch, let me be the devil's advocate here. I'm lucky enough not to be in the forecast business, so I won't give you a precise figure. The first thing is to take a look at what markets expect. If you look at the forward renminbi rate 12 months, we're looking about an expectation of a devaluation of about 4 to 5 percent, so it's actually a pretty small one. That's the first point I would note.

The second point, on the strategy, I think the Chinese government has made it very clear, and I think we should take their word because they usually follow up on that, that they will leave a lot of uncertainty about their cause of action. So I think it's a fairly safe bet not to expect them to go for a straight devaluation but, rather, something more sophisticated, like going to—switching to a basket of currencies, or to announce a widening of the band but leaving it open how far they widen it, or perish the thought, even go for a devaluation before they go for an appreciation. So all of that is a distinct possibility.

The third point, and this is where I put my lunch at risk, I just want to raise the thought that the case for the statement that the Chinese currency is actually undervalued is not as clear-cut as it may often sound. John Williamson of the IIE has also written quite extensively on that in terms of—

Commissioner MULLOY. John who?

Dr. SPEYER. John Williamson, the IIE—

Commissioner MULLOY. Yes, and Morris Goldman has.

Dr. SPEYER. Exactly, and has come up with more conservative figures than the 25 percent. And, in fact, if you look at the overall trade balance of China which, after all, is not a massive surplus but a slight surplus, if you look at the basic balance of China with

a huge inflow of long-term capital, it's actually not that clear whether the present rate is massively undervalued.

So, a piece of caution on that issue. Tongue-in-cheek, one might add that there are actually a number of estimates out there that now say that the U.S. dollar is 20 percent undervalued against the euro.

Chairman D'AMATO. Well, I guess we have room for one more question, if there's someone out there that has a question. Otherwise, I think—yes?

Mr. FOUQUET. Being outside this field, I'm not even sure I have [inaudible] what I read about the weight, the influence, the importance of countries like China and India and other Asian countries with their foreign reserves financing the U.S. balance of payments, balance of trade situation, and how vulnerable that makes either the U.S. to sudden shifts or how vulnerable it makes the Chinese economy. I'm really curious about that, and I would like to have some discussion.

Commissioner MULLOY. We're political people here. We're appointed by Republicans and Democrats. I went to the Democratic Convention this year. President Clinton spoke at the convention, and he alluded to your point. He said it's very difficult to be tough in trade talks with the person who is your banker, and he was referring to the fact that the Chinese are major purchasers of U.S. Government debt instruments. And if they move to get out of that business, it could impact our interest rates, which would then hurt our housing market and our stock market.

So I think that's out there, and people understand that it's out there. In fact, I think last week didn't one of the Chinese begin to say maybe they're overloaded in U.S. Government debt and they may move into the euro.

But I wanted to just follow up with one more question to Deutsche Bank. If the Chinese move their currency and it was revalued upward, would that have some impact on the other Asian countries like Japan and others, who are also intervening to maintain undervalued currencies? And would that not give both us and Europe some relief in the trade area?

Dr. SPEYER. I think you raise a very important point, Commissioner Mulloy, on the fact that it is not just the renminbi/dollar rate that is of importance in order to rebalance the global imbalances, but that there is a raft of other currency cross-pairs attached to that.

The reaction of the other Asian economies to a possible Chinese revaluation is not entirely clear and predictable, I'm afraid, for the simple reason that, on the other hand, there is great incentive for them not to move because then they would gain a comparative advantage, or competitive advantage, I should say, over the Chinese in third-country export markets. On the other hand, a lot of those countries are by now also great exporters to China themselves and obviously would be hurt if they would move in lock step with the Chinese. So I don't think there is a clear-cut answer yet, but it points to the fact, which I guess is a more general one, that when we talk about the current global imbalances, we really should be aware that this is more than a simple question of renminbi/U.S. dollar rate, but this is really, in the very true sense of the word,

a shared responsibility of all the players in the global economy. And action certainly has to be taken by all of them rather than just the People's Bank of China. Otherwise, I can only confirm that I always felt President Clinton to be a very intelligent man.

Chairman D'AMATO. Well, our time is up. We'd like to thank Professor Ferdinand and Dr. Speyer. And I also might mention that we were expecting Dr. Lemoine. She apparently was delayed because her train broke down. So she was not able to come, but she sent her paper, which we will include in the proceedings of this session.

This ends the morning session, and we'll reconvene again this afternoon for our third panel. Thank you very much for coming.

[Luncheon recess.]

AFTERNOON SESSION, 2:30 P.M., TUESDAY, NOVEMBER 30, 2004

PANEL III: PERSPECTIVES ON EU-CHINA SECURITY RELATIONS, THE ARMS EMBARGO AND TAIWAN

Chairman D'AMATO. I'd like to begin our third panel and welcome everyone back. This panel will provide a European perspective on East Asia security issues. One major area of concern, of course, between the United States and the EU is the debate over lifting the arms embargo.

A related issue is the differing approaches despite generally similar views to the cross-Straits issue possibility of arising tensions in the Straits. And more broadly, the Commission is interested in how the assumptions and analysis of the Europeans differ from those of the United States.

Today, we have with us Dr. Frank Umbach, from the German Counsel on Foreign Relations. Dr. William van der Geest, of the European Institute for Asian Studies. And we are also expecting a Dr. Kay Möller from the German Institute for International Security Affairs. He's not here yet, but I think we will start. We'll ask you to give your views for maybe seven or eight minutes, and then we go to questions and answers.

[Note: Dr. Möller was unable to appear in person.]

**STATEMENT OF FRANK UMBACH, RESIDENT FELLOW
HEAD OF THE ASIA-PACIFIC PROGRAM
AND CO-CHAIR, CSCAP EUROPE
RESEARCH INSTITUTE OF THE GERMAN COUNCIL ON FOREIGN
RELATIONS (DGAP), BERLIN, GERMANY**

Mr. UMBACH. I would like to thank you for inviting me here, specifically I think for two reasons. Firstly, I will stress I'm a true believer in the transatlantic relationship. I worked myself for NATO before I later changed my expertise and became an expert on Asia.

And secondly, I also belong to a small group of those Asian and China experts in Europe who have advocated for a long time since the 1990s for such a dialogue as is taking place today.

At that time, I was not very successful in the U.S.A., or in Europe for advocating such a dialogue. And I think also being back from Washington in October for having a number of talks, a kind of window of opportunity we now have, and that this very unique transatlantic dialogue on China and Asia will somehow be institutionalized in the future. That's my hope, and I will also explain why that is the case.

Let me start with the fact, which is also not very known in Europe, and including my own country. The EU is involved in the security dialogues in Asia since the mid-1990s. The EU is a full member of the ASEAN Regional Forum, as well as the Council for Security Cooperation, Asia-Pacific; I myself work in the CSCAP, and I'm one of the co-chairs on the European Committee.

So, I think that's surprising if you would ask most of the German foreign security experts, they wouldn't know it. And that explains another fact, which is that the attention certainly to the Asia-Pacific region is still limited at least in the wider public opinion.

Nonetheless, if you look back, and despite fair criticism you have to make in regard to the ASEAN Regional Forum and to other multilateral security cooperation taking place in the Asia-Pacific, those security, inter-regional security cooperation taking place between Europe and Asia, have been widened and have been deepened since the mid-1990s. The EU is also a member of the Board of KEDO, and was in the framework of the Asia-Europe meetings. We have security dialogues established. So, a lot of things are already taking place between Europe and Asia.

Nonetheless, it's also necessary to make the point already at the very beginning that the economic interests are, to a certain extent, determining our relationship with the Asia Pacific. And to some extent, this relationship is from time to time a little bit unbalanced, as I would argue, in a way that security issues are not so much at the forefront as I would like to see it.

Nonetheless, I think it would be a great mistake if you would overlook what is already in place, and what has been developed from the mid-1990s. And I think if you look also to the first-ever global security concept of the EU, adopted last December, which is a global security concept, as well as a global non-proliferation strategy. There are important changes underway on the EU side that are slowly developing global security conceptions and approaches, and we'll certainly need some time to implement it, step by step. But I think the direction is quite clear. And I think the transatlantic relationship needs also to be mentioned. If you look to the overall economic relationship what we heard in the morning to the growing, very rapidly growing, economic interdependencies, probably by becoming the biggest trade partner of China next year. Surpassing Japan and the United States, this has certainly political-strategic implications in other areas as well. Whether we like it or whether you the United States like it or not, we all have to face it. And that was one of the reasons why I have advocated for a long time a dialogue between the United States and Europe. Because I was of the opinion that the future transatlantic relationship will not be determined by the old, let's say, transatlantic issues, which means primarily European NATO issues—transatlantic trade issues. It will be much more determined by issues outside of Europe, such as the greater Middle East, but as well as Asia and China.

And, in this wider context, I think for me it was not surprising that we had this kind of new conflict in the transatlantic relationship; that our different approaches, the different priorities we put in our relationship with China has become another battleground. These could become much more serious conflict in the future if our

different approaches and strategies are not addressed in a common way.

This is what I wanted to say at the very beginning. And in this respect, given the growing economic relationship with the union of 25 states, with over 450 million people, but using a quarter of the world's GNP and with a wide range spectrum of instruments at its disposal, the EU is inevitably becoming a global player.

So, if you look at the different conceptual papers being adopted by the EU in the mid-1990s in its relations vis-à-vis Asia in general, as well as vis-à-vis China in particular, you can recognize in the new papers that we do have at least on the conceptional level a much more balanced relationship. We pay at least in the recognition much more attention to the security issues.

That's the reality. That's the daily negotiations with China or Asia is a little bit different. That is also true and needs to be taken into account. And that has certainly also to do I think with the expertise on our side. If you take the security, a wide range of security issues, we started I think in the 1990s by recognition that we need a kind of a comprehensive security concept, which will not just be focused any longer on military issues.

And certainly, if you took the soft security issues, this is the area where the EU has a lot of expertise. It's very strong. It has instruments at its disposal. And that's quite often, in my view, overlooked in the U.S.

But it's also true, and that's in my criticism vis-à-vis the EU, that there is also a lack of expertise if it comes to hard security issues, if it comes to military issues, and specifically if you look to the European analysis and studies of CPLA and modernization trends.

There is a lack of expertise in the governments. There's a structural problem insofar as, as well as a difference to the U.S., that there's very little expertise on Asia-Pacific in our defense ministries. As there is certainly some expertise in the French and British defense ministry, but almost nothing in my own and I think in the rest of the EU member states.

And to a certain extent, that explains a little bit the unbalanced approaches.

That needs also to be taken into account, and that is also explaining a little bit how the arms embargo, and specifically the arms embargo issue, and specifically the decisionmaking by the French, and particularly as the German side has started, because it was more or less in a top decision by the Chancellor's office, by the Chancellor when he was visiting China, accompanied by CEOs, like Siemens, and reacting also to the Chinese pressure. If you look to a very unusual paper, released by the Chinese at the beginning of October, an official EU concept paper, something which is I think for the Chinese very unusual because no comparable paper is existing, not just vis-à-vis the U.S. It's even not existing vis-à-vis the other Asian states, which was also irritating the ASEAN states, for example, as you can imagine.

So, if you read the Chinese concept paper, then you know that it put the arms embargo issue into it. And though there is speculation what the motivation is on the Chinese side, and it's mostly ex-

plained as well as by all governments. By the way, it's primarily a political, symbolic issue.

The German Chancellor might have taken up that kind of argumentation because if it comes to expert controls, the German expert control is much, much more restrictive than the French and the British one.

And to a certain extent, also more important than the so-called Code of Conduct, which is regulating the EU by arms experts. So, the argumentation in the Chancellor's office was even by lifting the embargo, it wouldn't have any effect, and regarded German companies would export critical arms technologies that—or even exporting high-tech weaponry. That was, to a certain extent, also superficial as no doubt, because the entire area of the dual-use technologies has not been addressed in advance. This is an issue for a long time, which is on the transatlantic agenda, and it's still creating a lot of problems on both sides. And I think it's fair to say that during the last 10, 15 years or so, no major weapons system has been exported from the European side. There are dual-use technologies which have found their way from Europe to China. It was taking place on the U.S. side, too.

But given the fact that if you look to major weaponry such as tanks or ships and aircraft, there's almost no new generation of those weaponry, which is not based on dual-use technologies. The next generation there might be based exclusively on dual-use technologies. So, this area will become much, much more important. And, so, you need to find here and to address these issues in a new code of conduct totally regardless of the China issue. The China issue has only highlighted the problems. But it's not the only reason why the EU needs a new code of conduct I think.

So, that explains a little bit as the decisionmaking on the German side. It was not, as many people were speculating, that Germany was allying with French in creating, let's say, a new multipolar world. It was more or less in a talk decision. There are important differences between Germany and France. And if you look just to the official rhetoric, then you know that the German government from the last year on did not use as an expression a multi-polarity world.

So, here again, there are specific problems I think on the German side, specifically in regard to decisionmaking. Because the Chancellor's office also did not consult the foreign ministry in advance, the Foreign Ministry has the most expertise, and is in the daily operations with China; and to a certain extent, the foreign ministry has also counter balanced the Chancellor's office in this respect over the last 12 months.

I mentioned that the military modernization on the Chinese side is not an issue that is widely discussed in Europe, nor in the EU. Unfortunately, and that might be another area I think where the European side, as well as the EU, needs certainly some expertise coming from the U.S. side in regard to consultation. China has meanwhile the third largest defense budget in the world. It has increased its defense expenditures in the period 1997–2003 by not less than 140 percent. It's not becoming a global military superpower like the U.S., but it is certainly shifting the regional military balance, whether it's the South China Sea, whether it's Taiwan,

whether it's other issues. By taking these strategic trends into account, I think that explains why the embargo issue has become such a sensitive issue in the transatlantic relationship. And certainly France, has taken the lead in pushing for the lifting of the outdated embargo as it sees it, reflects Paris and Beijing's hope for a more multipolar world, at least in general, although there are important differences between the French conceptions and the Chinese one.

It also reflects the great pressure inside the European arms industry, which is much more dependent on exports than the U.S. arms industry, and viewed as a fact of our overall small defense budgets during that last years. And there is a disappointment, I have also to say, of the transatlantic arms projects, as there are very few ones, and that has certainly strengthened those voices, French processions, inside the ARS Company, for example, who have advocated for a long time that the U.S. will not really welcome any joint projects. And the Europeans need to look to other markets. And if you have to look to other markets, then besides the Middle East, there's only market which has really grown over the last 10, 15 years, Asia. Asia has become the only region besides the Middle East, which has tremendously increased its defense budgets in contrast to the global strategic trends of declining defense budgets.

And so, there is a natural interest in the European arms industry to look to these promising new markets. The transatlantic arms projects I think are a very important political issue, too, in this wider context, which needs to be addressed, because if European companies have no choice, they have to look to something else. That will also tremendously, in my view, influence our foreign security policies.

As I stated, it was a remark as a true believer in the transatlantic relationship, this is something I think which is certainly raising concerns.

On the Chinese side, it's my view that it's not just a politically symbolic issue. If you look to the PLA modernization and the Chinese arms industry, they are facing a number of challenges.

And the first challenge certainly has to do with China's relationship with Russia. Eighty percent of its imports are coming from Russia. But, nonetheless, the Russian President, Putin, has put additional constraints on its exports and has established a strategic relationship with India, and both face no common border, and so they are not comparable security concerns on the Russian side like in the Russian general staff.

So, we have a situation in Russia, where, on one had, the arms industry is pushing for more high-tech weaponry exports to China. There's a general staff, who are advocating much more constraints on the Russian side, and Putin put more constraints on it, and advocated an alternative for the Russian arms industry, and that is India. And Russia is, for example, willing to leave even nuclear bombers to India. It has also started a number of joint arms projects, missile projects, but also has some major new generation weaponry projects developed to get [inaudible] India this weaponry. This is not taking place on the Chinese side, and that explains also the disappointment on the Chinese side, besides other issues such

as energy, where you can also see these problems. That puts also pressure on the Chinese modernization processes for looking for an alternative. And I think the EU is an alternative for the Chinese arms industry, for modernizing its industrial base and also of getting critical technologies in which the Chinese are much more interested let's say than major weaponry such as ships or tanks or aircraft.

But here again, that's also one of the reasons why these dual-use technologies play such a tremendously important role, and which needs to be addressed on the European side as well as to guess I would say the United States.

Given the time, let me say at the very end that there is a certain tendency on both sides—this explains the different strategies, but there's a certain tendency of adopting unilateral approaches. I'm not criticizing here just the U.S. It has criticized the European side, too. And the embargo issue is the typical example. We always blame the unilateral approaches of the U.S. But what the Chairmen of the French government were doing were the same. We were not consulting our Asia European partners in advance. Yes. So, we were presenting the Asians with a situation in which the Chairman of the French government has taken a decision. And that is clearly undermining a common foreign security policy. It is also undermining our foreign security policy vis-à-vis Asia and China. And if these unilateral tendencies will be maintained on both sides, I think we will face certainly much more problems in the future transatlantic relationship. And that is the reason why we have to overcome this, and why we need such a dialogue, an institutionalize dialogue on Asia and China, including on a number of security issues.

So, whatever the EU decides in regard to the future arms embargo on China—I don't expect any decision in the next months. It has been shortsighted for Europe not to consult and to coordinate with Washington on the future sanctions policy towards China. Especially, given the fact that both the U.S. and European prohibitions on arms sales on China are complementary, and were imposed for the same reasons. But it's also striking, and I will add this point, if you look back over the last 12 months of the European discussion, that most critics on the arms embargo issues criticizing Germany and France are not citing security reasons. The criticism has much more to do with human rights. And that is also a reason why I'm concerned in addition that we're not addressing security issues here. And, therefore, again, both sides, the U.S. as well as Europe, have still to recognize and learn that they often still, in my view, they overestimate their own power. There's an arrogance of power on the U.S. side; and an arrogance of weakness on the European side. And they underestimate many strategic challenges they face, and will have to cope with in the forthcoming years. Neither the U.S. side, solely not the European side sort of will be able to cope with these many challenges we face.

And despite some kind of rapprochement, which took place over the last 12 months in regard to the arms embargo issue, I still don't feel that this is really recognized to the full extent on both sides.

So, we need even more than in the past is to cooperate and to develop common transatlantic strategies to cope successfully with the numerous new security challenges around the world. Thank you very much, Mr. Chairman.

[The statement follows:]

**Prepared Statement of Frank Umbach, Resident Fellow
Head of the Asia-Pacific Program, and Co-Chair, CSCAP Europe
Research Institute of the German Council on Foreign Relations (DGAP)
Berlin, Germany**

1. The Gradual Evolvement of the EU's CFSP and Its Security Cooperation in Asia-Pacific Since the Mid-1990s

Since 1993/94, the EU and its member states are already involved in the regional security cooperation in Asia-Pacific. The EU is a member of the multilateral security activities of the ASEAN Regional Forum (ARF) and the Council for Security Cooperation in Asia-Pacific (CSCAP). Whilst the ARF as "track-one" represents the governmental level (mostly diplomats from the foreign ministries), CSCAP as "track-two" involves regional experts of think tanks and universities as well as government officials in private capacity. In 1996, the Asia-Europe Meeting (ASEM) process with the Council for Asia-Europe Cooperation as Track II has been initiated which also includes a multilateral security dialogue on various levels between Europe and Asia. Finally, in September 1997, the EU through its Commission has also become a member of the Korean Energy Development Organisation (KEDO), created to implement denuclearisation objectives in North Korea.

Although Europe has no permanent military forces deployed in East Asia after the return of Hong Kong to PR China, Great Britain is still a member of the Five-Power Defence Arrangements (FPDA)—a military consultation agreement with Australia, Malaysia, New Zealand and Singapore and the most important hard security network involving a major EU power. Moreover, France has an operational military presence in the Indian Ocean and the South Pacific, totalling some 16,000 troops which can be made available in East Asia too in a relative short time.

Since their establishment in the mid-1990s, all these interregional security cooperation activities have been widened and deepened, bolstered by bilateral security and military cooperation between European and Asian countries and accompanied by a gradual convergence of their respective "security cultures." They are the result of the fastening interdependence processes of economic and political ties as well as of the "globalisation of security policies." In this light, the EU has recognized long before the terrorist attacks on September 9, 2001 that it is in Europe's own strategic interest to engage the rising Asia-Pacific region not just on economic and trade but also increasingly on important global and regional security challenges.

Today, both sides are at the threshold of a strategic re-orientation of relations between the major powers. On one hand, they are also pre-occupied with their own internal regional developments and externally with their relations to the U.S. as the sole superpower. On the other hand, Asia and Europe cannot afford just to be inward-looking due to their increasing economic and political interdependencies and the need to cope with regional as well as global security threats. Therefore, both sides need a much stronger security engagement based on a wider strategic interest among them as well as together with the U.S.

By comparing the various regional and sub-regional concept papers of the EU and its member states since 1994, when the EU published its first comprehensive "Asia concept" paper, the European Commission has already admitted before September 11, 2001 that the growing interregional trade between Europe and Asia is becoming increasingly dependent on the future national and regional political-economic stability in East Asia. The new EU-Asia concept paper of September 2001, for instance, reflects a much better balance between the EU's economic and political strategic interests in East Asia and Southeast Asia.

The EU's new "*Comprehensive Strategy for Future Relations with Southeast Asia*" of July 2003 has gone even further and has specified the European security interests in Southeast Asia in the light of the new security challenges arising since September 2001 in the following areas:

- Supporting regional stability and the fight against international terrorism;
- Continuing support actions in the area of conflict prevention and conflict settlement;
- Deepening and intensifying cooperation on the multilateral and bilateral basis on new agendas such as human rights (moving even at the top of the agenda

of “*new priorities*”), good governance, justice and home affairs issues and fighting against international terrorism as part of a “*comprehensive security concept*” that reflect a wider security understanding in the post-Cold War era.

Given the strategic importance of energy and the geo-strategic key position of the ASEAN countries in the supply (Indonesia is presently the largest *Liquefied Natural Gas/LNG* exporter in the world) and/or transport, the EU has also proposed a strategic dialogue and further co-operation in the fields of co-generation and renewable energies in its newest *Southeast Asia Strategy* paper of 2003.

The EU’s security engagement in Asia-Pacific, however, is in the wider European public still rather unknown, often not very well understood and underestimated in regard of its strategic importance for Europe’s own future security. Until September 11, 2001, the EU’s political profile and security engagement was still somehow underdeveloped, lagging behind the more substantial economic role, perceived as still rather weak and had been seen as a “subsidiary player” in order to play just a “secondary role.”

In December 2003, the EU has officially adopted a first ever global security concept (“European Security Strategy”) in which it has specified five key security threats to Europe:

- International terrorism;
- Proliferation of Weapons of Mass Destruction (WMD);
- Regional conflicts;
- State failure; and
- Organised crime.

The EU has also announced a global “Non-Proliferation Strategy” in December 2003 which has important implications for its Common Foreign and Security Policy (CSFP) and the European Security and Defence Policy (ESDP).

However, its security engagement with the Asia-Pacific is still challenged by the overriding economic interests of its main member states which are often compromising the EU’s long-term security interests in the region.

Furthermore, the present intergovernmental policy of cooperation and coordination translates into insufficient coherent EU foreign policies of the European Troika (European presidency, European Commission, and the High Representative for the CSFP) and its main member states such as Germany, France, Britain and others.

The EU and Asia favour strongly multilateral approaches for regional security. But, the future interregional security cooperation between the EU and the Asia-Pacific region will remain dependent on the future integration policies of both sides, the regional security cooperation in Asia-Pacific itself, the future security role of the U.S. in the region and the interregional coherence of European and Asian security cultures.

2. The EU-China Relations: A Strategic Partnership Emerging?

The growing economic ties and interdependency will also have strategic consequences for the political relationship between the EU and China, whereas the future transatlantic relations will have to address more potentially divisive transnational and regional issues beyond Europe’s borders, including the relationship with Asia and China.

Whether the United States is welcoming these strategic trends and a stronger EU political role in Asia or not (which seems disputed in the U.S.), Washington will hardly be able to halt these stronger economic and political ties between Europe and Asia. As an union of 25 states with over 450 million people, producing a quarter of the world’s Gross National Product (GNP), and with a wide range spectrum of instruments at its disposal, the EU is inevitably becoming a global player.

Since the promulgation of its guidelines for a “*Comprehensive Partnership with China*” on June 29, 1998, the European Union has been struggled for a coherent, comprehensive and balanced China policy based on a long-term strategy that reflects China’s growing economic and political weight on the regional and global level as well as the EU’s interest to implement its own pursued CFSP. Since the year 2000, the EU’s assistance programmes to China have also included its WTO accession, the fight against illegal migration and trafficking in human beings, social security reform, telecommunication/information society, environment, energy, and human resource development.

In this context, the China-Strategy paper of 1998 listed the following major aims for the future EU-China relationship:

- Engaging China further through an upgraded political dialogue;
- Supporting China’s transition to an open society based upon the rule of law and the respect for human rights;

- Integrating China further in the world economy;
- Making better use of existing European resources;
- Raising the EU's profile in China.

The future of European-China relations will increasingly be affected by global policy issues arising outside China and Europe. Hence the EU as well as China will have to assume more responsibilities for global political and economic stability such as an increasing engagement in regional security in the Middle East or Central Asia.

This necessity is complicated by the fact that, on one hand, national interests of both sides can differ given China's and the EU's growing energy demands and, subsequently, their increasing economic dependence on these politically highly sensitive regions. It cannot be totally excluded that both China and Europe may see each other in the future as "strategic competitors," leading even to strategic rivalry in the Asia-Pacific, the Middle East and Central Asia. On the other hand, the strategic interests of both the EU and China concerning their access to the energy resources in the Middle East and Central Asia makes them both more interested in the maintenance of political stability in these regions. Apart from their growing ties in trade and investments, the growing interregional energy interdependencies between Europe and China on the one hand and the Middle East/Central Asia on the other require common EU-China strategies vis-à-vis this increasing "arc of instability."

In September 2003, the EC has updated and published a new policy paper in September 2003, called "A Maturing Partnership—Shared Interests and Challenges in EU-China Relations." The new China strategy paper includes a comprehensive list of both short and medium-term action points in the following five priority areas:

- Political Dialogue and Global Governance which addresses global and regional governance and security issues, including non-proliferation and arms control, international crime, illegal migration, the situation on the Korean Peninsula or in other world hot spots;
- Supporting China's transition to an open society based upon the rule of law and the respect for human rights, which will also enhance the visibility and transparency of this dialogue;
- Promoting China's economic opening at home and abroad, which also includes to assist China's compliance with its WTO commitments and closely observe new regional trade initiatives to ensure China's WTO-compatibility;
- New EU co-operation programmes which will also include new initiatives such as the fight against SARS;
- Raising the EU's profile in China.

The paper also points out the EU priorities for the political dialogue, but which—inter alia—includes even strengthened relations to Taiwan: "Stress EU insistence on a resolution of the Taiwan issue through peaceful dialogue, and underline the importance of growing economic ties for an improvement of the political climate; underline EU interest in closer links with Taiwan in non-political fields, including in multilateral contexts, in line with the EU's 'One-China' policy." This intention might be the result of repeated criticism by the *European Parliament (EP)* at the EU's official and unofficial Taiwan and Tibet policies.

Furthermore, by looking back the last decade, the primacy of trade advantages in the EU-China policy, particularly by France, Germany and Great Britain, has mirrored the still overriding national interests of the main European powers. Meanwhile, China has become the third largest trade partner of EU, while in 2002, the EU was also the third largest foreign investor (behind the U.S. and Japan) in China, totaling US\$ 4.5 billion. Since 1978, the bilateral trade volume has increased 30-fold. Although the expansion of the bilateral trade is a success story of its own, simultaneously it has undermined the implementation of a more effective CFSP both in a material and normative context towards China.

3. The Debate of Lifting the EU Arms Embargo Towards China and the Implications for the Taiwan Strait Conflict¹

In its "EU Policy Paper" of October 2003, Beijing has also declared of seeking to lift the ban on arms exports to China "at an early date" to "remove barriers to greater cooperation on defense industry and technologies." Understandably, China wants

¹See also F. Umbach, EU's Links with China Pose New Threat to Transatlantic Relations, *European Affairs* (Washington, D.C., USA), Spring, Vol. 5, 2/2004, pp. 38–47 (also via Internet—http://www.europeanaffairs.org/current_issue/2004_spring/2004_spring_38.php4.) and idem, Will the EU Arms Embargo towards China be Lifted? Perspectives and Implications, *Taiwan Perspective e-Paper* (published by INPR, Taipei), Issue No. 29, 23 June 2004 (via Internet—<http://www.tp.org.tw/eletter/print.htm?id=20002484>).

to end the arms embargo at times where both sides see each other increasingly as strategic partners in an era of global uncertainties. Indeed, such an EU embargo has only been adopted also against Sudan, Myanmar and Zimbabwe. Hence China does not want to belong in the same questionable category of “rogue states.”

But China has not just become one of the fastest growing major economies worldwide, but has also probably the third largest defense budget (after the U.S. and Russia) in the world. During the last six years (1997–2003), Chinese defence expenditures increased even by more than 140 percent.

China has also become the world’s largest arms importer since 2000, but is heavily dependent on Russian high-tech weaponry exports due to its insufficient national arms industry output and the Western arms embargo. Since 1999, it has signed new arms agreements worth more than \$11 billion as a rising regional military power with legitimate regional and global maritime security interests.

To understand Beijing’s interest at lifting the EU-arms embargo of 1989, one needs to take into account that Russian President *Vladimir Putin* has put additional constraints on its weapon exports and technology transfers to China. Hence China is seeking alternatives to fasten their military modernization processes and to diversify its arms imports and technology transfers.

Within the EU, France has clearly taken the lead in pushing for the lifting of the “outdated” 15-year-old embargo. It reflects Paris’ and Beijing’s hope for a “*multi-polar world*” as well as the intention to strengthen the French and European arms industry of selling more weapons systems and particularly dual-use technologies to China. The pressure to export high-tech conventional weaponry is greater on the EU-side than on the U.S. side due to the small European procurement budgets of the overall small defence expenditures.

Moreover, the European arms industry (such as the European Aeronautic Defence and Space Company/*EADS*) have begun to shift their business strategies towards the Asian and particularly the Chinese markets. Although they often overestimate the prospects that China is willing and able to buy large numbers of high-tech weaponry, China is indeed very interested to acquire specific niche technologies and minor weapon systems such as radar, air-to-air missiles, sonar equipment, torpedoes and other important force multipliers to increase the fighting capabilities of both its old and new weapons systems.

The French President *Jacques Chirac* has officially condemned Taiwan’s referendum as “*irresponsible*” and a threat to Asia. On March 16, 2004, it even held joint naval exercises for the first time just four days before Taiwan’s presidential elections, which Beijing called “*the most comprehensive military exercise ever held between China and a foreign country.*” However, this policy is not shared in the EU.

Germany and the EU have rather denied that the lifting of the arms embargo would lead to a significant rise of high-tech weaponry to China because arms sales would still be barred under a separate *EU Code of Conduct* aimed at preventing sales to repressive states or unstable areas. Furthermore, Germany’s national regulations on arms exports are more strict than those of France and the United Kingdom.

However, those regulations have not hindered it to export naval ships and other weaponry equipment to Indonesia during the 1990s when Jakarta occupied East Timor with brutal force. Other EU member states had already in the past years adopted its own interpretation of the Code of Conduct in general and the arms embargo vis-à-vis China in particular.

However, unlike the embargo, the code is not legally binding, and its political restraints have become insufficient as the present debate on the EU’s arms embargo is showing itself. Even more important is the fact that the EU member states (including France and Germany themselves) did not really address the question in advance whether the *Code of Conduct* is really effective to prevent the export of not only major weaponry but also the increasingly important dual-use technologies. These dual-use technologies, which often do not meet the criteria of being “lethal” for preventing exports, do nonetheless significantly augment China’s military modernization and power projection. In contrast to the past, no major high-tech weapon system today exists exclusively of purely military technologies. In this regard, the *EU Code of Conduct* is rather liberal and does not really address those critical gray areas of dual-use technologies.

Since the beginning of 2004, the U.S. has launched a diplomatic campaign against the EU as well as its main EU and NATO partners to lift its arms embargo on China because it is strongly opposed to such a move for basically four reasons which have found support across the entire political spectrum of the U.S.:

- If the EU would indeed lift the embargo, it will put the U.S. in a difficult position to maintain its own sanctions, imposed in 1989.

- Although the human-rights situation in China has undeniably improved since 1989, China human-rights record is still very questionable in the U.S. view.
- It would increase China's military capabilities and, therewith, destabilize the military balance which is already eroding in favour of the PLA.
- Any weapons exports and particularly technology transfers may increase the proliferation risks due to China's inefficient export-control system as the result of the weakening of the state control structures in times of fastening economic and political transformation and reform processes.

Since the end of 2003, Beijing had intensified the pressure towards the EU to lift the arms embargo before the enlargement takes place. It was fearing that with the new East European members, being politically more closely allied with the U.S., it would be even more difficult to lift the arms embargo after the enlargement.

Meanwhile, the EU itself has demanded from China to take more concrete steps to improve human rights such as ratifying the *International Covenant on Civil and Political Rights*, which China signed in 1998. In Germany, the *Green Party*, a junior member of the government coalition, wants to maintain the embargo because of the continuing human rights violations in China. The *European Parliament* already passed a resolution on December 18, 2003, appealing to the *European Council* and the EU member states not to lift the EU embargo on arms sales to China by a overwhelming majority of 373 to 32 with 29 abstentions. It has also argued that China has not made enough progress in its human rights records. The EP also reiterated its belief that in view of China's military threats against Taiwan and by its unwillingness to dismantle its more than 500 missiles targeting Taiwan, it would be the wrong time to lift the arms embargo in the near future.

Moreover, on June 3, 2004, the WEU Assembly, the Interparliamentary European Security and Defence Assembly, has also issued a warning to lift the EU embargo on arms exports to China until Beijing makes significant on arms export controls and human rights. It has criticized that the human rights situation in China is rather worsening and that the Chinese space programmes lack transparency in its objectives and information of its space programmes. It has also demanded that China should ratify the UN Covenant on Civil and Political Rights and to join formally the Missile Technology Control Regime (MTCR).

A new EU Code of Conduct on arms sales is expected that shall stop any weapons exports being used by China for "external aggression or internal repression." In addition, the EU expects more concessions in regard to human rights from China.

In the more medium- and long-term future, given the increasing transatlantic defence technology cooperation, the U.S. may still in the position to block any European nation—which sells arms to the PRC or is opposed to the lift the EU arms export—from having access to critical U.S. military technology.

In summarizing the intra-European and transatlantic discussions of lifting the EU arms embargo towards China, the French-German initiative and its decision-making process without consulting its own Foreign Ministries and major EU partners in advance has clearly demonstrated the lack of a *stabilizing* arms export policy of the EU towards Asia.

Notwithstanding the fact that the EU and its main member states hitherto have adopted a policy with tendencies of a free-riding attitude towards the Taiwan Strait conflict, in the future the EU and its member states may be forced to adopt a policy that can no longer avoid to take more clear positions in the Taiwan conflict. The reasons that the EU will to be dragged into this conflict—even against its wishes—are to seek in the globalisation of the EU's own CSFP and living up to its new responsibilities of its global European Security concept, in the future transatlantic relations, the growing role of the European parliament and the further rise of NGOs influencing the wider public opinion vis-à-vis Beijing.

Ultimately, the very root of the Taiwan conflict is not so much that Taiwan is rocking the boat of the present status-quo in the Strait but Beijing's irredentist policies toward a mature democratic state and society that defines increasingly its own national identity. The Taiwanese threat perception and the widespread feeling of insecurity in the Taiwanese society remain a severe obstacle for any rapprochement and progress in the Taiwan Strait negotiations.

China's present debate about a new broad national strategy with ancient roots to build a "prosperous nation and powerful military" reflects rather its anxieties and inability to further constructive dialogue that promotes a peaceful reunification.

Summary and Conclusions

With the increasing global outlook and the first ever global foreign and security policy strategies as part of the implementation of the *CSFP* and *ESDP*, the EU's strategic interests at regional stability and security challenges in the Asia-Pacific will inevitably further grow—a strategic trend which is unstoppable as the recent

developments in cooperating to fight the international terrorism are highlighting. The traditional self-perception of being “distant” and a “soft power” with limited strategic interests in Asia is clearly contradicting the EU’s newly proclaimed global “European Security Concept” and Non-Proliferation Strategy (both adopted in December 2003) as well as its growing economic interests with Asia—translating it in an interregional economic-security nexus with Asia-Pacific.

The EU and its member states have been helpful at a practical level by supporting Asia to implement CBMs and to share their experiences in multinational peacekeeping missions.

The European security engagement in Asia-Pacific becomes even more important in the years ahead also in regard to common collaboration to ensure that Americans remain honestly committed at multilateral security cooperation. But therefore European and Asian states also need to address more self-critically the short-comings and ineffective circumstances and pre-conditions of regional as well as global multilateral security cooperations. Hence more “effective multilateralism” needs to be discussed and operationalized within ASEAN, the ARF and other regional fora.

In the light of the recent EU debate on lifting its arms embargo towards China, it is important to recall that any armed conflict in the Taiwan Strait, on the Korean Peninsula or in the South China Sea could have not only regional but even global economic and security impacts. Unless carefully managed, the hot spots in these three theatres have the potential to escalate even into a global conflict by involving the U.S. and even its European allies in NATO and the EU.

Given the complex and rapidly changing nature of East Asia’s strategic chessboard, crisis and conflict prevention have become urgent requirements for East Asia. Against this background, closer cooperation between Europe and Asia should also include the experiences of the OSCE in managing ethnic-religious and separatist conflicts and its record of agreed CSBMs in Eurasia.

Europe and the EU should recognize the imperative to play a more substantial role. The unavoidable globalisation of both economic and security policies compels Europe, together with the U.S. and Japan, to shoulder a greater diplomatic and political burden than it has in the past. Hence it should also include the launching of a strategic dialogue with China and Taiwan about new CSBMs to prevent miscalculation and misinterpretations of an unprovoked attack and escalating conflict in the Taiwan Strait.

While the U.S. and the EU often possess similar general visions for dealing with the rise of China and its implications, both sides sometimes are guided by different strategies or adopting varying priorities in pursuit of their policy goals vis-a-vis China.

Ironically, the U.S. becomes now more interested at the EU’s China policies which had been rather overlooked and often dismissed hitherto. But very few joint transatlantic China study groups so far, for instance, have analyzed the differences and commonalities of their respective China policies and tried to enhance mutual understanding of American and European perspectives of China’s future regional and international role.²

If both sides are continuing to overlook their different China strategies and interests, a new serious conflict of the transatlantic relationship may only be a matter of time. On both sides, a certain tendency of arrogance and unilateral strategies can be blamed for these developments. These strategic trends are also reflecting the “globalisation of security policies” on all sides. Up to now and despite many positive developments in the right direction, the EU and its member states have still problems to find the right balance in its China policy between its economic and security interests.

Whatever the EU decides in regard to the arms embargo on China in the next year(s), it has been short-sighted for Europe not to consult and coordinate with Washington on the future sanctions policy towards China given the fact that both the U.S. and European prohibitions on arms sales on China are complementary and were imposed for the same reasons.

²One of the few exceptions was a joint transatlantic study group, organized in 2001 by the Henry L. Stimson Center and the Research Institute of the German Council on Foreign Relations (DGAP). The two partner institutions organized and supported two working groups, one based in Washington and the other one in Berlin, to explore the rationale, risks, and benefits of a transatlantic dialogue on China from the summer of 2001 until the fall of 2002—see “Transatlantic Dialogue on China—Final Report.” Gemeinsames Projekt des Henry L. Stimson Center (Washington) und des Forschungsinstitutes der DGAP mit Unterstützung des German Marshall Fund of the United States und der Volkswagen Stiftung. DGAP-Analyse Nr. 22, February 2003 (the English report is also available on both websites of the Henry L. Stimson Center and the DGAP.)

Moreover, the EU needs to establish clear rules and criteria for the EU's future sales of military equipment and particularly transfers of dual-use technologies—which is not just a matter for internal discussion because of China. But the lifting of the embargo will have to wait until a functioning new EU “code of conduct” for arms sales has been adopted.

Both the U.S. as well as the EU have still to recognize and to learn that they often still overestimate their own power and influence and underestimating many strategic challenges they face and will have to cope with in the forthcoming years. More than ever before, they need to cooperate and to develop common transatlantic strategies to cope successfully with the numerous new security challenges around the world.

The U.S., on the other side, has to recognize that the EU's economic and political interests in China and Asia will continually grow—and therewith also its political ties and security interests. Both sides have to choose whether they will adopt increasingly unilateral strategies or whether they have the political will to define cooperatively common strategies to deal with the rise of China on the regional as well as global level. A transatlantic China and Asia dialogue is overdue for years. The recent embargo dispute between the EU and the U.S. is just one indicator highlighting such a need for closer transatlantic relations.

Chairman D'AMATO. Thank you. Thank you, Mr. Umbach.

We want to move to Dr. van der Geest, Director of the European Institute for Asian Studies.

**STATEMENT OF WILLEM VAN DER GEEST
DIRECTOR, EUROPEAN INSTITUTE FOR ASIA STUDIES**

Dr. VAN DER GEEST. Thank you. Thank you very much. I am very pleased to be here. Thank you, Mr. Chairman, Ms. Dreyer.

I direct a small think tank, the European Institute for Asian Studies, which is particularly focusing on EU-Asia relations. It's supported by the European Commission, through a so-called European Commission Partnership Agreement, but I'm emphasizing that the views that I am putting here are really my own. They cannot be attributed to the Institute, or to some of its sponsors like the Commission.

We work very closely with both the representatives of the PRC here in Brussels, as well as those of Taiwan. And since 2000, we have been conducting informal consultations on cross-Strait relations, involving both mainland scholars as well as Taiwanese scholars, as well as other knowledgeable specialists from Europe and elsewhere in Asia.

Now, the key principle that informs my statement: It's written, and there is a photocopy that is not yet typed out and will eventually be done. But the key principle is I would say that informs my statement is essentially a pacifist perspective, a search for long-term regional stability in the greater China region. And this I perceive to be the key EU interest in this whole issue as well, in particular in view of the very extensive trade and investment commitments which we have in that region.

So, that's my starting point. The overall viewpoint which I develop is that I think it's very important for the EU to send a positive signal—this is the phrase that came out of the last General Affairs Council—to send a positive signal to China as regards to issue of the lifting of the weapons embargo. My view is that we should indicate in using a kind of Chinese formula one yes and three no's. Or more precisely a yes but, or a yes if signal at the EU China Summit, which, of course, will be held next week on the 8th of December in the Hague.

Now, the three “no’s” are first of all, perhaps I better call them not yet, indicate an eventual lifting, say, in the short- to medium-run, perhaps one to three years of the embargo. But that there would not be, and that’s the second no, it would not be unconditional.

First, we would seek a demonstration of commitment from the Chinese side to implementing some of the recommendations that follow from the so-called EU-China human rights dialogue, and I think here the U.S. human rights dialogues are also pertinent. And we should also seek what I would call a major Taiwan dialogue initiative from the Chinese side, from the PRC side.

On the EU side, we should, of course, and I take Frank’s points very well here, we should develop the EU Code of Conduct for Weapons Exports further, and, of course, China should then sign to that Code of Conduct, which may have certain re-export controls, as China would be a signatory.

The third no or is that we should not do this without, not without an analysis of the bigger picture of the U.S. involvement in the greater China region.

Those are the three “no’s.” Now, of course, I’m aware it’s an apparent paradox to say essentially I start from a peace seeking or pacifist position, and it leads me to suggest the eventual lifting of the weapons embargo. But we are very much in a second best world in any case, as it is. We are de facto facing a fairly significant arms and defense race within the greater China, involving both China and Taiwan. This is the reality. Taiwan’s defense budget has remained very high throughout the ’90s, with about \$8 billion a year. That of the PRC has risen very sharply over the last 10 years. Estimated official numbers indicate something on the order of \$25 billion. Pentagon and other analysts put it about three times as high as that. I know Frank has done a lot of work on that. It’s a very serious arms race that de facto is taking place. And the EU embargo in place throughout that period had not in any sense prevented this arms race from accelerating over the last 10 years.

Now, the PRC’s build-up of arms capabilities is undoubtedly rationalized by the perceived threats of Taiwan declaring de jure independence under the DPP’s Chen Shui-Bian’s leadership. De jure independence declaration as it’s often referred to. All indications we get from speaking with Chinese scholars and insiders is that in such a scenario, China would launch missile attacks on Taiwan’s military and economic infrastructure intended to inflict what they call limited damage in physical and human terms, with the intention of reducing Taiwanese support for independence within Taiwan, sharply decrease any FDI that might still be entering Taiwan, and, of course, terribly upset and terrify the stock exchanges and indeed Taiwanese citizens.

Again, this situation has developed while the EU embargo was in place, and it has especially become more serious since 1996. Now, Chinese—the Chinese new leadership, the fourth generation of leaders, has now completed its accession to power, with Hu Jintao taking over the CMC’s Chairmanship in the fourth CCP, Central Committee Plenary meeting held in September this year.

And taking information from a very recent forum we had in Madrid where we analyzed the position of Hu Jintao on Taiwan, I

would think there are three strands to that, informed here in particular by an analysis of Willy Lam, South China Morning Post, who displays three strands. First of all, to be combat ready, and this is where the modernization of the PLA is a very ongoing business and accelerating business. Second, to seek dialogue with the Taiwanese, although not with Chen Shui-Bian, but perhaps with others in Taiwan—the PFP, the KMT, and perhaps other factions within the DPP. And third, not to panic as time is on the mainland's side. Time is on the Chinese side. So, it's not a dual—it's a three-point kind of thing, and it's difficult to know which point will reign. There is not a duality, but a kind of flexibility in that position. On the one hand, you say be ready for attack; on the other, you say seek dialogue. And on the third hand, you say, well, we don't need to do anything because it's going our way in any case. So, it's a very complex interesting position.

Now, why do I say, coming back to my three no's on addition to the yes on eventual lifting of the weapons embargo?

Well, first of all they have to consider that the Chinese leadership is not quite ready to develop any new initiatives for dialogue with Taiwan or conflict prevention or confidence building measures. I mean, Hu Jintao has just taken over, about two months ago, from Jiang Zemin, who was much more of a hardliner vis-à-vis Taiwan. I think that any initiative for seeking dialogue would have to be at a very senior level on the Chinese side, for example, Prime Minister Wen Jiabao. We cannot think of lifting the weapons embargo unconditionally. If we replace a voluntary non-binding embargo on the EU side, we must have a code of conduct, which is very much clearer on the exports to China and re-exports by China. The political motives, of course, for imposing the embargo must also be considered. They were, of course, immediately after Tiananmen Square in '89, end of June in Madrid, and there we would like to see also some very clear tangible progress. For example, a release of political prisoners, perhaps greater freedom of the press, and certainly stopping harassment of press and Internet in the PRC.

We mustn't overlook the bigger picture. I think that the U.S. missed an historic opportunity to defuse tension when Jiang Zemin offered to soft peddle the attitudes for Taiwan in early '90s, in 1992, in exchange for the U.S. Administration reducing or even canceling some of the huge weapon deals that were on line with Taiwan at that point in time. And George Bush, daddy Bush, actually did not accept that offer in '92. So, hence, while the EU embargoed weapons export to China, increased insecurity was fueled by weapons sales to Taiwan from the U.S.

Okay. Concluding remarks. Two. The EU and the U.S. should collaborate to persuade the PRC's leadership to take a high profile dialogue seeking initiative with Taiwan. But perhaps send the Prime Minister Wen Jiabao to the island. That could be the type of initiative that has been lacking for quite a few years.

Second. The EU and the U.S. should insist on tangible progress in the implementation of the human rights dialogue, which both EU and U.S. are carrying out. For example, release of prisoners, active support for the institutional framework that human rights needs, better lawyers, better institutions, legal training, allowing

the freedom of association, a free flow of information for press, et cetera. So, these are my two observations. Thank you very much. [The statement follows:]

**Prepared Statement of Willem van der Geest
Director, European Institute for Asia Studies**

- I. Key Principles informing my statement “pacifist perspective”
 - A. Search for long term regional stability in the greater China region, which I perceive to be in the EU’s long-term interest in the region (trade/investment/commitment)
- II. Overall viewpoint that it is important for the EU to “send a positive signal” to China as regards the issue of the lifting of the weapons embargo. My view is that we should indicate “one yes and three no” or more precisely a “yes but” signal at the EU-China Summit on the 8th of December in The Hague.
- III. The three “no” are
 - A. Not yet—indicating eventual lifting in the short/medium term of 1 to 3 years.
 - B. Not unconditional:
 1. Seeking a demonstration of commitment to implementation of the recommendations of the EU-China Human Rights Dialogue as well as a Taiwan Dialogue Initiative.
 2. Develop further the EU code of conduct for weapons export to which China PRC would be a signatory.
 - C. Not without an analysis of the bigger picture of U.S. involvement in the greater China region.
- IV. “Apparent paradox” that an essentially pacifist starting point leads to suggest the eventual lifting of a weapons embargo. We are in a second-best world. We are defacto facing a arms and defense race within the greater China involving China and Taiwan. Whereas Taiwan’s defense budget since ’93 had remained high at approx. \$7.5 billion a year that of PRC China has grown rapidly rising more than threefold over the last 10 years. Hence the EU’s embargo has not prevented this arms race from accelerating.
- V. PRC China’s buildup is undoubtedly rationalized by the perceived “threat” of Taiwan declaring de jure independence under the DPP’s Chen Sui Bian’s leadership.
- VI. All indications are that in such a scenario China would launch missile attacks on Taiwan’s military and economic infrastructure intended to inflict “limited damage” in physical terms but to (1) reduce Taiwanese support for independence (2) decrease FDI inflows to Taiwan (3) tersely bother the stock exchange and Taiwanese citizens confidence. Again, this situation has developed while the EU embargo was in place, especially since 1996.
- VII. China’s new leadership (Fourth Generation) has now completed its accession to power with Hu Jintao’s taking over the CMC Chairmanship at the 4th CCP Central Committee plenary in September this year.
- VIII. Hu Jintao’s Taiwan policy displays 3 strands
 - A. To be combat ready i.e. ongoing modernization
 - B. To seek dialogue with the Taiwanese (though not with the pro-independence DPP factions linked with CSB)
 - C. Not to Panic as time is on China’s side (e.g. stop discrimination of Taiwanese merchants)
- IX. Why the three “No’s” or not yet
 - A. Not yet
 1. Persuade the Chinese leadership to develop new initiatives for dialogue—conflict prevention/CBM
 2. More time needed as HJ as just taken over from Jiang Zemin
 3. At the level of PM Wen
 - B. Not unconditional
 1. Replace a voluntary non-binding embargo on EU side with a code of conduct signed by the Chinese
 2. Note the political motives after the Tianemen square massacre for example: release political prisoners (stop media harassment)
 - C. Not without the bigger picture
 1. U.S. missed an historic opportunity to defuse tension when Jiang Zemin offered to soft-pedal on Taiwan (in 1992) in exchange for the U.S. Administration canceling the huge weapons deal (worth \$20 billion (G. Bush) later scaled back to \$18.2)

2. Hence, while EU embargoed weapons export to China, increased insecurity was fueled by weapon sales to Taiwan from the U.S.

Concluding Remarks

EU-U.S. should collaborate to persuade PRC leadership to take high profile initiatives to seek dialogue with Taiwan—perhaps a visit of PM Wen Jiabao to the island—as well as insist on tangible progress in the implementation of HR dialogue (release of prisoners, actively support for the institutional framework for HR promotion through legal training of the judiciary, freedom of association, free flow of information).

Panel III: Discussion, Questions and Answers

Chairman D'AMATO. Thank you very much. Let me start by asking each a question. I'm not sure I understand your three-point policy position—

Dr. VAN DER GEEST. I see that as—

Chairman D'AMATO. As coming here. That this is his policy. First, to be combat ready?

Dr. VAN DER GEEST. Yes.

Chairman D'AMATO. I think that there's no dispute about that.

Secondly, it sounds peculiar that you would seek dialogue with somebody other than the leader of the country.

Dr. VAN DER GEEST. Yes, well—

Chairman D'AMATO. That doesn't sound like that would work very well. Particularly since Chen Shui-Bian has already offered him a dialogue.

Dr. VAN DER GEEST. Well, Chen Shui-Bian is the right cart for the Chinese leadership. He's the leader; 50.1 percent is certainly the leader, but it's not a very strong leader. It's even a contested leader within the country.

So, in that sense, they might want to seek contact with PFP and KMT leaders as well.

Chairman D'AMATO. Well, that sounds peculiar to me, frankly. But the third point I find interesting—

Dr. VAN DER GEEST. Sure. Yes.

Chairman D'AMATO. —that you believe that time is on the Chinese side?

Dr. VAN DER GEEST. Yes.

Chairman D'AMATO. I think that's something that might be debated in—

Dr. VAN DER GEEST. Sure. It's much debated.

Chairman D'AMATO. After all—what's going on in Taiwan is a development of a nativism, if you want to call it that.

Dr. VAN DER GEEST. Sure.

Chairman D'AMATO. A sense of nationalism, if you want to call it that, and it's growing. As long as the generations remain on Taiwan, and Taiwan is separate from China, obviously, you're going to have integration; and it would seem to me that in terms of any future hope of some kind of unification or reunification or whatever one calls it, it would dim as time went on because of the march of progress on Taiwan. That I think would be open to some debate, but it seems to me that that's a position one might want to take.

Why is it that you say time is on China's side?

Dr. VAN DER GEEST. Right. Well, first of all, the very strong economic performance of China. Secondly, I also think that democra-

tization in China is progressing and will be proceeding, although slowly.

Chairman D'AMATO. We call that at a snail's pace.

Dr. VAN DER GEEST. Well, slow. By Chinese standards, it's quite fast perhaps, but not by European or American standards. We talk about 15 or 20 years. At this stage, the leadership can cut a deal. If it becomes a democratic issue in the mainland, then there may be much stronger sentiments, teaching the Taiwanese a lesson. The nationalist sentiments may actually be more negative than that what the leaders are currently be able to offer, so the deal, which would be offered today might be—or in the nearer future—might be much better than a deal that will be offered in 2030 or 2050.

Chairman D'AMATO. What would the deal be?

Dr. VAN DER GEEST. Well, it's not about recognition of Taiwan, but about positions for Taiwanese leadership in a greater confederation. For example, that's the kind of deal Europeans like to talk about as a way forward in this long stalemate. I see a certain irony.

Chairman D'AMATO. Yes. Mr. Umbach. Welcome to the stage.

Mr. UMBACH. I'm also more skeptical whether time is on the Chinese side. And if you take the European models of confederation, it was always a first step to a federation, and then to a united state, if you take the European history.

Chairman D'AMATO. The Union you meant.

Mr. UMBACH. I meant in the Union, yes.

Chairman D'AMATO. Yes.

Mr. UMBACH. So, meanwhile, recognize on the Taiwanese side, this kind of discussion of a confederation and federation, and that is I think largely disputed on the Taiwanese side as a kind of model. In this respect, too, I'm more skeptical in this context. Also, whether even if you would have a democratic China one day, whether that would very much change on much strengthened national identity we already have on the Taiwanese side. And that has to do not just with the democratic processes inside Taiwan, but also with the generational changes of people, of a large majority growing up on Taiwan, which has very few linkages to China. And it's also interesting if you look at the issue of the economic interdependencies, which are very striking if you look to the development, which are improving. There's no doubt about this. But so far, it's also striking that there's no automatic linkage to the national identity problem, which has not weakened those tendencies on the Taiwanese side.

Maybe I'm wrong, and developments will take place on the Taiwanese side. But I think as a European experience or the European assumptions in this respect on the hopes that trade will automatically lead to a decrease political tension has not been proved so far by the fact, and it might be also counterbalanced by other factors.

Chairman D'AMATO. Thank you.

Mr. UMBACH. In this respect, I am personally more skeptical. But I might be wrong.

Chairman D'AMATO. Thank you.

Dr. VAN DER GEEST. Yes. I agree if I may come back on that—

Chairman D'AMATO. Go ahead.

Dr. VAN DER GEEST. Too; that clearly the economic integration which has proceeded very fast, and there's a great complementarity between the economists has not translated into any kind of political constructive dialogue.

Chairman D'AMATO. Well, it seems to me that that is not surprising, and there is this theory that economic integration will ease the tensions on both sides, and there may be something to that, but it seems to me then to jump to political integration when you have completely different systems—

Dr. VAN DER GEEST. Sure.

Chairman D'AMATO. You have a tyranny on one side, a dictatorship, and a one party rule, a very small group of people running the whole place. They're not going to give anybody else any power, including the Taiwanese. How that integrates with a democratic Taiwanese structure, it seems to me to be completely unrealistic. But that would be just my opinion.

You have a question?

Commissioner DREYER. Actually, I have quite a few comments. I wonder if we're talking about the same island. First of all, I think that the chances that Taiwan is going to declare de jure independence are very close to zero, particularly since for the last five years or so they've been saying "we are an independent sovereign state." There is therefore no reason to declare any kind of independence. This is accepted by the Kuomintang as well as the DPP, both the major parties. I realize it was Willy Lam you were quoting when you say the Chinese leadership should seek dialogue with the Taiwanese but not Chen Shui-Bian; maybe with the other parties.

The best thing for Taiwan and for the DPP is to have the mainland seek dialogue with the other parties. It makes votes for the DPP hand over fist. Let me give you an example. There's a Taiwan politician named Feng Hu-hsiang, Elmer Feng. Elmer Feng was the darling of the mainland. He used to get invited to the mainland, and he would come back with messages. In other words, he was being used as an intermediary. Feng ran for reelection on December 1, 2001, and he was not just defeated. He was humiliated. Another case involves a friend of mine, named James Soong aka Soong Ch'u-yu. The more Soong Ch'u-yu says things like, "wouldn't it be nice if we had a dialogue with the mainland," the more his popularity ratings go down. So, if the Chinese government seeks dialogue but not with Chen Shui-Bian, that is a most unwise strategy. I've been following Taiwan politics long enough to tell you that a couple of years ago, people like Willy Lam said, well, the mainland really wants to seek dialogue, but not with Lee Teng-hui, but what happens is that the mainland gets someone far less acceptable to them. After they said "we really can't have dialogue with Chen Shui-Bian." We'll wait another election, and surely he will get defeated. But he didn't. He was reelected.

The polls don't look good for Pan Blue in the upcoming December 11th election. But, anyway, you mentioned the arms race across the Strait. Again, daddy Bush, PRC offered a deal in '92. I'm not sure this was a—

Dr. VAN DER GEEST. It wasn't a deal. I said it was a request to try to stop the build-up of arms in Taiwan.

Commissioner DREYER. Okay. But this was—

Dr. VAN DER GEEST. Not a deal.

Commissioner DREYER. After the mainland contracted for the SU Sukhoi 27s, the U.S. was bound under the Taiwan Relations Act to redress the military balance across the strait. The other thing that happened is that PRC must have known daddy Bush had to say no, because the real reason for the sale, although it was justified by the sale of the Sukhoi 27s, the real reason for the sale was that George Bush 41 was running for reelection and polls showed him way behind in Texas and California, both of whom had aerospace industries that were really hungry for contracts. So, when the PRC started that dialogue, it was a non-starter, and they must have known it.

You mentioned the arms race across the Strait in the last couple of years. As somebody who's been involved in these talks, the problem is definitely not an arms race. The U.S. offered to sell the Taiwan government a package of arms in April 2004, and they just turned down the deal after over two and a half years. They won't buy them. We've been telling them, look, guys, it's you who are responsible for your own defense. You better buy some weapons, because we're the only ones who are going to sell them to you. And they say, no.

So, that's why I said I wonder if we're talking about the same island. And finally, lastly, this is one of these things we can debate until the cows come home but I'm not sure China's economic progress can be extrapolated into the indefinite future—

Dr. VAN DER GEEST. No. I don't think that either.

Commissioner DREYER. Yes.

Dr. VAN DER GEEST. No. On the many points, I would take the last point first. I don't think in a linear progression of China as it has been over the last 20 years. It was an extraordinary phase, and it's running into many, many problems. But there are always inequalities in non-performing loans, SOEs, some of them were referred to in the morning as well.

But nevertheless, the prospects remain very good, even though it's not going to be such a straight run as it has been. So, the prospects for Taiwan, however, may be more difficult. We don't know. In fact, the arms expenditure itself may be rather heavy to take for them. For example, there may be other problems as well.

Now, on the Taiwan politics, if you like to call it that.

Commissioner DREYER. Well, what else would you call it?

Dr. VAN DER GEEST. Well, when the alternative is for China to just stay where it is, you know. My real point is that the EU should try to persuade China to take a positive initiative in this regard. That is my essential point. Who precisely and how precisely I was in terms of deals offered, I am informed by a talk we had at our institute a couple of years ago, though. It's perhaps not current, but it was from the ARF Chairman at that time, who was quite forthcoming in a number of quote unquote concessions for Taiwanese leadership in a greater—now, he is off the scene, and perhaps there are other hardliners which would not wish to consider that. But perhaps this can be brought on line again, especially as Jiang Zemin was much more ferocious about Taiwan than perhaps Hu Jintao will be. It's early days.

Chairman D'AMATO. Yes. Mr. Mulloy has a question.

Commissioner MULLOY. One, Mr. Umbach—I welcome what you said about the need for closer transatlantic dialogue and relations. That's one of the reasons we wanted to come here. And I just tell you, my father served in World War I. He was here in France as a young man, and I grew up with both my grandparents from Europe, and I believe that we have similar values, and we should be working much more closely. In this period of history, there's been some division, but I think that we ought to work to get this relationship back on track. And I hope that we can.

With regard to China, you made a very good point. Taiwan used to claim to be the government of all of China. They no longer claim that. They have de facto independence essentially. But you're right. They're talking more and more about de jure independence. They're talking about being a sovereign nation. They're talking about seeking a seat in the U.N. The United States public policy is we do not support Taiwanese independence. That's our public policy. Now, what we need to do, and we need help in this, we need to have a better dialogue between Taiwan and China. This could be a very difficult situation otherwise. We have no defense agreement with Taiwan. We do have an obligation under our Taiwan Relations Act, which was our own unilateral law to provide them what they need to defend themselves, and we do that. We have no obligation to put our troops on the line for them under that Act, although some people say—

Chairman D'AMATO. There's a disagreement within the Commission on that.

Commissioner MULLOY. Some people say we keep that strategically ambiguous. But if you read Secretary Powell's statement of a month ago, I think it's becoming less ambiguous. So, what I'm saying is the EU can help us in the heat of this overall relationship if the EU were to propose to the Chinese in this coming December 8th meeting that you should encourage Taiwan and China to talk. I think it's very important for us, very important for you.

Secondly, I think then both of us should be much more closely discussing how this economic relationship with China should be managed. We had a very good meeting with a number of your members of Parliament at lunch today. And you discussed the trading relationship, and I'll just mention it. We brought the WTO into existence as if it was a NAFTA. When you bring in new countries, you bring them in gradually. You bring them up. We have thrown ourselves into a globalized economy like a NAFTA with steroids, without understanding that what we were doing, and it's having tremendous dislocations; and they're only just beginning. And I think we need to be talking with you how to manage these dislocations. And so, that's what I urge in this dialogue with the U.S. and the EU: work with us to help us resolve the Taiwan problem, and then work with us as we figure out, both of us, how to deal with this globalized economy.

Chairman D'AMATO. Let me just reinforce what Commissioner Mulloy has said. The Commission, in its report last July, which is available here, had a fairly strong chapter on this issue. And the highlight of it was the need for a more vigorous American attempt as an intermediary to bring about a dialogue.

Now, since that report came out, of course, Chen Shui-Bian has proposed a dialogue. We think that is in good faith, and we've strongly recommended that the Chinese government respond constructively to what we think was a constructive proposal. Unfortunately, that did not occur. So, we're still at the place where there is no dialogue, and we have encouraged the Europeans to work with us in terms of bringing both sides together in the form of a dialogue. We think that this is not going to be able to go anywhere without some kind of a dialogue beginning, because there is the possibility of a tension. And the problem is that most of us believe that the TRA does obligate the United States to come to the defense of Taiwan in both the military operation or if there's an attempt to isolate Taiwan economically, which we think the Chinese are trying to do; that we have an obligation to resist that as well.

So, we're not going anywhere in this situation unless some kind of a dialogue breaks through. And we think we should be working with the Europeans together in terms of putting pressure on the Chinese to engage the authorities in Taiwan in a dialogue, because otherwise we don't know where else this would go. Taiwan is not going away, nor do we think that the political authorities that are currently there are going away. The probability is that as a result of these elections in December that you're going to have a leader that's going to have a majority of the Parliament. He's going to be stronger politically than any leader has been.

So, you deal with the devil that's there or you don't deal with him at all. You don't have a dialogue with somebody else. That doesn't seem realistic to us in that respect.

Anyway, that's I think where we are.

Mr. UMBACH. I wanted to make also two or three additional points to Taiwan.

Firstly, if you're looking more ahead to the next let's say just five years, 10, 15 years, I'm not so sure whether Taiwan is not seeking independence. If it's doing it, it will certainly be very careful to do it. But I don't think that the Chinese interpretation and perception of the kind of salami tactic on the Taiwanese side is all wrong. Mostly many experts cite opinion polls in Taiwan, which indeed indicating that a big majority is favoring a political status quo of not seeking independence but also not giving in to China.

However, all these opinion polls, which are favoring the status quo, are somehow misleading in a way, because most of those being asked to have in mind what will happen if they seek independence.

Chairman D'AMATO. Yes. That's right. We actually—

Mr. UMBACH. There are opinion polls where people have been asked whether you're in favor of independence if China would not cause trouble. And then you have opinion polls quite different; that 70 percent favoring independence. And that has to do with the generational changes.

So, and, in my humble opinion, that needs to be addressed in the future. I don't believe that the present status quo can be maintained for the next 15 or 20 years. And if that is not addressed by the international community in some way—and I'm not speaking about independence now, there are some possibilities at least for making some room for Taiwan in international organizations, for example—if that is not addressed, I would not exclude that some

kind of Taiwanese is emerging. And then the picture will be different.

Chairman D'AMATO. I think, though, what the Commission has arrived at is the conclusion that essentially the great majority of people on the island do favor status quo for various reasons, but that a large majority don't want the political situation to go spiraling off in either direction, either independence or accommodation with China. That's what we think.

So, we do think that there is a time period available. The only problem, and I'll just leave it at that is that when you have a democracy, you get a lot of noise. That's what democracies have. They have a lot of noise. You run some risks. But that, of course, is the price of a democracy.

But what we'd like to do now if we may, because there may be some interest in the audience, is open this up to questions for the members of the panel or three commissioners here, if anyone has any interest in pursuing any of these things, a little further.

Does anyone else have a comment or a question for the panel? Don't be shy. In the back.

Open Microphone

Mr. STEINER. If the EU were to lift the embargo, how might that impact U.S. military sales to Europe?

Chairman D'AMATO. To Europe? That's a good question. Actually, you will find some recommendations in our report in that regard. The United States does feel that lifting the embargo at this particular juncture would complicate the situation in the Straits, and might send the wrong kinds of signals to the Chinese, which would make the strait situation more difficult.

In order to dissuade the European governments from doing that, there is a strong sentiment in the Congress that we would cut off those firms that are engaged in that process from further cooperation with the U.S. Defense Department. So, they would lose their opportunity to work with us; which would be very costly for many of those firms, to make them think twice about complicating this situation in the Straits.

So, there is a general feeling that that would be unhelpful, and that we would try to take action against companies that were engaged in that trade so in order to dissuade them from doing so.

Commissioner MULLOY. Could I just comment? You should understand that there was a Commission recommendation of this type to the Congress.

Chairman D'AMATO. It is not current law.

Commissioner MULLOY. It's not current law. But it would be the idea that if a French company, a British company, were selling things to China, that company should not then be contracting with our own Department of Defense. That was the recommendation. Nothing against the governments. Only against the firms that can have one market or the other. Their choice.

Commissioner MULLOY. Yes, sir. Mr. Umbach?

Mr. UMBACH. You make me curious with your remark, Mr. Chairman, on the economic embargo that China might impose on Taiwan.

Chairman D'AMATO. Excuse me?

Dr. VAN DER GEEST. Economic embargo.

Chairman D'AMATO. Economic embargo?

Dr. VAN DER GEEST. Which is not—that was not a term you used.

Chairman D'AMATO. No. I might have said—

Mr. UMBACH. Blockade. Blockade I think was the word.

Chairman D'AMATO. Economic isolation.

Mr. UMBACH. Isolation. I'm sorry.

Chairman D'AMATO. Oh, economic isolation.

Mr. UMBACH. I wondered what you had in mind specifically, and maybe you could expand a bit on the likely responses that the U.S. Government might employ, which I presume would be more of an economic nature at least in the first place.

Chairman D'AMATO. Well, what I was trying to say was that there is a broader protective shield, let's say, in the TRA, the Taiwan Relations Act, that states the United States should resist the economic deprivation or I forgot what the wording is, but the economic isolation if the Chinese were to, which we think they are, attempting to isolate Taiwan in various ways, including economically. It is the law of the United States that we would resist that.

Now, what kind of actions we would take to resist that we can only speculate about. But there is not a menu of actions that we are recommending or that's in place now. Only that it is our obligation to ensure that or to work to resist the kind of economic isolation of Taiwan by the Chinese.

Mr. Umbach, did you have a question?

Mr. UMBACH. Yes. I wanted to make one or two remarks again to the European-Taiwan policies, because there is a difference. You mentioned the parliamentarian side. The European Parliament has always taken a much more pro-Taiwanese attitude to a number of issues, including the military pressure coming from the mainland side. But one should not overlook that the government policies, as well as the policies of the EU Commission, is certainly different. And the European Parliament's influence on those policies on the government side is limited so far.

Nonetheless, I personally believe if you look ahead that those governments' policies in regard to Taiwan will change. So far, the governments were reluctant to deal with the Taiwan Strait conflict, to be very fair. I criticized it even as a free riding attitude, because it did not want to cause trouble to our economic policies with the mainland. We expressed certainly our concerns like in 1996 about the Chinese military build-up and military pressures. But essentially, we did not address the Taiwan Strait conflict on the government side.

That may change, and I believe there are four or five reasons why that will change, not over night but in the mid and long term.

Firstly, it has to do with the globalization of the EU's own foreign security policies and living up to its new responsibilities as outlined in those global concepts.

Secondly, it has to do with the future transatlantic relationship. This I hope that will be maintained, and so if you have some more dialogue between us, it will certainly have a positive influence in this respect.

Certainly, it has to do that, despite my point, I made a few seconds ago, I believe that the influence of the European Parliament

and the national parliaments on those issues will increase. The fourth point has also to do with that, and that is I believe the influence of the first arise of NGOs influencing as a wider public opinion.

So, that means that sooner or later over time, the EU, as well as its national governments, will step by step address the Taiwan relationship and the Taiwan Strait conflict more than it has in the past.

Chairman D'AMATO. I think we have time for another question, if there's anyone out there that has one. If not, I think we're—

Commissioner DREYER. I would actually like to ask Dr. van der Geest—

Chairman D'AMATO. Yes.

Commissioner DREYER. This is very interesting, and I assume you mean Mr. Tang, the ARATS man?

Dr. VAN DER GEEST. Yes. Tang Shubei.

Commissioner DREYER. Tang Shubei. What specifically he said because every so often the Chinese government—

Dr. VAN DER GEEST. Sure.

Commissioner DREYER. Seems to very slightly back away from the one country, two systems, which 85 percent of the people on Taiwan have said no to.

Dr. VAN DER GEEST. He did—let me be clear. He did not back away from that particular precondition at all.

Commissioner DREYER. Oh. Okay.

Dr. VAN DER GEEST. Otherwise, we would have seen another scenario. But then, okay, within that framework, then he discussed various I thought rather far-reaching suggestions like a vice president from Taiwan and stuff like that. I don't know whether he was at liberty. He was later sacked I understand for saying the wrong thing in Japan. But nevertheless, there may be openings.

But importantly, that was during Jiang Zemin. Now, there is a new window of opportunity, which has not yet been explored, because that window only really exists since the last two or three months. In fact, Hu Jentao will probably have to appear to be tough in the beginning in order to establish his credibility. But given the fact that we are talking about this embargo or putting something else in place for that, this may be a time to also talk about dialogue initiatives with Taiwan, and this could come from the both the EU and the U.S. And I think that's one of the two main points I wish to convey.

Chairman D'AMATO. Yes. I think we both certainly agree with that.

Commissioner MULLOY. We would agree with that.

Chairman D'AMATO. Well, we're going to break now. We will have a five-minute break. We're going to start a little earlier on the next panel, at five of four. So, we'll take a five-minute break. Thank you.

PANEL IV: EU PERSPECTIVES ON HUMAN RIGHTS IN CHINA

Chairman D'AMATO. We're about to begin our fourth panel of the day. This is a panel that deals with the question of human rights, which is a question that has been consistently emphasized in Europe, more so than in the United States. Europe has been very pro-

gressive in seeking to improve human rights conditions worldwide. There has been some slight shift in that it appears with the economic relationship with China there are some kinds of contradictions in Europe in this area.

We are fortunate today to have a member of European Parliament who deals with human rights with us, Dr. Charles Tannock, who's Vice Chairman of the Parliament's Subcommittee on Human Rights, as well as Mr. Phillippe Amersfoort, who's an Administrator at the European Commission's Directorate General for External Relations, Office of Human Rights. So we have the European Commission here as well. And Mr. Jim Cloos, who is the Director General in the General Secretariat of the Council of the European Union. So, we have the whole complex of checks and balances and the various perspectives of the European Commission, Council and Parliament with us today.

I know that you're under some time constraints, Dr. Tannock. If you could go first and summarize your views in seven or eight minutes and then if you have to leave early, we'll have some questions for you, and then I'll have the others go.

**STATEMENT OF CHARLES TANNOCK
MEMBER OF EUROPEAN PARLIAMENT
VICE CHAIRMAN, EUROPEAN PARLIAMENT'S SUBCOMMITTEE ON
HUMAN RIGHTS**

Dr. TANNOCK. Thank you very much, Chairman. Yes, I'm Vice Chairman of the Human Rights Subcommittee of the Foreign Affairs Common Security and Defense Committee. So, I wear both a foreign affairs hat, and a human rights hat. I have prepared a 2,000-word piece, copies of which I've given to you to distribute.

Chairman D'AMATO. We'll include that in the record as well.

Dr. TANNOCK. Which is quite extensive. And I have to emphasize this is a personal perspective. I'm not necessarily speaking on behalf of the Parliament, my party or my group, but I think that, by and large, most members of the Parliament would uphold the principles laid out in my document. But it hasn't been subject to a vote or debate in committee, so it's a personal perspective.

To my surprise, as I was doing my research on this whole issue in anticipation of this meeting, China has now become the second largest trading partner to the European Union in recent time. This is quite an extraordinary development really.

Former Commissioner Chris Patten, who's just left office, in his valedictory speech to the Human Rights Subcommittee, did come out with the candid announcement that the bigger the state, the less of a stick we have to beat them with over issues concerning human rights. And I think he had China very much in mind when he discussed this, having formerly been a Governor of Hong Kong, in fact the last British Governor of Hong Kong.

I, with another hat, happen to be the President of the Friends of India, and I just had lunch today with the Indian Ambassador. I've always liked to compare and contrast the two giant countries to our east, which are both a challenge in economic terms but also a great opportunity from a trade perspective. But they also markedly compare and contrast in terms of human rights and democracy. And it was interesting that discussing it at lunch with the Indian Ambassador, of course, the Indians as well, and I'm very well

disposed towards India, generally politically strongly support maintaining the export ban for obvious reasons: that arms exported to China, of course, can be re-exported, but also China still occupies Indian territory.

Some of you may or may not know I've had one of the busiest weeks of my life because I happen to be "Mr. Ukraine" in the Parliament. I'm the Country Monitor for the Foreign Affairs Committee on Ukraine, and it's been an endless series of interviews, television, radio, and what have you. But what you probably don't know, or you may or may not know is that China was the only other country in the world that recognized Mr. Yanukovich prematurely as President, along with Russia.

Now, this may or may not be surprising, as they obviously prefer his style of post-Soviet authoritarianism as compared to the rather liberal pro-western democratic views of Mr. Yushenko. But I think that's an interesting point to mull over in the current political scenario.

The British Foreign Office is probably the publisher of the largest report this year in terms of human rights. And they specifically detailed the China situation. And not surprisingly, they list a number of areas of major concern, which I think are shared by all the member states and, of course, the European Union itself, namely the extraordinary use of the death penalty, particularly for crimes which would not traditionally be regarded as capital crimes—economic crimes, prostitution, pimping, all sorts of things which—drug use and so on—which we would never use the death penalty for, although, in fact, there is a ban on the death penalty throughout the European Union. But I mean, we would never remotely think or conceive that that was a possible use of the death penalty. And although we remain critical of the death penalty full stop, even in the United States, we certainly think it's absolutely outrageous the way it's used in China.

The use of torture. The restrictions on freedom of speech and association. Press freedom. Interestingly enough, Internet censorship is one which is very common in China. And, obviously, persecution of religious minorities, particularly unregistered Christian groups, certain Buddhists, the Falun Gong are the ones that have been very active in lobbying. Muslim groups, particularly the Uighurs and in the last couple of weeks the Uighur community, but, of course, it's more complicated in the case of the Muslims, because they actually been dabbling regrettably and flirting with Al Qaeda connected groups. I was the author of a question regarding the East Turkistan Islamic Movement, why it was not a proscribed organization. And I think the Chinese government will be delighted to hear that as a result of my question, at least in part, it's now a proscribed organization.

So, it's slightly complicated there, but clearly China doesn't permit any kind of religious education for minors. So, in schools, it's banned by law. They don't think that that should be within the state system whatsoever.

And, of course, last but not least, the whole issue of Tibet, and we have been debating in the Parliament recently the case of Tenzin Deleg Rinpoche, who is facing imminent execution as we speak. I think the moratorium on his death penalty expires on the

second of December, and there have been urgent pleas from the Parliament for a commutation of the death penalty and a thorough investigation of his case, because we believe he's been subject to a miscarriage of justice.

In terms of formal mechanisms, I do tell about them in the paper, but there, of course, the famous annual EU-China Summits, in which human rights are part of the regular dialogue, including things like discrimination against people who are HIV/AIDS sufferers. And then there are the six monthly human rights dialogues, which go into these issues in more detail.

Now touching on the issue, which I'm sure is of great concern to my American colleagues here, is the whole issue of the export ban on arms sales, going back to 1989, post Tiananmen Square. This was imposed by both the European Community at the time, as it was then, as well as the American Administration. Recently, there's been enormous pressure in the Council of Ministers, supported particularly by France, Germany, to a lesser extent by Britain and Italy, but opposed by the Scandinavian countries, by Holland, by the former communist countries, well aware of what communist suppression can be all about. And this debate has been very lively.

In the Parliament, there have been a number of debates on this. I spoke in one about six months ago. There is cross-party and cross-national consensus opposing the lifting of the export ban you'll all be relieved to hear from an American perspective.

One of the problems that we face, of course, and this is little discussed, is that if there were a lifting of the ban, we certainly can't rely on the Code of Conduct, which is not binding. There is a school of thought that it should be binding. France, of course, cites this as a way of controlling it. But at the moment, it's not binding, either in terms of the EU Code of Conduct, and there is certainly no international mechanism either which is binding in the export of arms. And there's no way of policing or controlling the re-export of arms by China to third parties. China does not have a good track record in terms of re-exporting arms. It has got a particularly poor record in the proliferation of weapons of mass destruction. Once again, wearing my pro-India hat, we are only too well aware of the role of China in the construction of Pakistan's nuclear bomb. We are only too well aware of China having been involved with the export of missile technology and cooperating with North Korea in the past. And certainly, we don't quite know what their involvement is now with Iran in terms of these sort of technologies.

So, there are serious considerations beyond China itself if the export ban were to be lifted. But, of course, the one that most concerns this audience no doubt is the issue of Taiwan. I have been a steadfast friend of Taiwan, not just on this issue, but in other issues in terms of their status with the WHO. I believe it's a country that is based on democracy and free markets and respect for human rights. It would be indefensible to jeopardize them in any way in terms of security. America, of course, is obliged to defend them under the Taiwan Act. And also America even more lesser known, of course, is obliged to stop trading with those who subvert that and export arms to Red China, threatening Taiwan.

So, it's a very complex issue, but clearly in the Parliament the issues which come up are the human rights considerations, which I've already mentioned and the risk imposed on Taiwan and the use of these weapons were they available to internally repress such people as the Tibetans in particular.

So, I think I've mentioned most of the areas of concern. Last but not least, which is controversial, which I don't know whether you've touched upon, is the issue of Galileo; that, of course, China has been allowed to participate in the Galileo Project. Galileo may or may not have security and defense implications in terms of its accuracy. Some of us are doubtful as to whether it was wise to allow China on board on this, but that is a fact, and that's the reality we have to live with.

I think that summarizes what I've said, but I would urge you to read what I say and ask any questions from the text, if that's appropriate. Thank you, Chairman.

[The statement follows:]

**Prepared Statement of Charles Tannock
Member of European Parliament**

Vice Chairman, European Parliament's Subcommittee on Human Rights

A Personal Perspective From the European Parliament on Human Rights in the People's Republic of China and Its Bearing on the EU's External Policies

China as the world's most populated country with 1.3 billion people shares with the world's next largest country, India, a common challenge which they pose to the EU in terms of economic competition but at the same time both offering a huge opportunity for exports into such massive and rapidly growing markets. China is now the EU's second largest trading partner after the U.S.A. However the parallels with India then diverge as not only is China focusing strongly on its industrial and manufacturing sectors, unlike India which has specialised in service sector development, but also China with its corresponding more rapid rise in national income has barely reformed at all in terms of human rights or democracy, unlike multicultural, secular, democratic India. The latter is due to overtake China in population in the next twenty years and demonstrates that vast size *per se* does not preclude a functioning democracy.

Recently, and not surprisingly perhaps, China along with Russia was alone in the world in rushing to the premature recognition of Mr. Yanukovich as President of Ukraine. Clearly free, fair and transparent elections are not considered by China as an essential part of the consent required for governing a modern country. Perhaps also China had a sense of déjà vu in seeing the thousands gathered in Kiev's Independence Square being reminiscent of their own Tiananmen Square protests 15 years ago, which they brutally put down.

The British Foreign office's annual report for 2004, the most comprehensive of its kind in the EU, gives a mixed verdict in terms of China's improvement in human rights with outright condemnation of China's extensive use of the death penalty, (even for what we in the west would never regard as capital crimes such as corruption, pimping, drug offences and tax fraud), it's systematic use of torture of dissidents, and restrictions on freedom of speech and expression (for instance China recently arrested a Chinese researcher for the *New York Times* and notoriously censors Internet sites including access to NGO's like Amnesty International). China is criticised strongly for its lack of freedom of association and religion, in particular targeting Falun Gong practitioners but also Muslim, Buddhist and unregistered Christian groups. Most recently China has encountered serious ethnic and religious minority problems including violent outbreaks in its Muslim communities. Last month this centred on the Huis, but there is also the longer running differences with the Uighur community in Xinjiang, who have, like their Turkic kinsmen elsewhere in central Asia such as Uzbekistan, developed dangerous links with Al Quaeda through the banned resistance group, the so-called Eastern Turkistan Islamic Movement. In fairness Chinese nationals have indeed been targets of Islamic terrorism in Pakistan and Afghanistan. China routinely forbids all religious education in schools to minors.

Much longer standing and better known in the west is the repression in Tibet, where following invasion 45 years ago some 20% of its population (1.2 million) was killed which was followed by a campaign of political re-education of Tibetans remaining in the territory and a massive movement of Han Chinese into Tibet. The European Parliament recently debated in advance of the 7th EU-China summit meeting this 8th December the case of a Tibetan Buddhist monk Tenzen Deleg Rinpoche who faces imminent execution on charges of advocating Tibetan independence and planting explosives in Sichuan Province. After alleged torture lasting several months he “confessed” to his crimes but in court shouted out his innocence and his suspension of execution expires the 2nd of December. In contrast China recently released Tibet’s longest serving prisoners of conscience, Ngawang Sangdrol and Jigme Sangpo.

Amnesty International has repeatedly condemned China for human rights abuses claiming some 30,000 political prisoners in detention, with torture and executions commonplace and these topics have repeatedly been raised at EU-China summits since 1995 based on EU heads of delegations in Beijing’s detailed reports to the Council of Ministers. For instance at the October 2003 summit the issue of China and accession to the International Criminal Court was raised as so far China has refused to sign the Rome Statute. At the November 2003 six monthly EU-China human rights dialogue meeting (started in 1997) the issue of discrimination against persons suffering from HIV/AIDS was raised.

Recently much of the debate has focused on the June 1989 EU Arms Export Embargo imposed on China following the Tiananmen Square brutal killing of innocent protesters and the ongoing imprisonment of many who were never subjected to a fair trial. To this day mothers of those killed or activists demanding a re-evaluation of the 1989 demonstrations face imprisonment. Simultaneously in 1989 the U.S.A. also imposed an arms export ban and remains committed to maintaining it on the grounds of continuing human rights violations as well as the very real concern these arms could be used against its democratic ally, Taiwan. China considers Taiwan a renegade province but the U.S.A. rightly believes more arms to China will further threaten cross-strait stability, where already there are 600 Chinese missiles pointed at the island. China in turn feels threatened by President Chen’s increasing independence leanings.

Furthermore no existing mechanism prevents the use, were such EU arms to become available, either for internal repression or for re-export to other brutal regimes friendly with China such as North Korea. China has a poor record historically in its proliferation of weapons of mass destruction having helped Pakistan build its atom bomb in the past and China’s current role in missile and rocket propulsion material sales to countries like Iran remains unclear. Although under the “Six-Party talks” China is committed to stopping North Korea’s nuclear weapons programme but China has an appalling record of returning refugees to North Korea, against its commitments under the UN Geneva Refugee Convention, where they face imprisonment and execution. Some states in the EU, with a strong lead taken by France and Germany, with Britain and Italy not far behind but strongly opposed by Holland, Scandinavian and former Communist countries of Eastern and Central Europe familiar with Communist repression, claim this unduly critical thinking is outdated. They claim it does not reflect the real human rights improvements in China, such as withdrawal of the controversial repressive laws proposed under Article 23 of the Hong Kong Basic Law. France in particular claims this ban labels China unfairly as a pariah, and penalizes European jobs compared to Russia, which enjoys a lively arms trade with its neighbour. France believes lifting the embargo would be symbolic and recognise China’s essential role in fighting international Islamist terrorism (Libya had such EU restrictions lifted last October ostensibly for joining the fight against terrorism and abandoning its WMD programme). China apologists claim that the ongoing 1998 EU Code of Conduct on Arms Exports would suffice to limit arms sales—conveniently forgetting the Code of Conduct is a voluntary one and not enforceable. Neither is there yet any other binding international code of conduct on arms exports. It is also noteworthy that exporting arms to China by EU member states would have serious repercussions on EU-U.S. relations as the U.S. “National Defense Authorisation Act” precludes future business relations with anyone trading arms with China. The U.S. is also legally obliged to ensure Taiwan can defend itself adequately under the Taiwan Relations Act.

The European Parliament strongly voted cross party and nationality on 17th November this year against lifting the ban, until the EU Code of Conduct becomes binding and as an ongoing measure required to politically protest at the continuing Chinese human rights violations. It is also worth pointing out that non-arms EU-China trade is flourishing, following WTO accession in 2001, and unaffected by the ban, and that lifting the ban could spark off an arms race between China and Tai-

wan who would then both have less funds to invest in the Asia-Pacific region or import EU goods, which overall would neither help the EU nor the rest of the global economy.

China, under its new President Hu and Premier Wen still remains poorly compliant with the UN Covenant on Civil and Political Rights which it is dragging its feet over ratifying, having agreed in principle to observe its contents. For instance China detains people purely for expressing personal opinions, illustrated by it recently torturing Mao Hengfeng in custody at a “re-education through labour camp” (which allows detention for up to three years without charge or trial), for protesting at China’s family planning policies, having been herself subject to a forced abortion. China has the unenviable record of having the youngest political prisoner in the world, when the Panchen Lama was arrested aged 6. China recently refused a visit by a UN Torture researcher citing scheduling problems.

Mindful of these abuses the U.S.A., and still critical of China’s failure to comply with promises made in 2002, only recently agreed to restart the bilateral human rights dialogue. As recently as last March 2004, the U.S.A., threatened a UN resolution criticising China’s human rights’ situation but it failed to get a majority on the 53 nations UN Human Rights Commission, vulnerable to anti-American political pressures.

There can be no doubt the EU’s Arms Embargo should clearly stay and one can only wonder at the EU’s wisdom of allowing Chinese participation in the Galileo GPS system with military dual use and what long term danger that might pose to civilised peaceful Taiwan.

Chairman D’AMATO. Thank you very much, Dr. Tannock. We really appreciate all your preparation of this paper for us and for your coming at time when you are very, very busy. We know you have a vote I think at 4:30 p.m.

Dr. TANNOCK. On Turkey, and the admission of Turkey, and another country.

Chairman D’AMATO. Turkey. Let me ask you one quick question, and that is it seems to us that the Parliament, of course, is very strong on the question of human rights. You, as a member of Parliament, are one of the leading voices there; but that perhaps the Commission is in the frame of mind of being committed to a dialogue on the issue and that the Council may have a different perspective. What is the difference? Can you just summarize it? And what would be the strategy of the Parliament to bring a common approach to human rights on the part of the Commission and the Council?

Dr. TANNOCK. Well, obviously, we are determined to try and find a common position between the three EU institutions, but what happens in the Council is very much in camera, behind closed doors, and I dare say, Mr. Cloos, they may want you to comment on this. It’s not quite as transparent or open to scrutiny. And obviously, they represent the interests of the member-state governments, and often have different political agendas. What we do in the Parliament is obviously an open debate, much more open to scrutiny and examination and challenge. So, that’s the main difference, and obviously the Commission sits somewhere between the two ways of operating, and, by and large, the Commission has been extremely cooperative with us in terms of trying to sharpen up for human rights, not just in China, but everywhere in the world. And we can—the Commission is directly accountable to the Parliament, as we recently witnessed over the issue of Mr. Barroso’s Commission, which was rejected. We have direct powers of scrutiny, control, and even the right to sack the Commission; whereas, we don’t have those sort of powers over the Council who are responsive to their national parliaments.

So, that's the political dynamic that operates.

Chairman D'Amato: Yes. Yes. And do you expect that the human rights issue will have full expression at the Summit?

Dr. TANNOCK. Well, I sincerely hope so. I think that that's obviously a major concern, and I think that China has not been particularly helpful; and, from what I've read, the track record recently, if anything, has deteriorated in some respects over what they promised to the American government in particular. And I know that you did attempt to vote in the U.N., in the Human Rights Commission there, but because of anti-American sentiment that was to a certain extent undermined. But it will certainly be raised at the Summit, and we will carry on raising it repeatedly. But whether they will listen, that is another question.

Chairman D'AMATO. Well, we just think you ought to keep going at it. We really appreciate your effort in this respect. By the way, the Galileo program does have defense implications—we believe that there's been a successful effort to separate out the ones that are most sensitive from the situation. Do you have any questions?

Commissioner DREYER. First of all the hard one. I have dabbled somewhat in Xinjiang politics over the years, and I find if you talk to experts, economic and think tank and NGO experts on Xinjiang, they are absolutely adamant that, although a couple of these East Turkistan Independence Movement (ETIM) people may have met with Osama bin Laden, there are really very few connections between them. The low estimate I get for the number of ETIM members involved with Osama bin Laden is four, and the high estimate is 13. You seem to have heard information that convinces you that there is a connection. Can you elaborate on it? Or is it—

Dr. TANNOCK. No. I can't elaborate. All the information I've got is in the public domain. I mean, clearly, post September 11th, we were looking at all sorts of organizations which had some kind of operational capacity and ability to raise money or were funded from various charities operating within the European Union territory. One of the issues was the issue of the East Turkistan movement—why—and it was asked why they were not on the proscribed list of the Council. And I think it's just a gap in the security.

But certainly, as I understand it, from time to time, there have been Uighurs found, in various operations, from Chechnya to Iraq.

Commissioner DREYER. Okay. But not all Uighurs are members of the ETIM.

Dr. TANNOCK. Well, sure. I meant found in compromising situations, suggesting that they're doing things—and they've been found in Afghanistan as well.

Commissioner DREYER. Sure.

Dr. TANNOCK. So, whatever they've been up to in those particular theaters of operations, it's suspicious that they've been involved with radical Islamist activity.

Commissioner DREYER. No. Sure. And if you get any more concrete information, I would be thrilled to get it. It's just that there seems to be this disconnect between people who know the Xinjiang situation on the ground, who say that ETIM is a terrorist organization, and then the State Department, our State Department people, who say they have seen classified information that ETIM is a terrorist organization.

Dr. TANNOCK. No. Well, I don't think they'll [inaudible] classified information. I'm afraid I'm just a humble MEP. So, [inaudible] ask Mr. Cloos your question about classified information.

Chairman D'AMATO. Do you have a quick question?

Commissioner MULLOY. Yes. Dr. Tannock, thank you very much for being here. I just want to clarify something. You stated that we are obliged to defend Taiwan under the Taiwan Relations Act. I think you should know that that Act itself provides that we will provide the Taiwanese what they need to defend themselves. It does not commit us to defend Taiwan.

Dr. TANNOCK. Defend themselves? This is—

Chairman D'AMATO. By the way—we do not agree with—

Dr. TANNOCK. I think in the text I've actually used that wording. Sorry.

Chairman D'AMATO. Yes.

Dr. TANNOCK. That's some shorthand that I meant for the—

Commissioner MULLOY. I just want to make sure. And the other part is ambiguous because we did not want to give someone the ability to drag us into a conflict that may not [inaudible] not want to be part of. And, so, I just think it's important to realize that. We did have a defense treaty with Taiwan, which was abrogated in 1979.

Chairman D'AMATO. Let me just point out that we don't agree with Mr. Mulloy's position on this. The rest of the Commission thinks that we do have a right to its defense.

Dr. TANNOCK. Can I read a paragraph just to compare those facts?

Chairman D'AMATO. Yes.

Dr. TANNOCK. This is in my working paper. "It is also noteworthy that exporting arms to China by EU member states without serious repercussions on EU-U.S. relations as the U.S. National Defense Authorization Act precludes future business relations with anyone trading arms with China." Is that a fact?

Chairman D'AMATO. That's right.

Dr. TANNOCK. That is fact. Okay.

Chairman D'AMATO. Yes. Good.

Commissioner MULLOY. Thank you, Dr. Tannock.

Chairman D'AMATO. Thank you very much for coming.

Dr. TANNOCK. My pleasure.

Commissioner DREYER. Bless you for doing this good work.

Dr. TANNOCK. We try.

Chairman D'AMATO. Thank you very much, doctor. We'd like to go ahead and proceed with—if either one of you would like to go first.

**STATEMENT OF JIM CLOOS, DIRECTOR
GENERAL SECRETARIAT OF THE COUNCIL OF THE EUROPEAN UNION**

Mr. CLOOS. Thank you, Mr. Chairman. Like Dr. Tannock, I have distributed a few speaking notes. I'm not going to read this out, although I'll summarize it in a minute.

Before doing so, let me maybe briefly react to the debate we've just had in one or two words. First of all, I very much hope that Dr. Tannock didn't want to imply that there was a major dividing line between European institutions on the importance of human

rights. Human rights is a major element of our foreign policy. This is explicitly stated in our treaties, and certainly also in the constitution. There are different angles. Like in Congress and the administration, there are different ways of going about things. The Parliament can be more outspoken than people in government. This is normal. Incidentally, I would also say the Commission and the Council are represented at parliamentary debates. We have to respond to oral and written questions, as is usual in any democracy. So, I simply wanted to put this point on the record here. I think it's very important to say that basically the importance of human rights for our foreign policy, everybody and all the institutions in the European Union agree.

Now, let me make a few remarks on the basis of my notes. First of all, thank you very much. I think it's a very good idea to come to Europe and to listen to what we have to say on a very important issue. We appreciate that.

China is a very important partner and a major partner, both for the EU and the U.S., so, again, I think it's very important that as very close transatlantic partners, we should be talking together about our relations with this important country. We share a common interest. We want to integrate China into the international community. We want China to respect democracy and human rights. Sometimes we have different ways of going about things, but our objective is common, and I wanted to state that quite clearly here.

I want very briefly to tell you, and I'm sure that Phillippe will maybe give more details here on, first of all, the way the EU has addressed human rights with China over the last years. Secondly, a very quick evaluation of where we are; and thirdly, the future perspectives and what we try to do.

Before doing so, let me, from my side, tell you one word on the arms embargo. I know this was discussed before. I think you had a session before, so I'm not going to enter into any details. I simply wanted to say that there has been a very in-depth debate going on for the last month. There is no decision yet by the EU Council. We are fully aware of concerns expressed by the U.S. Administration and Congress. And we obviously take that very seriously. At the same time, many Europeans consider that to lump together China with countries like Sudan and Myanmar and Zimbabwe, these are the only countries on which we have arms embargoes, is—does not reflect the state of relations. But as I said, no final decision is taken. The final decision will take into account various factors: the state of human rights obviously; also the way we can handle the Code of Conduct; and, so, the overall strategic relationship.

So, I just wanted to make these quick remarks. Coming back to human rights generally speaking, I think there are many similarities in the way the U.S. and the Europeans have dealt with this problem. Both of us, both sides, have imposed sanctions after Tiananmen. Both sides have progressively lifted most of the sanctions over the years. In our case, the arms embargo is the only one that is remaining. There are also some differences. While both sides launched a human rights dialogue, by the way, I forgot to say that—obviously very important—we have been a bit more consistent with the dialogue. Yours was interrupted. Ours happens

more frequently. But again, the overall approach is the same, and I understand that the United States is in talks with the Chinese about a possible resumption of the human rights dialogue.

Another slight difference sometimes is the position taken in the Commission of Human Rights. We used to propose resolutions. We have stopped doing that some time ago. The U.S. went on for a little longer proposing resolutions, but, of course, they hit the snag we—unfortunately, frequently hit now with no motion actions. I mean, we lost two or three recently in the third committee. We strongly protest each time when someone comes with a no action motion on human rights. But there we are.

We have eight benchmarks. I will not list them here. They're in my paper, and maybe Phillippe can say a few words on those.

As far as the evaluation is concerned, just a few quick remarks. First of all, maybe three methodological caveats. The first one is that benchmarks are for ideal situations. You try to measure what you're doing. Obviously, you're never going to reach the benchmarks fully. The second is that it's sometimes difficult to measure the link between your dialogue and what happens on the ground. Modifications, for instance, in approach and mentalities is a very slow moving process, difficult to measure.

And thirdly, of course, however much the United States or the Europeans can do in our dialogue with the Chinese, it's quite obvious that the major change will have to come from within and from the people of China.

Now, as far as the evaluation is concerned, we carry out periodic evaluations. We have recently done one. There's a very mixed picture emerging. To summarize, social economic rights, there has been clearly progress. There has also been some progress on the cooperation with human rights mechanisms. We have had the signature of the two covenants and the ratification of one. We have had some visits of the High Commission on Human Rights, and I understand that Luis Abba [ph] is shortly going to China, so that's positive. We have had more difficulty getting the rapporteur for torture to be invited. He was invited several times, but then it didn't work out. We hope that he's going to be there shortly.

As I said before, we remain worried about the failure to ratify the ICCPR, and the refusal to join the optional protocol to the Convention against Torture. The death penalty was mentioned before. We're against the death penalty. We say so in our contacts with our American friends as well. As far as China is concerned, there has been some marginal improvement in the sense that the number of offenses punishable by death has been taken down, but it's still very, very high. And they have decided that they have banned the death penalty for juvenile offenders, which is a positive move. On the other hand, of course, there is a very high amount of executions, and there is one very serious problem we have. We have a total lack of transparency here. They don't tell us what is happening, and we think that's not right, and we can—we pressure them.

There are some other reforms we commend like at least the announced reform of the reeducation through labor system, but, again, this is counterbalanced by an increase in detentions. Just a few examples. I don't want to go too much into details.

Finally, what are we going to do in the future? Our evaluation comes to the conclusion that we want to continue the dialogue. We think it's worthwhile. Despite all of the difficulties to actually achieve tangible progress, we see it as a way to get our opinions across quite firmly with the Chinese. We see it as a way, a long-term investment, and we have some reasons to think that, at least, some of it has an impact on our Chinese interlocutors in the longer term, while obviously we are pressing for short-term improvements as much as we can.

But we have also told the Chinese quite clearly that the dialogue is not an end in itself. We want—we need results; otherwise, we'll have problems with the European Parliament. We'll have problems with our public opinion, and rightly so.

So, we want to tell them that we need some results and obviously this is going to be also at the agenda of the upcoming summit. Human rights are always on our agendas with most of the countries we are talking about. It is a major element in our policy.

We have a certain number of ideas to improve the dialogue. I'm not going to go into this now, but maybe Phillippe can say a few words.

Finally, I would also say we have seminars each year with academics, and hopefully, in the future, more with NGOs as well; getting the Chinese around the table, too, talk to them in a slightly more informal setting, which is sometimes more conducive to getting ideas across and messages. And there I must say there seems to be a willingness on the part of our Chinese partners to engage with us about that. I forgot to mention the fact that torture is obviously one of the things we always care very strongly about. Again, they accept to talk about it relatively openly, which is a new development, and we encourage that. Obviously, we feel that on the ground, there are still many, many problems.

So, all in all, to sum up, this is a difficult area. We work very hard on this. We invest in the long term with our Chinese partners. We think this is an important country. We want to get this country into the international system. We want it to develop peacefully as a growing democracy. We want it to respect human rights, and that is what we're going to continue to do, and I see in many respects we see eye to eye with our American friends about this. Thank you.

[The statement follows:]

**Prepared Statement of Jim Cloos
Director, General Secretariat of the Council of the European Union**

Mr. Chairman, Mr. Vice Chairman:

Thank you very much for the opportunity to participate in this symposium devoted to the transatlantic perspectives on relations with China. China is a major partner both for the EU and the U.S. We share a common interest in fully integrating this huge country into the international community and in seeing China develop into a stable and prosperous country governed by the rule of law and respecting human rights. Our methods may sometimes differ, but our objectives are alike.

I am very pleased to share this panel with Charles Tannock and Philippe van Amersfoort who both probably know far more about today's subject than I do. Having here representatives from the three major EU institutions will give you, I hope, a better overall understanding of the EU position.

My opening remarks will first of all address the way the EU has raised human rights concerns with China since 1989. I will then give a rough evaluation of our

human rights dialogue with China so far. Finally, I will try to look ahead at future developments.

Before doing so, let me make a brief reference to an issue that raises a lot of questions on both sides of the Atlantic, the possible lifting of the EU arms embargo. The EU has conducted an in-depth debate about this issue for the last few months, but has not yet come to a decision. It is fully aware of concerns expressed by the U.S. Administration and it obviously looks at those concerns with the attention they deserve. At the same time, many Europeans consider that having China lumped together with countries such as Burma/Myanmar, Zimbabwe or Sudan, does not really do justice to our relationship with this country. The final decision will depend on several factors, such as the state of human rights in China, the functioning of the EU Code of Conduct on arms exports, and overall strategic considerations.

There are many similarities in the way the EU and the U.S. have approached human rights questions with China. Both the EU and the U.S. imposed a series of sanctions on China following the Tiananmen Square massacre in 1989. Both started a human rights dialogue with China in 1995. And both progressively lifted most sanctions other than the arms embargo in the course of the last few years.

But there are also some differences. While the EU-China human rights dialogue has continued to function up to this day, with a brief exception in 1996, the U.S.-China dialogue was suspended after December 2002. The EU has also organized annual legal seminars bringing together practitioners and NGOs from the EU and China, thus creating a network of contacts broadening the official dialogue. Another difference concerns the position taken within the CHR in Geneva. While the EU has always made it clear that the dialogue does not exclude action within the UN structures, it de facto stopped introducing resolutions in the UN Commission on Human Rights in 1998. The U.S. tabled resolutions from 1999 to 2001, but they were all defeated by 'no action motions.'

In 2001, the EU defined eight benchmarks for its dialogue with China, which largely overlap with key areas of concern publicly and privately mentioned by the U.S.: (1) ratification and implementation of ICCPR and ICESCR; (2) cooperation with HR mechanisms; (3) compliance with minimal standards for application of the death penalty and statistics on executions and death sentences; (4) reform of 're-education through labor,' fair trial; (5) respect for the rights of prisoners and access, reply to individual cases of concern; (6) freedom of religion; (7) respect of the right to organize; (8) cultural rights and religious freedoms in Tibet and Xinjiang.

What results have we achieved so far? Before trying to answer that question, two methodological caveats: One, benchmarks tend to reach for the ideal situation. Once they are all 100% fulfilled, Tiananmen Square will have finally lived up to its name (the square of "heavenly peace"). Two, there is not necessarily a measurable link between "dialogue" and "progress on the ground"; modifications in approach and mentalities are subtle and slow-moving phenomena not captured by statistics. Three, while outside encouragement can help under certain conditions, eventually, sustainable change will have to come from within the country, by its own people.

The EU carries out periodic appraisals of the HR dialogues with third countries. The most recent evaluation concerning China has just been completed. The global picture emerging is a mixed one. Generally, the dialogue has been marked by increasing willingness to discuss difficult topics such as torture, legal reform and the situation in Tibet. However, concrete steps on the ground have been limited.

There is certainly overall progress on social and economic rights, despite regional discrepancies and concerns as regards freedom of association. There is also some progress towards cooperation with UN human rights mechanisms (signing of both Covenants, ratification of one, visits of High Commissioner of HR and some Special Rapporteurs and Chairs of Working Groups—although not yet the one on torture). The EU remains however worried about the failure as yet to ratify the ICCPR, and the refusal to join the Optional Protocol to the CAT. Concerning the death penalty, China has banned the death penalty for juvenile offenders; it has also reduced the number of offences punishable by death. This is welcome, but the EU is concerned about the very high number of executions still carried out and the lack of transparency in this field. A reform of the 're-education through labor' system has been launched, but this is counter-balanced by an increase in detentions. The proposal of a first Chinese Civil code is a step in the right direction. There seems to be a growing willingness to recognize the problem of torture and to start tackling it, but implementation appears to be slow. The situation regarding freedom of religion and belief and minority rights continues to be unsatisfactory.

Against this general background, the EU considers it useful to continue the dialogue. We understand that the U.S. is also keen on resuming its dialogue with China; we support that. The EU sees the dialogue very much as a long term investment, while of course constantly pressing for short term improvements as well. It

allows the EU to voice its concerns and obliges the Chinese administration to confront difficult questions. Stopping the dialogue could play into the hands of hardliners who do not believe that China should accept outside criticism on its human rights record. We need to think of ways to show our Chinese interlocutors that respect for human rights will strengthen China's image abroad and positive reforms within.

The dialogue cannot however be an end in itself. The question is how to improve it and make it more operational and eventually productive. We should avoid turning the dialogue sessions into a ritual of sterile exchanges between professional "dialoguers."

There are a certain number of ways to improve matters. I will just list a few of them, very briefly:

- Expand the dialogue and involve more officials from other Ministries than Foreign Affairs, such as the Ministry of Public Security, Justice, the Supreme People's Court, the NPC. We should enlarge our own delegation with experts in those fields;
- Focus the sessions on one or two issues at a time, accompanied by field visits and concrete assistance in legal reform, not only in the capital but also in provinces;
- Increase pressure for the release of individuals and improve the management of the lists of individuals;
- Establish a closer link between the official dialogue and the seminars. The latter have been useful in creating a network among academics and for circulating new ideas. The participation of wider circles including NGOs would be positive;
- Concerning the issue of resolutions at the CHR or the UN Third Committee is best addressed in the wider context of the debate on CHR reform. Clearly, the present situation in terms of country resolutions is not satisfactory, but there are no easy fixes. This is definitely an area where a close EU-U.S. dialogue will be crucially important.

I hope this very brief overview was helpful to you and your colleagues. I am at your disposal for any questions you may want to ask.

Chairman D'AMATO. Thank you very much for those very strong remarks. Maybe we can just go ahead with Mr. Amersfoort, and then after you finish, we'll open it up to questions.

**STATEMENT OF PHILIPPE VAN AMERSFOORT, ADMINISTRATOR
EUROPEAN COMMISSION DIRECTORATE GENERAL
FOR EXTERNAL RELATIONS
HUMAN RIGHTS AND DEMOCRATISATION UNIT**

Mr. AMERSFOORT. Thank you, Mr. Chair. Well, I'm in a very fortunate position to be the last speaker because what needed to be said has been said. And I'll be able to pick up on the brains of my predecessors to make a few comments.

The first thing I wanted to mention was that the promotion of human rights, democracy worldwide, beyond China, has become a very important aspect of the EU's foreign policy. They've become part of the EU's corporate image of our identity, and it has become a very fashionable image to compare the EU's soft power influence. But this is truly an important aspect of our foreign policy.

The second thing I wanted to mention as a scene setter maybe was that the enlargement of the EU to the new member states which have gone through a process of democratic transition and vigorous reform which has been an asset for the EU's human rights policy and particularly in relation with countries like China, which are, in a number of ways, facing similar challenges.

The other comment I wanted to make is that there is a very long list of EU instruments to promote human rights and democracy worldwide. The human rights dialogue that we have with China is one of these instruments, and I will get back to you on this point

if you want. But beyond this dialogue, there's a broad set of instruments that we are using to promote human rights and democracy.

One of these instruments, for instance, is the fact that whenever the EU concludes a trade and cooperation agreement with a third country, whenever we engage the negotiation of a framework agreements governing relations with this country, we have to include what we call a human rights clause in these agreements, a commitment by the EU and the third party to abide by a number of human rights provisions, to respect human rights. And this clause is suspensive, which means that in some cases, when we believe [inaudible] or would believe that they do not respect our commitment to human rights, we could suspend the implementation of the agreement.

In the case of China, what is interesting to mention is that we have a trade and cooperation agreement with China which dates back from 1985, which is what we call the first generation agreement, which does not include such a reference to human rights. What you may know is that the EU engages in the reflection about a possible negotiation of a new trade and cooperation agreement with China. And if we decided to move forward with such a negotiation, of course, there would be—there would need to be within such trade and cooperation agreements a commitment to human rights in the agreements.

Then, of course, human rights are an important element of what we call our political dialogue with China. You mentioned the upcoming EU-China Summit. Human rights will be on the agenda of the summit, as they are on the agenda of ministerial meetings, all kind of political meetings at the more junior level. This is what we call the mainstreaming of human rights in our political dialogue with several countries like China.

Then, of course, another way for the EU to pursue human rights objectives is the use that we try to make of U.N. multilateral fora, such as the Commission on Human Rights, and such as the U.N. GA Third Committee. And within this particular context, the EU is trying to approach issues like human rights in China in a coherent and cohesive manner.

Then another instrument which is very close to the heart of the Commission because we are in the driver's seat when it comes to the use of these instruments is technical cooperation, technical assistance. We are investing a lot of money in China to promote human rights, the rule of law, to strengthen civil society. We are spending a lot of money on cooperation programs in China. A few years ago, the EU set up in China a huge rule of law project, a cooperation project I mean to [inaudible] the rule of law in China that has become a flagship program, a very important aspect of our presence in China.

I want to emphasize the importance of this cooperation, because very often the Chinese—China is very keen to project a very positive image on the world scene, which is very keen to promote a better image; is very keen to avoid initiatives such as the tabling of resolutions in Geneva. And China does not very much care about what foreign countries do in terms of cooperation on the ground in China. And it is a paradox because many of these cooperation projects sometimes are very much more intrusive and likely to trig-

ger a change than the resolutions that we may want to table in Geneva or otherwise.

A few words on the dialogue. The human rights dialogue is another way to promote human rights in China. As was said, the EU attaches a lot of importance to this process. We value this process because it is a channel of communication, a platform for the EU to express concern, to seek information. More importantly, it is a way to expose Chinese decisionmakers to international standards, EU practices, and dialogue has become over time a way, a vehicle for the EU to extract concessions, to negotiate a few gestures or gifts which are being made sometimes.

Last but not least, this dialogue is also a way, as I mentioned, for the EU in particular, the Commission to identify priorities for possible projects to spend money on the promotion of human rights in China.

Of course, this dialogue can be a frustrating process, and EU partners would confirm that they do have some mixed feelings about this process. Someone once used the expression “controlled cynicism” to characterize the state of mind one has to adopt in order to take part in this process. But, of course, it is difficult to establish performance indicators for this process and to assess whether dialogue is useful in improving the human rights situation in China. And this is probably one of the reasons why the process is so frustrating.

The second reason why the process can be seen as a bit frustrating is that while China is engaged in a number of dialogues with many countries, many third countries—Norway, Switzerland, Australia, Canada, Brazil, many others—and the Chinese experts who take part in these dialogues have become professional dialoguers, ready to address any issue in a rather predictable manner.

Commissioner DREYER. Controlled cynics.

Mr. AMERSFOORT. And then maybe there is also misunderstanding about the whole purpose of the exercise, of what is this human rights dialogue. But it's clever on the Chinese side. China sees the dialogue as a way to avoid being stigmatized in Geneva, in the Commission on Human Rights, and sees the dialogue as a confinement mechanism, a way to avoid that human rights concern will spill over on other areas of the [inaudible] relationship.

Whereas, on our side, in a very naïve manner maybe, we see the dialogue as a way to trigger a change and to change sometimes crucial aspects of China's social and political system. And we have to understand that for the Chinese side, this diplomatic process, this dialogue is not a process that would commit the regime to deliver on any of these sensitive issues on which they are not prepared to change.

Voilà. Another reason why our dialogue can be a bit frustrating over time, and this is something which has been mentioned by Mr. Cloos in his presentation, and this is a difference between the EU and the U.S. approach to dialoguing with China. The EU's dialogue with China is a regular process, which takes place under each EU presidency, and sometimes we maybe lack a certain degree of certainty in the process. And we sometimes envy the U.S., the habit

of the U.S., to use the scheduling of their own dialogue as leverage to achieve results, which rewards progress.

[Inaudible] naturally, what I wanted to say in compliment to the very eloquent presentations made by my predecessor, and I will be very happy to take any questions.

[The statement follows:]

**Prepared Statement of Philippe van Amersfoort, Administrator
European Commission Directorate General for External Relations
Human Rights and Democratisation Unit**

Human Rights in China

The promotion of HR and democracy worldwide has become a very important aspect of the EU's foreign policy and of the EU's identity as a value-guided and rule-based community.

EU enlargement to new member states has been a great asset for the EU's human rights policy. The accession to the EU of countries which have gone through a process of democratic transition and past HR violations has given additional legitimacy and credibility to our policy and brought additional expertise in the conduct of processes such as the EU-China HR dialogue.

The EU is using a broad range of instruments to promote human rights in China:

1. Political Dialogue

Human rights are "mainstreamed" on the agenda of our political dialogue with China. The EU-China Summit that will take place this week, as do all ministerial meetings or regular meetings of the political dialogue at a more junior level address human rights concerns.

2. UN Human Rights Fora and Mechanisms

The EU has consistently made clear that its participation in a human rights dialogue with China was not conditional on EU member states abstaining from voicing their concerns about China's human rights record in fora such as the UN Commission on Human Rights or the UNGA Third Committee. The EU encourages greater cooperation from China with UN human rights special mechanisms, notably the visit of Special Rapporteurs and Working Groups.

3. Cooperation

The funding of technical cooperation projects is an important way for the EU to promote human rights in China. The EU has in recent years invested a significant amount of money in the setting up of cooperation projects such as a wide-scale Rule of Law programme; a projects aiming at promoting the rights of women and ethnic minorities in Yunnan province as well as a project seeking to promote village governance and democracy at the grass-roots level. A recent flagship project has been the setting up of a "Human Rights Small Projects Facility" in the Commission Delegation in Beijing, to quickly deliver support to small-scale civil society initiatives in the field of human rights.

The EU attaches a lot of importance to its Rule of Law and human rights cooperation programme in China, as initiatives in this field are potentially more intrusive and likely to trigger visible change than processes such as the human rights dialogue.

4. Human Rights Clause

Since the early 90s, all EU Trade and Cooperation Agreements (TCAs) with third countries need to include a standard "human rights" clause, a provision committing both parties to respect human rights. This clause is suspensive, which means that each side can suspend the implementation of the agreement (e.g. suspend development aid) if it believes that the other side does not respect its commitment to human rights. The EU's TCA with China, which dates back from 1985, does not include such a clause. The EU and China are currently studying the merits of negotiating a new TCA. Such an agreement would have to include a human rights clause.

5. The EU-China Human Rights Dialogue

Without repeating what has already been quite eloquently explained by Jim Cloos, I wish to emphasise that the EU-China human rights dialogue remains a valuable process:

—It is a channel of communication, a platform for the EU to express concern and seek information; it is a way to expose Chinese policymakers to international

HR standards and EU practices (our legal seminars are attended with great interest by Chinese academics and a wide range of people engaged in reforming the Chinese legal system);

—The dialogue has become over time a vehicle to negotiate concessions, to extract small gifts which the Chinese side usually prepares for each round (e.g. invitation of UN special rapporteurs, release of prisoners). EU Troika Ambassadors in Beijing are actually tasked to carry out demarches to the MFA in Beijing, a few weeks before each round of the dialogue, to flag the potential deliverables we look forward to;

—The dialogue is a way to identify priorities for future technical cooperation. Projects on the death penalty, on the promotion of ethnic minorities and many other concerns are discussed within that framework.

Of course, the EU-China human rights dialogue can be a frustrating process. Someone once used the—quite cynical—expression “controlled cynicism” to characterize the state of mind of those who take part in this process. It is difficult to establish performance indicators and to assess whether the dialogue is useful in improving the situation of human rights on the ground (the EU has adopted benchmarks in this respect). China has engaged in many HR dialogues with third countries (e.g. Norway, Switzerland, Australia, Canada, etc.) and Chinese experts taking part in these meetings have become professional dialoguers ready to address any issue in a rather predictable manner. China sees HR dialogue as a way to avoid being stigmatised at CHR sessions in Geneva, as a confinement mechanism to prevent HR concerns to spill over EU-China relations, a diplomatic process rather than a forum in which it would commit the country to changing any significant aspect of its social or political system. There are issues relating to the Party’s monopoly on power on which our interlocutors in the dialogue cannot deliver.

Another reason why our dialogue can be frustrating, and this is the difference between the U.S. and the EU approach to dialoguing on human rights with China, is that the EU has engaged in a regular dialogue, taking place every six months under each EU Presidency, whereas the U.S. hold ad hoc consultations when they believe it is useful, likely to trigger results or serve bilateral relations. One can claim that the merits of the EU approach are continuity, consistency and the willingness to generate positive change in the long-term. But this approach also makes the dialogue more predictable and sometimes difficult to avoid that it turns into a routine exercise. The challenge is to avoid engaging in a recitation of well-known positions heard six months ago. We maybe lack a certain degree of uncertainty in the process and sometimes envy the ability of the U.S. to use the scheduling of their dialogue as a leverage to achieve results or reward progress.

Panel IV: Discussion, Questions and Answers

Chairman D’AMATO. Thank you very much. I think we’re very impressed with the level of commitment across all the institutions represented here today to furthering human rights in China. The problem I guess is despite all these efforts, the track record appears to me to be so dismal. Let me ask you this: is there a—and certainly the Chinese would be glad to have a dialogue, and it doesn’t have any impact—the question is: is there another mechanism that one could use? Is there a—have you thought of a measurement system of some kind, given the half a dozen or a dozen critical things that are continually talked about, like torture, death penalty, or other measurable things that can be identified, and to try and develop some kind of a scorecard over time.

And the second question is: if there is no progress, are we prepared to do, to put sanctions on or use any other kind of measures that penalize the Chinese for this kind of lack of progress in basic human rights?

Mr. CLOOS. Well, thank you, Mr. Chairman, for that question.

Maybe my first remark is taking up something that Mr. Amersfoort said; that maybe we look a bit naïve sometimes in those issues. There is an element of truth in it. At the same time, I would point out that maybe after Helsinki in 1975, with the

U.S.S.R., we were naïve for about 20 years, and then the U.S.S.R. collapsed. I do not see China's collapse—but my point I want to make is that was what I meant by sowing long-term seeds, sowing seeds, trying to move things. Let's face it, China is undergoing huge changes. They have undergone huge changes economically, socially. People live better in China now than 20 years ago. I'm not an expert on China—but the average GDP in China has gone up from something like \$350 to \$900. It's very rapid.

So, the picture is not all bleak. There are things that work. The fact that they accept to talk about torture and all that.

Now, the second, more precise question you mentioned, are there measurable things. As I said before, not everything can be measured. Some things can be measured. And the benchmarks we were fixing were exactly to measure programs. And, if I look at the benchmarks very quickly. The first one is rapid implementation of the international covenant on civil and political rights, for instance. Well, that is something we can measure.

Chairman D'AMATO. Yes.

Mr. CLOOS. They have now promised us to set up a working group again, because they signed on to it a few years ago. They say it's very difficult to ratify. This is something. If they ratified this, if they announce this, for instance, on the 8th of December, I think it would be a major breakthrough.

Secondly, cooperation with human rights mechanisms. I mean, if they invite Mr. Van Borbon, the torture rapporteur, finally now for a meeting. That's something positive. We can measure it. We can read their laws. We can see what they do on the death penalty. There are many things you can check. The question of the right of prisoners, access to them; the way they reply to individual cases. Dr. Tannock was referring to a Tibetan case. Well, we have also at the level of the Council obviously made a recent demarche about this, and we are continuously making demarches and bringing up individual cases, but the response is not always as satisfactory as we would like it.

So, that really is the way we try to approach this.

As far as sanctions are concerned, it's obviously a tricky point. For the time being, we are trying to construct relations with China. We think it's an important partner. We do not start out reasoning in terms of sanctions, because that would mean we already, from the start say nothing will happen.

Incidentally, if you look at the Bush administration's public statements on China, they say that relations have never been as good as they are now. In many respects, I think that is an interesting statement.

Chairman D'AMATO. Very interesting.

Mr. CLOOS. We are trying to build a relationship with China. It is an important country, and, so, we would look at that country in a broad way. We try to advance human rights. We want to be tough with them on that. But we also look at the global picture. Thank you.

Chairman D'AMATO. Yes. Thank you very much. Did you have anything to add to that?

Mr. AMERSFOORT. No. I wouldn't want to give the feeling that my presentation gave a negative—well—

Chairman D'AMATO. No. It wouldn't suggest that at all.

Mr. AMERSFOORT. But, as Mr. Cloos said, there are a number of programs which are clearly there, and which we have recorded within the dialogue, and, of course, it's not very easy to establish a direct link between the dialogue and progress on the ground and to claim credit for what is happening. But there are things which happen, and, for instance, we are holding twice a year these EU-China human rights legal seminars, which are attended by a very wide range of Chinese academics, policymakers, and it's always very impressive to see these people taking notes, and you really have the feeling that what these people are listening and are trying to get the EU experience which is percolating through the system and influencing decisionmaking sometimes. So, as it was said, in the long run we believe it is a good investment.

Chairman D'AMATO. Yes. Well, thank you very much. We're certainly going to bring back to our Congress the structure that you in engage in on the periodicity, frequency of doing this kind of thing. Certainly, I think we could do more ourselves in this respect. Commissioner Mulloy.

Commissioner MULLOY. I believe it was Mr. Cloos who said that the EU at one point used to put these human rights things in its trade agreements.

Mr. CLOOS. Yes. Now, Mr. Amersfoort was saying that we have a system, Commissioner, where we have now decided that in every trade—every agreement, not only trade, general, and every agreement with third countries, we insist on including a human rights clause.

Commissioner MULLOY. Now, help me understand it. Chairman D'Amato was talking about sanctions for human rights violations. If they're trade sanctions, they're not permissible under the WTO, which is my understanding. Is that the way you understand it as well?

Mr. CLOOS. That depends. It's a complicated question.

Commissioner MULLOY. Yes. For the most part, they're not. So, then you get into what really could you do. I want to ask you about something else. Do you consider the ILO Core Labor Standards human rights? That is, freedom to organize, freedom to collectively bargain, eliminating forced and compulsory labor, effective abolition of child labor, and elimination of discrimination in respect to employment and occupation. These are the five ILO core labor standards. Do you consider those human rights, Mr. Cloos?

Mr. CLOOS. We certainly set great store by the ILO rules, and, for instance, if I can point out to the seventh benchmark we have, which is respect of the rights to organize generally speaking, for instance, the right to form trade unions. We object to the fact that the Chinese government, when they signed the International Covenant on Economic and Social Rights, that they had a reservation. I hope that my collaborator, Mrs. Hazelzet will correct me if I get the wrong article. I think they have a reservation to Article Eight on this, which is about the possibility for people to form free trade unions. We set score by this. This is for us part of a human right obviously, and we insist on this in our discussions. Actually, we have quite a serious debate within the EU concerning the WTO in

how far ILO rules should apply. This is a difficult debate, as you know.

Concerning the question of the human rights clause, but maybe there Mr. Amersfoort can be a bit more precise on that. We tried to introduce that into the various agreements. The human rights clause draws attention to the importance of human rights for us, for the importance for the relationship with that particular country of the human rights. The question is not necessarily to apply it on trade sanctions, but you could, for instance, suspend an agreement. You can always do that.

Commissioner MULLOY. Yes. Let me go just one step further. Mr. Lamey, when he was trade minister, and it was during the Clinton administration on our side, we worked to get these core labor standards entered into the new WTO round of trade negotiations.

Mr. CLOOS. Absolutely.

Commissioner MULLOY. That these should be included because the system we now have in place of export-led growth for all of these countries is not sustainable. So, you need to develop domestic demand, and part of it is building demand through laborers bargaining up their standard of living.

President Clinton at one time talked about putting core labor standards in trade agreements and then having them enforceable in the same way you would IPR. You violate the core labor standards; you're subject to trade penalties.

That is an area I think should be both talking about in moving ahead. I don't know whether this current administration will do that or not, on our side, but I think it's worth coming back and looking at those issues, because I think some of these are human rights, and we should be working together to move that dialogue forward. Sir, do you have any comment on that?

Mr. AMERSFOORT. I think it's a very good point, and I appreciate your view. We had a seminar with China on corporate social responsibility a few months ago, and there is a great deal of interest in China about labor issues. And one message we brought across to China was that the social tensions, the social troubles, unemployment, a number of the social frustrations which is expressing itself in China in the streets should be better channeled if there were in the country free labor organizations, if there were channels to express this concern.

Commissioner MULLOY. Yes. Good. Thank you both.

Chairman D'AMATO. Yes.

Commissioner DREYER. You don't happen to remember approximately what the number of political prisoners at that time. It used to be—

Mr. CLOOS. Sixty.

Commissioner DREYER. It used to be 72, I believe—

Mr. CLOOS. Yes. It's around 60 I think.

Commissioner DREYER. Around 60.

Mr. CLOOS. But, it should be zero.

Commissioner DREYER. Yes. Of course, But at least it's going in the right direction.

Mr. CLOOS. Sixty is better than 72.

Commissioner DREYER. Absolutely.

Mr. CLOOS. Fifty is better than 60.

Commissioner DREYER. "Hostage diplomacy." I'm wondering if you've heard this phrase.

Mr. CLOOS. Sorry.

Commissioner DREYER. "Hostage diplomacy." This is a term used by a friend of mine named Sydney Jones who's very active in human rights causes in the United States. She says that the Chinese practice amounts to hostage diplomacy, and that a high-ranking official will go to China and say, please release someone like Wei Jingsheng, and after wheedling and pleading and perhaps sacrificing his bargaining position on some other matters, the Chinese government will graciously release the person, the alleged offender. Then two weeks or so later, the person will be rearrested, or perhaps five other people—he stays free, but five more members of his alleged movement will be arrested. I wondered if you had had any experience with that. The Chinese government will give you some small victory in return for something else, and then take it back later.

Mr. CLOOS. I can't give you precise details, but maybe because I'm not familiar with them.

As far as we are concerned, I mean, we do have—we do look at individual cases. We try to bring them up when we meet with the Chinese. We give them lists. We ask for replies to them. And obviously, we are trying to follow what happens afterwards to them.

To be honest, this is not an area where we've been highly successful, if I may put it that way. I think that the U.S. side has been a bit more successful, but maybe you'll have to ask the question to the American Administration about how often this happened in detail. I am not familiar with those cases.

Commissioner DREYER. Just one sentence before Chairman D'Amato opens this up to questions. The statement that Secretary of State Colin Powell made is that U.S.-China relations have never been better. I have heard that many, many times, and it usually happens right before elections. What it generally means is that we and China are not yelling at each other today. But it normally also means that nothing has recently happened—for example, we haven't bombed their embassy and or they haven't seized one of our airplanes or something like that. So, I would leave you with the controlled cynicism. I love that phrase, by the way.

Mr. CLOOS. I will not comment on that.

Open Microphone

Chairman D'AMATO. We have time for two questions from the audience. One in the back there. The young woman.

Ms. SORENSEN. Yes. Hello. My name is June Sorensen. I'm working in the International Confederation of Free Trade Unions, and I actually had a question now on a former panel, now that we've brought up trade union rights. On a former panel, one of the speakers talked about businesses themselves bringing the social, the corporate spirit that they were using in Europe to China. And I was thinking that when we talk about promoting human rights and trying to have them come from the Chinese themselves, would it not perhaps be an option for decisionmakers in Europe and in the U.S. to perhaps lean on their own firms—

Chairman D'AMATO. Businesses?

Ms. SORENSEN. And corporations when they go to China so that instead of them voluntarily perhaps adopting guidelines or adopting or transferring their social responsibility to China, which is not always the case, far from that, would that be a possibility or an option?

Chairman D'AMATO. Let's elaborate. What was said this morning was that at firms, western firms often bring their own standards to China, which elevates human rights in China and that that is a salutary development. I don't know how much of that is accurate, but I think that's the question—

Commissioner MULLOY. And she's suggesting that there be a code of conduct actually put on those firms—

Chairman D'AMATO. Yes.

Commissioner MULLOY. So that they not just do it voluntarily. But they'd be required by their governments to do it.

Chairman D'AMATO. Right. All right. What do you think about that?

Mr. CLOOS. It's not a very easy question if you know the American system, the European system of enterprises where most of the time the view is that enterprises should respect the law, and within the law they should try to make profit, and they should obviously behave correctly.

The question of imposing on them how exactly they have to handle this is a tricky one. Morally, definitely you're right. In terms of coming from a government official, I am slightly reluctant to go too far down this road, and I think it's more of a question actually for my Commission colleague, if I may say so.

I think normally when you reason in terms of a code of conduct among enterprises, you would expect the enterprises to do that. Some do it actually, and we would certainly encourage that. I'd certainly impose it via Brussels. You would hear an outcry that would go right to the Pacific from here, so we have to be careful.

Chairman D'AMATO. Well, you could do something like find your most susceptible CEOs, who are really into doing this, to form a group that says, hey, we should change our culture. Something like that to be encouraged by the Commission. Is that right?

Mr. AMERSFOORT. Maybe just one comment. It is actually a very tricky question. We've been told in China that when foreign companies try to impose their own standards on, for instance, Chinese subcontractors, these people have to abide to a higher set of standards which have a cost, while these foreign firms keep pressing down the prices. So, these Chinese subcontractors find themselves in a situation where they have to abide to higher standards, to meet standards of big companies—I won't mention any names—but, while at the same time continue to delivering products at a low price. And this puts these Chinese subcontractors in a very difficult situation.

So, good labor practices, good CSS standards, is not an easy way to promote.

Chairman D'AMATO. By the way, we think you're on to something. It's a great idea, but we don't think that it can be imposed, but we could create a new culture among forward leaning businessmen that could help to develop a different paradigm here.

Commissioner MULLOY. Well, I just want to comment. Certainly, with regard to South Africa, we did impose by statute the Sullivan Principles on our companies, and I believe you did the same to your companies who operated in South Africa. Now, you can say China is quite a different matter, but there is a precedent for doing this.

Mr. CLOOS. Mr. Chairman, may I just add one word on this?

Chairman D'AMATO. Yes.

Mr. CLOOS. The very fact that we got China into the WTO, for instance, I mean will change matters over time we think. If you do trade, if you have mutual investment and all that, we very much hope that there will be an effect. It has been shown in history that when people open up economically speaking that sooner or later they open up socially and also politically.

Open Microphone

Chairman D'AMATO. Well, that may be true, but, it seems to me, the Chinese are trying to disprove that. We have one more question. Yes.

Ms. MARTHOZ. Thank you. My name is Jean-Paul Marthoz. I'm the international media director for Human Rights Watch.

I have a question to the EU officials. When we speak about China and human rights, we tend to focus on human rights [inaudible] in China, but there's another angle to the story, which is the international policies of China that have an impact on human rights outside of China. If we take the situation in Darfur in Sudan, for example, or in Cuba, China has not been a very positive actor in terms of human rights. So, how does the European Union engage China on these issues knowing that it's—I refer to what President Chirac said in Beijing—that he [inaudible] to China in his concept for multi-polarity. Doesn't it mean that there might be a danger that Europe, or some people in Europe, because there's that different position on this, might consider that in order to conceive this world based on multi-polarity that you need to be a bit softer on human rights issues, not only internally in China, but also in the international policies of China outside, which have implications for the rest of the world when we see what's happening in Darfur and the difficulty we have to get strong resolutions and action on Darfur, for example.

Mr. CLOOS. Well, this is a question we could spend the whole afternoon with, and we should have another session at some stage. It's a difficult question obviously because politics and international politics is complicated. You always have a tension between applying your principles and realpolitik and the real life. That's a fact of life. And when you're in government, you have to live with that. You try to remain as true as possible to your principles while not creating other problems. So, it's a very valid question.

Incidentally, you could also say the question of the North Korean refugees, for instance, which we regularly bring up with the Chinese, but that is more internal, of course. I think it's a very good question. Again, I would say that in our relations with the Chinese obviously we talk about issues. We talk about international politics, and we say when we disagree with something. The whole question we are going to see on the panel which Kofi Annan set up on the change, challenge and change and all that coming out in two days,

I would not be surprised if there was something about the responsibility to protect.

Now, we know that the Chinese are adamantly against that idea. I'm not quite sure what the U.S. reaction will be. We'll see. But we know that there is a strict understanding of sovereignty. And okay. We'll have to talk. We'll have to struggle on. We'll have to try to promote our ideas as far as Sudan is concerned.

We tried to work together with the United States, with the African Union, and with the U.N. It's very difficult, and we are certainly trying to move things forward, but, of course, China is a member of the Security Council, and we'll have to see how far we can go.

Chairman D'AMATO. Thank you very much, and I want to thank our panelists for a very, very interesting discussion. And we'll be providing a report to the Congress with this transcript, and we'll be back in touch with you shortly. Thank you very much, and this concludes this afternoon's session.

[Whereupon, at 5:00 p.m., the meeting was concluded.]

**Prepared Statement of Françoise Lemoine
Senior Economist, Centre D'Etudes Prospectives
Et D'Informations Internationales (CEPII), Paris, France**

***Trends in China-EU Economic Relations
Some Facts and Figures***

1. Trade and Economic Relations Between the EU and China

EU-China trade is driven by the dynamism of China's international trade

Over the last 25 years, EU trade with China increased at an accelerated pace. From 1978 to 2002, EU-15 exports to China grew by 12% a year and EU-15 imports from China at 18% a year. This pace was much faster than that of total EU trade (+6% a year), and China accounted for an increasing share of EU-15 trade: its share steadily increased from 1% to 3.3% in EU-15 exports (excluding intra-EU trade); and from 0.6% to 7.5% in EU-15 imports (Figure 1). In China's trade, the share of the EU-15 increased in the eighties but has tended to decrease since the beginning of the nineties (Figure 2). However, due to its economic and commercial size, the EU remains a much more important partner for China than China is for the EU. In 2002, the EU accounted for 18% of China's exports and for 13% of China's imports.

The intensity of EU-China Trade is relatively low

An indicator of trade intensity between the EU and China can be calculated, which eliminates the effect of this asymmetry in their commercial sizes. The indicator measures the ratio between the weight of bilateral trade flows in the partners' trade and their respective weights in world trade. An indicator above one corresponds to a high trade intensity.

The indicators of China's trade intensity with the EU-15 compared to its trade intensity with Japan and the U.S., over the 1978-2002 period, suggest two observations (Figure 3 and Figure 4):

First, China's trade intensity with the EU is considerably lower than with Japan and is also slightly lower than with the U.S. EU trade is less oriented towards China than Japan's and U.S. trade. This pattern of China's bilateral trade intensity confirms that geography matters and that geographic proximity between partners is an important factor influencing trade intensity. EU trade intensity with other East Asian industrializing countries is of the same order of magnitude as with China.

Second, there is a strong asymmetry in China's export intensity and China's import intensity in its trade with the EU. China's export intensity to the EU has increased significantly since the mid-eighties and it stood around one in 2002, indicating that the importance of the EU-15 in China's exports is in line with the respective importance of the two partners in world trade. By contrast China's import intensity from the EU-15 has remained below one (around 0.7) since the beginning of the eighties, indicating that the share of the EU-15 in China's imports has been systematically well below the level that would be expected if these imports had been proportional to the respective weights of the two partners in world trade.

European FDI in China is still relatively limited

According to Chinese statistics, EU countries invested more than \$32 bn in China from 1991 to 2002, representing about 7.7% of total FDI inflows to China over the period. EU cumulative investment is on a par with Taiwanese investment (7.8%), slightly behind Japanese investment (7.9%) and U.S. investment (8.8%) (Figure 5). EU investment flows increased dramatically in the late nineties and have tended to decline since 2001. This trend has reduced the relative contribution of European firms to FDI in China (Figure 6).

It is well-known that the Chinese data overestimates the amount of FDI inflows, especially inflows from Hong Kong (roundtripping), and thus presents a distorted picture of the geographic origin of investment flows.

The data provided by home countries confirms that Chinese figures tend to overstate FDI inflows (Table 1). The geographic pattern of OECD countries' outward investment also highlights that European countries, as well as the U, direct a still relatively small share of their investment abroad to China. In 2001, China accounted for less than 1% of the outward investment stock of most European countries. Over the period 1996-2001, Germany directed to China 1.3% of its outward FDI, the UK 0.7%, Italy 0.8% and France 0.3%. This reflects the fact that most of their FDI is concentrated within OECD, and that their FDI in developing Asian economies is still marginal.

The EU-15 records large structural trade deficits with China

Although the size of trade imbalances differs depending on the sources of trade data, there is evidence that since the late nineties China's trade surpluses have become larger (Table 2). Part of the inconsistencies in bilateral trade statistics comes from transit trade through Hong Kong. But taking into account EU-15 trade with Hong Kong leaves the EU-15 with still much larger trade deficits than those recorded by China's statistics.

2. Factors Underlying EU-China Economic Relations*Both the EU-15 and China are involved in a process of regional integration*

The process of economic integration is much more institutionalized in Europe. In Asia, this process is driven by the strategies of industrial firms which have built up production and trade networks across countries.

China's and Europe's trade flows are concentrated in their geographic area. Intra-EU trade makes more than 60% of total EU trade. China is increasingly dependant on East Asia for its supplies: more than 60% of China's imports come from East Asia. But China's exports are much less dependant on Asia, which receives only 35% of its total exports.

China's exports to the EU are driven by the reorganization of production in Asia which has followed China's opening up

In the nineties, China has become a production and export base for the manufacturing firms of the developed Asian economies (Japan, South Korea, Taiwan, Hong Kong). Assembling and processing activities (operations based on processing and assembling imported inputs) have become the most important and dynamic component of China's exports (Table 3) and most of these activities are carried out by foreign subsidiaries located in China.

More than half of China's exports to the EU-15 results from these international processing operations, which are responsible for China's trade surplus with the EU. Remarkably, almost all exports of "Office machinery and computers," and of "Telecommunication equipment," which are the most important items in China's exports to the EU, are the result of such activities (Table 4).

The reorganisation of production within in Asia is thus a major factor behind the rapid increase of China's exports. Since the end of the nineties, China's exports of electrical and electronic products to the EU have increased at the expense of exports by the industrialised Asian countries, reflecting the fact that the final stages of production of these products have migrated to China (Figure 7).

EU exports are driven by China's domestic demand

China imports stem from two different types of demand: the import demand of outward oriented industries on the one hand, the demand of imports for the domestic market on the other hand (Figure 8). In 2002, goods imported for processing and export accounted for about 40% of China's imports. As mentioned above, Asian countries are the major suppliers of this type of imports. China's imports for the domestic market still accounted for less than half of China's imports in 2002, but they have been increasing rapidly since the late nineties, thanks to cuts in tariff rates and to China's strong domestic demand. Most EU exports to China are aimed at the domestic market (60% in 2002). The EU has remained the biggest supplier of goods for China's domestic demand, accounting for 18% of these "ordinary" imports, ahead of Japan (14%) and the U.S. (11%) (Table 3). However, its share in these imports for the domestic market has tended to decrease since 1993 (when it stood at 22%).

The EU thus holds strong position in China's imports of capital goods used to expand and modernize its domestic industrial capacities. In 2002, almost half of machinery, of electrical machinery, and of motor vehicles that China imported for its domestic use was coming from the EU-15 (Table 5). The EU is thus in good position to benefit from the strong domestic demand associated with China's high economic growth and investment. However as barriers to entry in the Chinese market are lowered, due to China's import liberalisation policy, the competition between the foreign suppliers tends to intensify.

3. Prospects*Strong complementarities*

China's rapid economic growth fuels its demand for capital goods and technologies. Imports of equipment for energy production and infrastructure modernization, of transport equipment, etc. are expected to remain strong. The rise of living standard and the emergence of a category of population with a relatively high level of income are also increasing China's demand for up-market consumption goods.

New trends for FDI

FDI has contributed to support export flows to China. This can be explained by the fact that most FDI (62%), has been directed to the manufacturing sector, to supply either domestic demand or export-oriented industries. Foreign-invested firms thus play an important part in China's trade with Europe, as with other major partners (Table 6). Half of China's trade with the EU is carried out by foreign firm subsidiaries in China. The role of fully foreign owned firms is increasing at the expense of joint ventures.

China's entry into the WTO has enlarged opportunities for FDI in services, which should attract a growing share of capital inflows. As FDI in services was restricted, it received only 15% of cumulated FDI in China. Taking into account that, at world level, more than half of FDI is directed to the services sector, the potential for FDI in China's services sector appears to be huge. However FDI in services is likely to be less powerful in driving exports than FDI in manufacturing industry has been.

China's competitiveness in EU markets

China holds large shares of the EU-15 import market in a number of products (leather, domestic electrical appliances, consumer electronics, etc.) (Table 7). However, China's penetration in the EU market is still relatively low compared to its penetration in the U.S. market. One will play in favour of China's exports to the EU: the phasing out of IMF quota on January 1, 2005, which should enlarge China's market shares in textile products, at the expense of other EU suppliers (North Africa, Eastern Europe).

But other factors may slow down China's exports, among which, the new EU General System of Preference to be implemented in 2006-2008. China is up to now the EU partner which benefits the most from the present GSP: it accounts for one-third of imports within the GSP. But China, which has already taken large market shares in a number of products, will draw less benefit from the new GSP framework.

The increase of China's exports and of its trade surplus may induce the EU to use trade policy instrument to slow down these trends. In June a report on China's economy by the European Commission concluded that China had a long way to go to a market economy. By denying China the status of a market economy, the Commission maintains the present system of antidumping actions against China, which makes it much easier to prove unfair trade practice than against market economies.

EU-China trade in high-technology products

China's trade in high-tech products has increased rapidly over the last few years. According to OECD studies, high-tech products rose from 10% to 24% of China's manufactured exports from 1992 to 2002. According to the CEPII studies which use a narrower definition of high-tech products (according to which, their share increased from 11% to 15% of China's imports and from 7% to 13% of its exports over the 1997-2002 period), Europe plays a relatively small part in China's trade in high-technology products. Europe accounted for only 11% of China's high-tech imports and for 15% of its high tech-exports (Table 8). Asian countries account for the bulk of China's high-tech trade (70% of its imports and 56% of its exports in 2002), thanks to the segmentation of production processes which is taking place between China and its neighbors in electrical and electronic industries, as evidenced by the importance of trade in parts and components.

The high-tech content of China's imports from the EU (i.e. the weight of high-tech products in its imports) is below the average high-tech content of China's imports. High-technology thus may be a relatively weak link in EU-China trade. As high-tech products have been the most dynamic component of China's imports over the past few years, this weakness in EU exports may explain why they have increased at a relatively slow pace.

Figures

Figure 1 - Share of China in the EU-15 Foreign Trade, 1978-2002

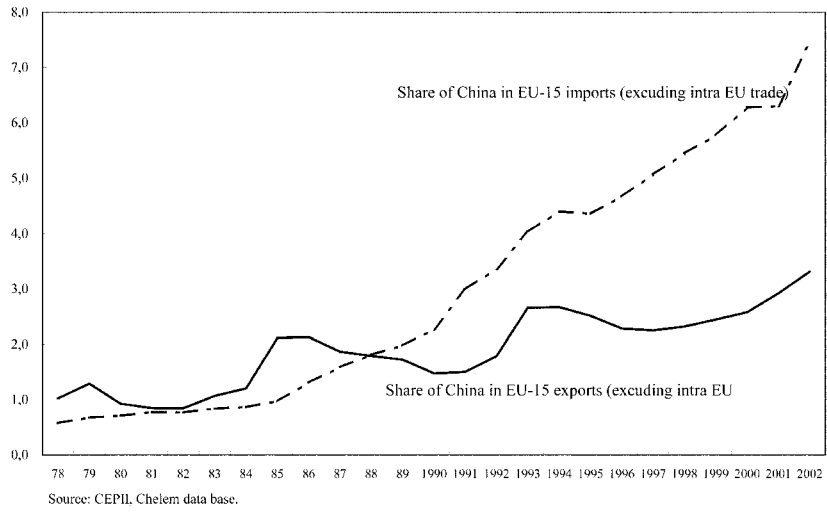


Figure 2 - Share of the EU-15 in China's Foreign Trade, 1978-2002

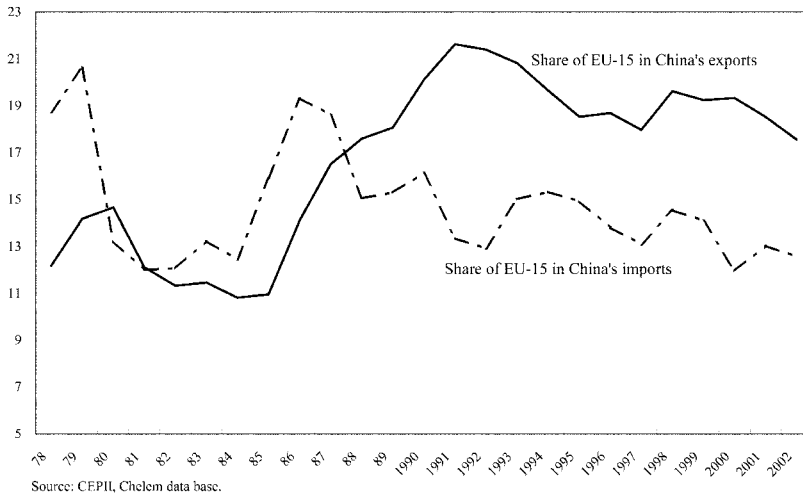


Figure 3 - China's Export Intensity by Major Partners, 1978-2002

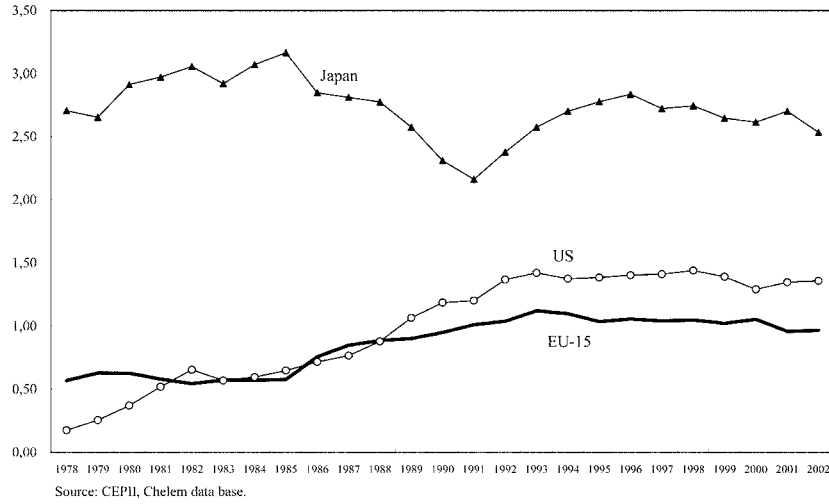
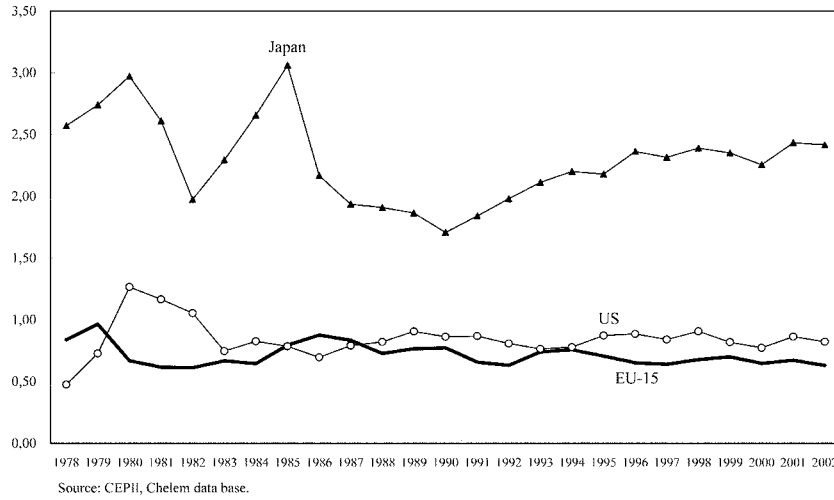


Figure 4 - China's Import Intensity by Major Partners, 1978-2002



**Figure 5 - FDI in China by Country of Origin
(Cumulative Flows, 1991-2002)**

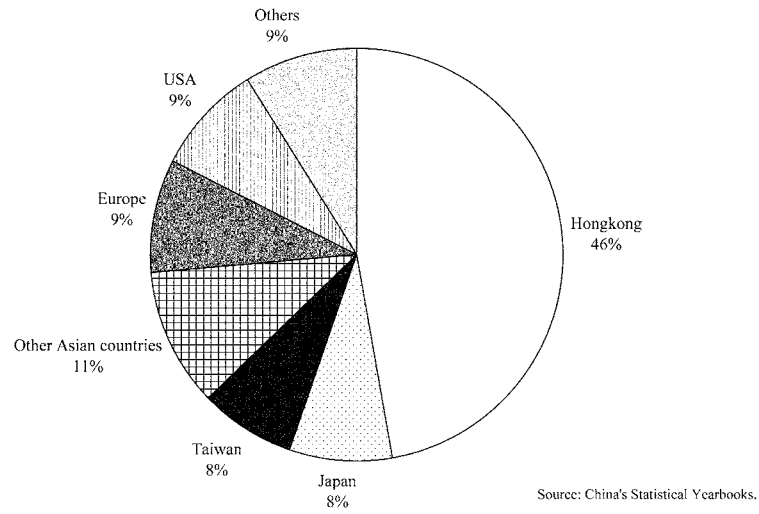


Figure 6 - EU FDI in China, 1991-2002

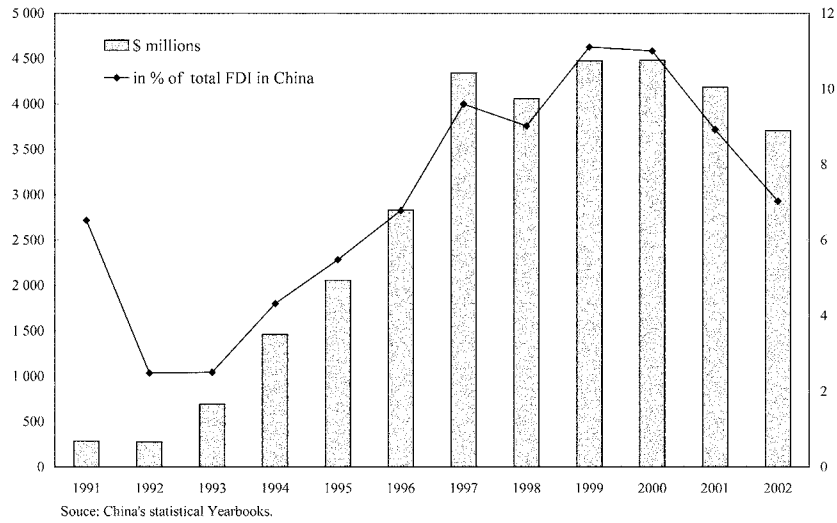


Figure 7 – EU-15 Imports from East-Asia, 1980-2002 (in million US \$)

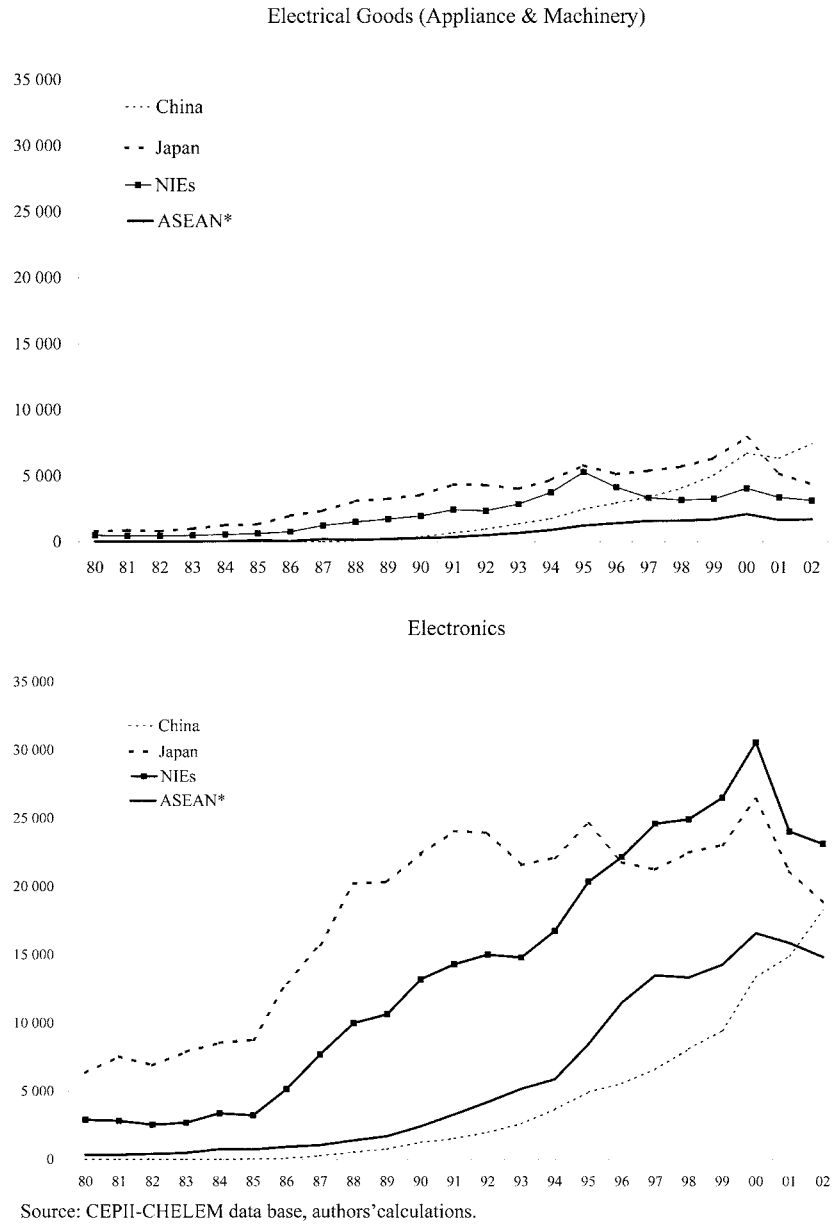
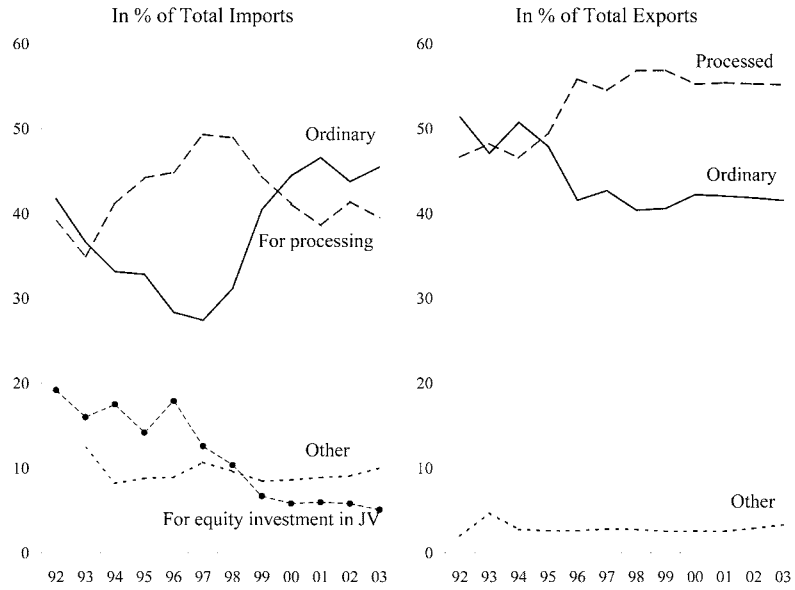


Figure 8 – Breakdown of China's Trade by Customs Regimes, 1992-2003

Source: China's Customs Statistics, author's calculations.

Tables

Table 1 - FDI in China According to Reporting Countries (US \$ billion)

	Chinese statistics (A)	Partner statistics (B)
US	32	11
Japan	30	11
South Korea	13	4
Germany	7	5
France	5	2
UK	9	2
Hongkong	177	122
Taiwan	29	34

(A) Cumulated flows 1990-2002 ; (B) Stocks in 2000 or 2001.

Sources: OCDE, Annuaire des Statistiques d'Investissement Direct International, 2002; China Statistical Yearbook, 2002; Hongkong Annual Digest of Statistics, 2002; Banque de France: Balance des paiements, 2002.

Table 2 - UE-China Trade According to Reporting Countries (US\$ million)

EU Trade with China according to EU statistics								
	1995	1996	1997	1998	1999	2000	2001	2002
EU-15 exports	19 237	18 384	18 537	19 235	20 639	23 282	26 909	31 949
EU-15 imports	32 333	35 436	39 972	44 012	48 609	59 354	63 575	72 530
Balance	-13 096	-17 052	-21 435	-24 777	-27 970	-36 072	-36 666	-40 580
Exports/Imports	0.59	0.52	0.46	0.44	0.42	0.39	0.42	0.44

China's Trade with the EU-15 according to China's Customs statistics								
	1995	1996	1997	1998	1999	2000	2001	2002
China's exports	19 258	19 868	23 871	28 162	30 245	38 230	40 891	48 211
China's imports	21 313	19 883	19 205	20 731	25 466	30 847	35 721	38 543
Balance	-2 055	-15	4 666	7 431	4 779	7 383	5 170	9 668
Exports/Imports	0.90	1.00	1.24	1.36	1.19	1.24	1.14	1.25

Table 3 - Breakdown of China's Trade by Main Partner and Customs Regimes in 2002 (in % of total trade and billion US \$)

Imports	World	4 Dragons*	Japan	EU 15	USA	ROW
Total Imports	100	29	18	13	9	31
Ordinary imports	44	8	6	8	5	16
Imports for processing	41	17	8	2	2	11
Other custom regimes	15	3	3	3	2	4

Exports	World	4 Dragons*	Japan	EU 15	USA	ROW
Total Exports regimes	100	27	15	15	21	22
Ordinary Exports	42	8	6	7	7	14
Processed Exports	55	18	9	8	14	7
Other customs regimes	3	1	0	0	1	1

Trade Balance	World	4 Dragons*	Japan	EU 15	USA	ROW
Total Trade	30.4	3.2	-5.0	9.7	42.7	-20.2
Ordinary trade	7.1	3.1	1.1	-3.1	6.7	-0.8
Processing trade	57.7	7.2	3.1	19.6	39.9	-12.1
Other customs regimes	-34.4	-7.2	-9.3	-6.8	-4.0	-7.2

Source: China's Customs Statistics, author's calculations.
 * Hongkong, South-Korea, Singapore, Taiwan.

Table 4 - China's Exports to the EU-15 in 2002 (in %)

ISIC	Commodity breakdown	Of which: Processed exports
Total manufacturing	100.0	55.2
Office machinery & computers	13.9	13.2
Radio, TV & communication equipment	12.7	11.8
Furniture; manufacturing n.e.c.	9.6	6.0
Machinery	9.3	4.4
Wearing apparel	8.8	1.8
Chemicals & chemical products	6.3	1.3
Electrical machinery	6.0	3.4
Textiles	5.5	0.8
Leather	5.4	2.2
Metal products	5.0	1.5
Rubber & plastic	3.2	1.9
Medical, precision & optical instruments	2.7	1.9
Other transport equipment	2.3	2.0
Food products & beverages	1.9	0.7
Motor vehicles, trailers & semi-trailers	1.8	1.4
Non-metallic mineral products	1.6	0.2
Basic metals	1.4	0.2
Wood & of products	1.2	0.2
Coke, refined petroleum products	0.8	0.0
Publishing, printing & recorded media	0.3	0.3
Pulp, paper & paper products	0.2	0.1
Tobacco products	0.0	0.0
Recycling	0.0	0.0

Products are ranked according to their share in China's exports, descending order.
Source: China's Customs Statistics.

Table 5 - China's Imports From the EU-15 in 2002

ISIC	Breakdown of China's Manufactured Imports from the EU	Of which Imports for the Domestic Market (Ordinary Imports)	EU share in China's Imports for the Domestic Market
Machinery	30,8	18,6	45
Chemicals & chemical products	13,0	7,8	14
Motor vehicles, trailers & semi-trailers	8,4	6,3	47
Radio, TV & communication equipment	8,3	5,4	14
Electrical machinery	7,9	5,9	44
Medical, precision & optical instruments	6,0	4,1	33
Basic metals	5,4	3,8	11
Other transport equipment	3,0	1,7	19
Office machinery & computers	2,5	1,7	12
Metal products	2,5	1,7	36
Pulp, paper & paper products	2,4	1,5	15
Textiles	1,5	0,5	29
Rubber & plastic	1,4	0,9	23
Food products & beverages	1,3	0,9	8
Publishing, printing & reproduction	1,2	1,0	51
Leather	1,2	0,2	39
Non-metallic mineral products	1,0	0,6	22
Furniture; manufacturing n.e.c.	0,7	0,5	45
Wood & of products	0,7	0,4	19
Wearing apparel	0,3	0,1	45
Coke, refined petroleum prod. & nuclear fuel	0,3	0,2	1
Recycling	0,2	0,2	30
Total, manufactured products	100,0	64,0	22

Source: China's Customs Statistics, author's calculation.

Table 6 - Foreign Invested Firms in China's Foreign Trade, 2002

In % of trade flows	World	EU-15	USA	Japan
China's total exports	100	100	100	100
Foreign-invested firms' exports, of which	52	50	58	62
Joint-Ventures	23	21	21	30
Wholly-foreign owned firms	30	28	37	32
China's total imports	100	100	100	100
Foreign-invested firms' imports, of which	54	49	48	67
Joint-Ventures	23	31	21	30
Wholly-foreign owned firms	31	18	27	37

Source: China's Customs Statistics, author's calculations.

Table 7 - Major EU-15 Imports from China (in %)

	Breakdown of EU Imports from China*	Share of China in EU Imports
Total	100,0	7,5
Computer equipment	12,7	16,3
Miscellaneous manuf. articles	10,7	31,4
Leather	7,7	26,5
Electrical apparatus	6,9	15,0
Clothing	6,7	16,5
Telecommunications equipment	6,0	17,7
Miscellaneous hardware	5,2	15,1
Consumer electronics	4,6	20,5
Knitwear	4,2	13,5
Domestic electrical appliances	3,2	35,4
Plastic articles	2,7	10,9
Optics	2,7	22,6
Furniture	2,2	12,7
Carpets	1,9	19,2
Electrical equipment	1,7	15,7
Yarns fabrics	1,4	8,6
Basic organic chemicals	1,4	4,1
Precision instruments	1,1	3,6
Engines	1,1	2,8
Clockmaking	1,1	19,3

*Products making more than 1% in EU imports from China.
Source: CEPII, Chelem Data base.

Table 8 - Breakdown of China's Trade in High-Technology Products by Production Stages and Major Zones, 2002

Imports	Asia-Oceania	Western Europe	America	Others	World
Semi-Finished Products	3	1	1	0	5
Parts & Components	40	5	6	1	52
Capital Goods	27	5	8	1	42
Consumption Goods	0	0	0	0	1
Total	70	11	15	3	100
Exports	Asia-Oceania	Western Europe	America	Others	World
Semi-Finished Products	5	2	2	1	9
Parts & Components	33	5	8	1	47
Capital Goods	17	8	14	2	41
Consumption Goods	1	1	1	0	3
Total	56	15	25	5	100

Source: China's Customs Statistics, author's calculations

The classification of high-tech product derives from a joint list elaborated by the OECD and Eurostat. It includes 252 high-technology products identified at the six-digit level of the HS classification. See Fontagné, L., Freudenberg, M. & Ünal-Kesenci, D. (1999). Trade in technology and quality ladders: where do EU countries stand?, International Journal of Development Planning Literature, 14(4), October-December, 561-582.

**Prepared Statement of Kay Möller
Senior Research Associate, Asia Unit
German Institute for International and Security Affairs, Berlin, Germany**

Perspectives on EU-China Security Relations, the Arms Embargo, and Taiwan

EU-China Security Relations

Security has been an issue in EU-China meetings and summits as well as in respective meetings between the PRC and individual EU member states. As a matter of principle, the European side since 2003 has designated Peking as a “strategic partner” who shares European interests on many international issues, and individual European politicians have adopted China’s vision of a multipolar world order. At the same time, the PRC has identified the EU as a partner who much as itself ‘is opposed to the control of the world by military means.’

In more concrete terms, given the lack of Peking’s global reach and ongoing problems with Europe’s Common Foreign and Security Policy, neither China nor the EU have been able to live up to such claims to any meaningful extent. There have been no attempts so far, for example, by either the European or the Asian side to turn Asia-Europe meetings (Asem) into a tool of multipolarity. The EU has not adopted common positions on issues such as U.S. missile defence that Peking views as being directed against itself, or the invasion of Iraq that the PRC opposed as a matter of principle (at the same time, Peking adopted a lower profile in the UN Security Council on the invasion and its aftermath than did France). Significantly, in its December 2003 security strategy document, Europe committed itself to the very principle of intervention that China views as illegitimate and that Peking interprets as a potential challenge, given the close relationship between EU and Nato.

In the absence of any significant European military presence in the Far East (i.e. mostly French deployments in the South Pacific and the UK presence on Diego Garcia), and given the EU’s failure to play an important security role in contexts such as the North Korean nuclear problem, security dialogues with China have not evolved far beyond an affirmation of general principles and exchanges of information (e.g. by the PRC side on North Korea and by the European side on Afghanistan). Neither have European arms exports to the Far East (constituting close to one third of all weapons exports to the region during the 1990s) and military-to-military contacts designed to stimulate such deals provided the EU or member states with a more comprehensive strategic perspective. Europe’s interest in East Asia remains basically commercial, and Europe’s greater readiness, when compared with the U.S., to let Peking participate in sensitive technologies such as the Galileo navigation system, reflects both the commercial imperative and a more benevolent view of China as a rising military power (under American pressure, the EU has since made provisions to keep the PRC out of certain potentially military aspects of the Galileo project).

The Arms Embargo

The EC’s 1989 embargo on weapons exports to China is not specific, and interpretation has been left to member states some of which continued their dual use exports whereas others felt obliged to fulfill contracts concluded prior to the Tiananmen massacre. However, according to a 1998 American assessment, European arms exports had probably constituted less than 3 percent of the PRC’s total imports during the decade (U.S.: 6.6 percent).

Since 1998, the EU’s (legally non-binding) Code of Conduct on worldwide arms exports has listed the following criteria for the issuing of export licences: (1) respect of international obligations by member states, which in the case of the PRC would include the arms embargo, (2) human rights situation in the receiving country, (3) domestic security situation in the receiving country, (4) maintenance of regional peace, security, and stability, (5) national security of member states as well as friendly or allied countries, (6) international behaviour of the receiving states (terrorism, alliances, respect for international law), (7) risk of diversion or reexport, (8) military spending in relation to social expenses. According to the December 2003 annual implementation report, 287 licences had been issued the previous year (of which 203 in the UK), and only 17 applications had been turned down, most of which by reference to criteria (4) and (1). Due to its political rather than legal character, implementation of the Code of Conduct has thus been subject to national policies and has never been stricter than national export laws the scope of which varies widely (in 1998 and 2000, France, the UK, Germany, Italy, Spain, and Sweden furthermore signed a “letter of intent” and a “common framework,” respectively, for transnational projects. In 1995, the EU issued a legally binding ordinance on dual use exports.).

Whereas a mere lifting of the 1989 embargo would leave criteria (2) to (8) of the Code of Conduct unaffected, a consensus appears to be emerging that the latter needs to be strengthened as a precondition to ending the embargo (supposing that China is aware of this likelihood, one could alternatively interpret its continued lobbying as the expression of an interest in symbolic policies or as a diversionary tactics to secure European concessions on other issues such as trade; see below). At the same time, suggestions to ask China to give certain guarantees or make gestures of goodwill would seem to be rather unrealistic given the EU's hitherto low profile on human rights in China and its irrelevance to the Taiwan Strait situation (in May 2004, Chinese Prime Minister Wen Jiabao explicitly turned down European proposals to link the lifting of the embargo to the PRC's ratification of the UN Covenant on Civil and Political Rights).

Taiwan

In 2004, two European leaders made surprisingly categorical statements on the Taiwan problem to the solution of which they have little to contribute. Although both Chirac and Schröder, as a matter of principle, called on Taipei *and* Peking to solve their dispute peacefully, they also criticised "irresponsible initiatives" or "independence," i.e. the policy that Peking has been accusing the Taiwanese president of pursuing. In contrast, the EU's official position insists on acceptance by both sides of any "arrangement between Peking and Taipei" as well as the taking into consideration of the "wishes of the Taiwanese people." Most EU member states have representative offices in Taiwan, and Taiwanese ministers have been unofficially received in some European capitals. The island is Europe's no. 3 trading partner in Asia, and both sides meet annually for consultations. In March 2003, the EU Commission opened an economic representative office in Taipei.

Brussels as well as member states have nevertheless been pursuing a "one-China-policy" and have been opposed to Taiwanese attempts to enlarge the island's "diplomatic space" in the grey zone of international organisations. When the General Assembly of the World Health Organisation for the second time dealt with Taipei's application to join as a non-state observer in July 2004, all EU members voted against debating the motion (the reason given being that Taipei was already benefiting from most WHO services and that its application was therefore politically motivated. At the same time, Taipei's then 26 diplomatic allies as well as the U.S. and Japan declared themselves in favour of a debate.).

Conclusion

Because of a lack of instruments, basic commercial imperative, and instances of multipolar visioning in certain quarters, the EU and its member states have not been important partners of China's as far as security policies are concerned. Concessions made to the PRC over dual use exports (the U.S. has unique technological capabilities in the most sensitive systems, and a generally punitive technology policy would harm its competitiveness as much as that of others) or Taiwan were meant to be symbolical rather than substantial and to improve the general bilateral climate, thus leading to a certain politisation of economic relations. At the same time, U.S. concerns have been accommodated to some extent in the past and will continue to play an important role in the future. To repair the Transatlantic relationship in more general terms, both sides should focus on means just as much as on ends and aim for policies that combine carrots and sticks.

Contrasting with the 1990s, however, the present politisation of economic relations from a Peking point of view has not just produced positive results, as the protracted debate on the arms embargo shows. The contrast between individual politicians' high expectations on the one hand and down-to-earth bureaucratic considerations on the other has not just been limited to the more sensitive issues. In February 2003, for instance, the EU joined the U.S. in demanding that the PRC revalue its currency for the sake of a fair competition. In June 2003, Brussels turned down a Chinese request for the PRC to be recognised as a market economy, a step that would have made the imposition of anti-dumping sanctions far more difficult. In this context, the European side referred to unresolved problems in the financial and legal sectors. The previous month, the same question had dominated Wen Jiabao's European tour, where representatives of the EU Commission, much as their American colleagues, addressed topics such as the trade deficit and product piracy. Contrasting with the EU's human rights policies, a kind of task sharing has thus emerged between the Commission and member states, with the multipolar rhetorics of individual European countries, while not binding them in reality, serving national trade policies with the Commission watching over the PRC's observance of bi- and multi-lateral agreements. Even on human rights, critical evaluations of ongoing bilateral dialogues have recently been made in both the Commission and the Council.

From a U.S. point of view, the most reassuring message would be that the emergence of a multipolar world will remain illusory for as long as both China and the EU suffer from institutional weakness (not to mention Europe's economic falling behind the U.S. since the early 1990s.) As far as the Pacific is concerned, PRC scholars have increasingly been alluding to a bipolar rather than multipolar setting. In more general terms, globalisation would appear to have moved the world towards a division between a (high-tech, democratic, market) core in which peaceful methods of conflict resolution apply and a more unstable periphery that can alternatively be contained or transformed. It remains to be seen whether China in the long-term will belong to the core rather than the periphery.

**PRAGUE, CZECH REPUBLIC SYMPOSIUM
ON TRANSATLANTIC PERSPECTIVES ON
ECONOMIC AND SECURITY RELATIONS
WITH CHINA**

THURSDAY, DECEMBER 2, 2004

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION,
Washington, D.C.

The Commission met at 8:45 a.m., at Knights Hall, Senate of the Czech Republic, Prague, Czech Republic, Chairman C. Richard D'Amato and Vice Chairman Roger W. Robinson, Jr., presiding.

OPENING REMARKS OF CHAIRMAN C. RICHARD D'AMATO

Chairman D'AMATO. The U.S.-China Economic and Security Review Commission of the United States Congress is delighted and honored to be here this morning in this historic room of the Czech Senate to participate in this symposium on transatlantic perspectives on economic and security relations with China. Today's event is part of a weeklong series of discussions and meetings the Commission is holding with European officials, business representatives, academics, and others. We began our trip in Brussels earlier this week where we held a similar symposium and had the opportunity to meet with numerous EU officials—from the European Commission, the Council, and the Parliament—as well as representatives of business and labor.

Our Commission was established by the U.S. Congress with one purpose: to assess the national security implications of our broad-ranging developing economic relationship with China and to make recommendations to correct situations or practices which the Commission believes may be adverse to American interests. The members of the Commission were appointed by the Republican and Democratic leaders of both the U.S. Senate and House of Representatives. It is a bipartisan effort to address a number of very important issues.

We are here in Europe because an understanding of the relationship between Europe and China is critically important to U.S.-China relations. Our meetings in Brussels reinforced our concerns that this area has not yet been the focus of sufficient attention in the United States. We believe the United States has some work to do. We think that a renewed dialogue is in order and hope that our events in Brussels and here in Prague will help to stimulate that dialogue.

We believe the people of the Czech Republic have a unique perspective on China. We in America all participated emotionally in the Czech revolution, overthrowing of tyranny, which occurred

under the leadership of Vaclav Havel. The political actions of the Czech people coincided with similar actions in the same time frame by the Chinese at Tiananmen Square. Unfortunately, the results were not the same: liberation in the Czech Republic, continued tyranny in China.

Here I will read a letter that the Commission received yesterday from Vaclav Havel, welcoming the Commission to Prague, and we'll include this letter officially in the symposium's record. And it reads as follows, dated yesterday:

VÁCLAV HAVEL

12-01-04

Dear Chairman D'Amato and Vice Chairman Robinson,

It is an honor to welcome the U.S.-China Economic and Security Review Commission to Prague for a valuable symposium on E.U.-China trade and security relations hosted by the Czech Senate. I commend the Commission for its efforts to understand how such relations compare to those of the United States. These sessions will advance the prospects for free and fair trade, more stable security relations and strengthened human rights.

China's rapid economic growth and dynamism have impressed the world, but no modern state can long prosper without justice, human decency and respect for individual liberties. China's central challenge in the period ahead will be the replacement of authoritarian rule with a vibrant democracy. The Commission's fine work has illuminated this challenge and is charting a path toward a more candid, realistic U.S.-China relationship and greater freedom and sustainable well-being for the Chinese people.

We in the Czech Republic are proud to play a role in this historic debate and wish your proceedings well in the days ahead.

Vaclav Havel

"Dear Chairman D'Amato, Vice Chairman Robinson: It is an honor to welcome the U.S.-China Economic and Security Review Commission to Prague for a valuable symposium on EU-China trade and security relations hosted by the Czech Senate. I commend the Commission for its efforts to understand how such rela-

tions compare to those of the United States. These sessions will advance the prospects for free and fair trade, more stable security relations, and strengthened human rights.

“China’s rapid economic growth and dynamism have impressed the world, but no modern state can long prosper without justice, human decency, and respect for individual liberties. China’s central challenge in the period ahead will be the replacement of authoritarian rule with a vibrant democracy. The Commission’s fine work has illuminated this challenge and is charting a path toward a more candid, realistic U.S.-China relationship and greater freedom and sustainable well being for the Chinese people. We in the Czech Republic are proud to play a role in this historic debate and wish your proceedings well in the days ahead.” it’s signed, “Vaclav Havel.”

The nations of Central Europe have been deepening their economic relations with China in recent years. Today, bilateral economic and trade relations extend to investment and cooperation in the manufacturing sector, beyond the basic import and export trade of the past. While current trade statistics favor China, Central European nations are seeking to develop policies to attract Chinese investment here and to increase exported goods and technologies to China.

An important part of the Commission’s mandate is to monitor China’s record of compliance with its World Trade Organization commitments and to evaluate the effectiveness of WTO mechanisms to enforce compliance. While we recognize that China has made progress in many areas, we continue to be dismayed at the compliance shortfalls in critical areas such as intellectual property and agriculture and the failure of the WTO’s Transitional Review Mechanism to adequately press China to address those shortfalls. In Brussels, we discussed with our European counterparts the need for the U.S. and the EU to better coordinate their WTO activities with regard to China, and we look forward to exploring this issue with our panelists today.

We would like at the outset to recognize the outstanding support and assistance we have received from the American Ambassador to the Czech Republic, William Cabaniss. Special recognition and thanks to his very capable staff including Mike Dodman, Kenneth Hillas, Tricia Cypher, and Andela Kunstova. They did an outstanding job for us and were instrumental in our ability to conduct this important event.

I want to note that we are recording today’s symposium, and from this we will produce a report to the U.S. Congress on today’s proceedings, and we believe it will be of great use to policymakers in the United States.

I now turn the microphone over to our distinguished Commission’s Vice Chairman, Mr. Roger Robinson.

[The statement follows:]

Prepared Statement of Chairman C. Richard D’Amato

Good Morning Everyone:

Welcome to our symposium on “Transatlantic Perspectives on Economic and Security Relations with China.” Today we are here in this beautiful room to talk about EU-China relations and the impact that relationship has on Central Europe as well as on the United States. Today’s event is part of a weeklong series of discussions

and meetings we are holding with European officials, business representatives, academics and others. We began our trip in Brussels where we held a similar symposium and had the opportunity to meet with numerous EU officials—from the Commission, Council, and Parliament—as well as business and labor representatives.

Our Commission was established by the U.S. Congress with a clear central mandate—to assess the national security implications of our broad ranging economic relationship with China and to make recommendations to correct situations or practices which are adverse to our interests. In setting out our mandate, the Congress directed us to take a broad view of security to include an assessment of both traditional national security issues as well as how our economic relationship with China is impacting U.S. economic health, be it our manufacturing base, the development of vital technologies, the state of our economic growth and research and development efforts, and the impact on employment. The Members of the Commission were appointed by the Republican and Democratic leaders of both the U.S. Senate and House of Representatives. It is a bipartisan effort to address a number of very important issues.

We are here in Europe because an understanding of the relationship between Europe and China is critically important to U.S.-China relations. Our meetings in Brussels reinforced our concerns that this area has not yet been the focus of sufficient attention in the United States. We think that a renewed dialogue is in order and hope our events in Brussels and Prague can play a role in this.

The nations of Central Europe have been deepening the economic relations with China in recent years. Today, bilateral economic and trade relations extend to investment and cooperation in the manufacturing sector, beyond the basic import and export trade of the past. While current trade statistics favor China, Central European nations are seeking to develop policies to attract Chinese investment and to increase exported goods and technologies. We look forward to discussing these dynamics with our panelists.

An important part of the Commission's mandate is to monitor China's record of compliance with its World Trade Organization commitments and to evaluate the effectiveness of the WTO mechanism to enforce compliance. While we recognize that China has made progress in many areas, we continue to be dismayed at the compliance shortfalls in critical areas such as intellectual property and agriculture and the failure of the WTO's Transitional Review Mechanism to adequately press China to address these shortfalls. In Brussels we discussed with our European counterparts the need for the U.S. and the EU to better coordinate their WTO activities with regard to China and we look forward to exploring this issue with our panelists today.

We are also interested in examining similarities and differences in EU and U.S. perspectives on traditional security matters. China's military strength, along with its intentions toward Taiwan and countries in the region, are global concerns. So are human rights, consistently emphasized in Europe, and which are a mutual concern of people everywhere. On both points we think that the manner in which the EU and U.S. deal with these issues will be of paramount importance in determining the future security and human rights situations globally.

We would like at the outset to take this opportunity to personally thank Czech Senate President Petr Pithart for hosting this important event. We would also like to recognize the outstanding support and assistance we have received from Ambassador William Cabaniss. Special recognition and thanks to his very capable staff including Mike Dodman, Kenneth Hillas, Tricia Cypher, and Andela Kunstova. They did an outstanding job for us and were instrumental in our ability to conduct this important event.

I want to note that we are recording today's symposium and from this will produce a report on today's proceedings that we believe will be of great use to policy-makers in the U.S. Congress and to American and, we hope, European researchers and scholars on China.

I am now turning the microphone over to the Commission's Vice Chair, Mr. Roger Robinson.

OPENING REMARKS OF VICE CHAIRMAN ROGER W. ROBINSON, JR.

Vice Chairman ROBINSON. Thank you, Mr. Chairman.

I'd like to second the Chairman's expressions of appreciation to all of those, particularly our embassy friends, who have played such a key role in setting up today's proceedings. In addition, I'd like to offer special thanks to my good friends Olda Cerny, Jan Havernak, and Alice Savovova of the Prague Security Studies Institute. They, too, were instrumental in assisting the Commission

with the organization and logistical arrangements for this symposium, which I think is an important event.

In our meetings in Brussels, we heard from EU officials, labor and industry representatives, and scholars about the challenges and opportunities posed by Europe's expanding relationship with China. As we explore this issue more closely, we recognize that the views on many economic and security concerns with China are not at all uniform throughout Europe. In fact, we've come to Prague to hear the perspectives of Central Europeans on this issue, which could vary significantly from some of those that we heard in Brussels. Given its history, Central European nations are particularly sensitive, for example, to repressive or restrictive political and economic policies of authoritarian regimes and are thus in a unique position to understand the developments ongoing in China today.

The much discussed EU arms embargo, which has been in place since the Tiananmen Square events of 1989, is another issue which we talked about at some length in Brussels. We look forward to a continued discussion on that matter in Prague about European concerns regarding the embargo as well as the prospect for possible alternatives such as a strengthened code of conduct. And as we did in Brussels, we hope to serve today as an informal conduit in relaying American concerns with respect to the embargo issue. The changing dynamics in the cross-Strait relationship are another major focus of the Commission's ongoing work, and we look forward to a dialogue on the prospects for conflict as well as possibilities for peace in the Strait.

The first two panels today provide us with the opportunity to hear perspectives on the security dimensions of the evolving relationship between our Central European friends and China. We're honored to be joined by the Honorable Jiří Schneider, and Senators Jan Ruml as well as Josef Jarab, and Dr. Jean-Pierre Cabestan. During the afternoon session we will be gaining insights into China's economic and trade policies from a distinguished group of industry and labor representatives.

We in the Commission are honored to be here today and to be addressing such a vital issue for both the United States and Europe. So with that, I'd like to commence with our first panel and turn the floor over, if I may, to Senator Jan Ruml.

[The statement follows:]

Prepared Statement of Vice Chairman Roger W. Robinson, Jr.

Thank you, Mr. Chairman.

I would like to second the Chairman's appreciation to all the people who played a role in setting up today's event. In addition we would like to thank Olda Cerny, Jan Havernak and Alice Savovova of the Prague Security Studies Institute. They were instrumental in assisting the Commission with the organization, facility and logistical arrangements for this important event.

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The much-discussed EU arms embargo, which has been in place since 1989 is another issue we discussed at length in Brussels. We look forward to a continued discussion in Prague about European concerns regarding the embargo and the prospect for possible alternatives such as a strengthened code of conduct. And, as we did in Brussels, we hope to serve as an informal conduit in relaying American concerns on the embargo issue. The changing dynamics in cross-Strait relations are another major focus of the Commission's work and we look forward to a dialogue on the prospects for conflict and the possibilities for peace in the Strait.

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**PANEL I: PERSPECTIVES ON SECURITY DIMENSIONS OF THE
RELATIONSHIP I**

**STATEMENT OF JAN RUML
VICE PRESIDENT, SENATE OF THE CZECH REPUBLIC
CHAIRMAN OF THE OLYMPIC WATCH COMMITTEE**

Senator RUML. [Translated from Czech.]

Dear Chairman D'Amato, Dear Vice-Chairman Robinson, Dear Commission Members, Dear Guests:

I am greatly honored to be able to welcome you to the floor of the Czech Upper Chamber as the outgoing Vice-President of the Senate. The Senate of the Czech Parliament has been involved in security and international relations issues for a long time; however, in relation to the executive power, the authority of the Senate is limited. For a long time, the Senate has expressed its concern and care for human rights and democracy in the world. We understand human rights and democracy as a basis for the world's stable development and we believe that the development of China and the relationship between China and the European Union, and between China and the United States, represents one of today's great challenges, and is a challenge that we must face in the long-term.

I strongly believe that Europe, the European Union and the United States must search for joint answers to the question of the relationship with China. After all, our transatlantic partnership is built on shared values that found expression in the concepts of civil rights and freedoms and in the concepts of democracy. Experience tells us that extending of space for human rights and democracy clearly results in the strengthening of peace and stability worldwide. In my opinion, human rights are not an exclusively western concept that would not be understood and desired by people elsewhere in the world, as some insist.

If we look at East Asia, we see that people there are also longing for democracy and human rights. We can also take a look at Taiwan, which has clearly undergone very complicated development, but in any case its citizens have shown great interest in the issue of human rights and freedom, and express great pride in their democratic institutions.

Similarly, in Hong Kong, citizens clearly reject attempts to curb freedom of speech and demand that Beijing respects the general election for legislative bodies and for the chief executive. But even

on the Chinese mainland itself, for a long time people have called for and craved their internationally guaranteed rights. We can mention the 1979 "Wall of Democracy" movement as well as the Beijing Spring 1989 that was brutally suppressed by the Tiananmen massacre. Lately there is an increase in the protest movements of people who have been chased from their homes for the sake of the reconstruction of Beijing and Shanghai. Despite all of this, we are witnessing China's continued policy of harshly suppressing human rights. Dozens of journalists, dozens of interned activists, hundreds or even thousands of religious movement participants and many others who only peacefully demanded their basic rights and freedoms are still in prison.

Every year, without due trial, China executes thousands of people; more than all other governments of the world together. For the last six years China has generally ridiculed international law by delaying ratification of the International Pact on Human and Political Rights. This means that China's impressive economic development is not going hand-in-hand with the corresponding political reforms; it is not going hand-in-hand with respect to human rights and human freedoms, which of course has an impact on the international economic and security situation.

Not only that, the absence of any environmental protection and absence of employee rights in China, of course, creates unfair economic competition and generally puts the skids under the U.S. economy and industry. China's current dynamic economic growth is pushing oil prices up, which creates economic problems. I am sure that other more knowledgeable panelists will address this issue this afternoon.

I return to the security and strategic challenges. I consider those a priority. The problem is that while some economic reforms have taken place in China, at the same time the ideological legitimacy of the Chinese régime has weakened, and I assert that ideological impotence together with growing economic potential creates great danger and the potential for international conflicts. This is well illustrated, for example, by China's reaction to democratic processes in Taiwan, and it is very likely that the militant behavior of the Chinese leadership vis-à-vis Taiwan is aimed at supporting their fragile legitimacy with some new All-China patriotism or nationalism.

Clearly Beijing is attempting to become a hegemon in Asia and a world superpower in the future. But let me remind you that it maintains contacts with non-democratic régimes: in Northern Korea, in Burma; the Chinese President recently visited Fidel Castro's dictatorship régime in Havana, Cuba. Chinese oil purchases in Sudan support the Darfur genocide and while we, both the U.S. and its European allies, are accused of exporting democracy, I can responsibly state that China exports its attitude towards dictatorships, attitude in which it shakes hands with the remaining dictatorships all over the world.

As I mentioned before, Europe and the United States must seek common answers and joint steadfast with regard to security and economic issues related to the development of China. What do I mean by that in particular? In my opinion, both sides of the Atlantic must continue to maintain strict limitations on arms exports to

China. We must stand up against the lifting of the arms embargo. We have some disturbing news from Europe and the European Union—generally only three European states—Great Britain, Denmark and the Czech Republic still insist that the embargo on arms exports to China be extended and not lifted. However, given the attitude of France, and mainly Germany, we may say that this embargo is not likely to last long. We believe, at the very least, that the Beijing leadership should not have access to western arms technologies until this country respects human rights and until the democratic control of power prevails in this country.

Thus, continuing the arms embargo against China is one means of pressuring it to adopt political reform. I believe that the issue of arms is clear, but that in other business dealings, too, the democratic states of both Europe and America should insist on the principles of observing human rights and freedoms and, during negotiations with their Chinese partners, should consistently remind them of the need for political reform. I think we must remind ourselves that democratic countries are bound by international law and that we must demand China be as well.

I have already mentioned the necessary ratification of the International Pact on Human and Political Rights. The Olympic Games are expected to take place in Beijing in 2008. In my opinion, this is a great opportunity for us to exploit and put serious pressure on the Chinese régime to adopt political reforms, to free all political prisoners, to look for a new relationship with Tibet, to seek a new, internationally guaranteed relationship with Taiwan and to respect basic human rights and freedoms. I believe that both Europe and America must seek common paths, and, as we have often seen, Europe appears unenlightened and seems to complicate its relationship with the United States.

We must seek common paths in the fight against terrorism, common answers to the issue of human rights in Cuba and, of course, a common approach to the dictatorship ruling China. Europe cannot afford to commit another historical suicide. I believe that today's meeting, this esteemed Commission and its work will assist us in finding answers to some questions that were asked here today and that this meeting will help create the basis for a more permanent dialogue between the parliaments of countries on both sides of the Atlantic Ocean. I believe that our commonly shared historic values bind us to do that and I appreciate that the Commission has selected Prague as the venue for its meeting. We are greatly honored by that and I wish success to this meeting. Thank you for your attention.

[The statement follows:]

**Prepared Statement of Jan Ruml
Vice President, Senate of the Czech Republic
Chairman of the Olympic Watch Committee**

Dear Chairman D'Amato, Dear Vice-Chairman Robinson, Dear Commissioners, Dear guests, it is a great honor for me to welcome you as the outgoing Senate Vice-President on the premises of the Czech upper house.

Our Senate has long been paying close attention to international relations and security issues, despite its limited powers in its relation to the executive. We have also been expressing our concern for human rights and democracy in the world, which we understand to be fundamental to stable development of the world. The develop-

ments in China and its relations with the European Union and the United States certainly present one of the greatest challenges that we need to deal with.

I believe that the EU and the U.S.A. need to seek common answers to this question. Our transatlantic partnership is, after all, based on common values that have found its expression in the concepts of civil rights and democracy. History also teaches us that spreading human rights and democracy also leads to spreading peace and stability in the world.

At the same time, human rights are far from an exclusively Western concept, which people elsewhere in the world would not understand or would not wish, as some say. If we look at East Asia, we see that the people there also long for democracy and civil rights. Taiwan has gone through complicated evolution, but its citizens certainly show great interest and great pride in their democratic institutions today. Hong Kong citizens clearly refuse the efforts to limit freedom of expression and demand that Beijing allow general election of the legislature and the chief executive.

As you well know, people in mainland China have long been calling for their internationally recognized rights. We can mention the Democracy Wall movement of 1979, or the Beijing Spring of 1989, brutally suppressed in the Tiananmen Massacre. Recently, a protest movement has been growing of people evicted from their homes during the re-development of Beijing and Shanghai.

Still, the brutal suppression of human rights in China continues. Dozens of journalists, dozens of Internet activists, hundreds or thousands of followers of religious movements and others who have just peacefully demanded their fundamental rights and liberties, remain in prison. Yearly, China executes thousands of people—more than all other governments of the world combined. For six years it has been ridiculing the international legal order by failing to ratify the International Covenant on Civil and Political Rights.

And thus the impressive economic growth of China is not accompanied by corresponding political reform and respect for human rights. This of course begins to have its impact on the international economic and security situation.

The absence of environmental protection and labor rights creates unfair competition and undermines American and European industries. The dynamic growth of the Chinese economy pushes up oil prices and further threatens economic growth. Others will probably be better able to testify on these issues here. What is perhaps even more important are the security and strategic challenges.

After carrying out economic reform, the ideological legitimacy of the Beijing regime has weakened. And this ideological weakness, together with the growing economic potential, brings greater risk of international conflicts.

This can easily be seen in the way Beijing responds to the democratic processes in Taiwan. It is very likely that the militant behavior of the Chinese leadership towards Taiwan is aimed at strengthening the frail legitimacy of the regime by new patriotism and nationalism.

Beijing is evidently interested in achieving hegemony in Asia and prospectively becoming a global superpower. That is why it maintains close relations with North Korea and Burma, that is why the Chinese president recently visited his comrade in Havana. Chinese oil purchases from Sudan finance the genocide in Darfur. While the U.S. and its European allies are sometimes accused of exporting democracy, one could say that Beijing aims at exporting dictatorship.

As I have said, it is crucial for Europe and America to seek common answers to the economic and security challenges from China. What specifically should this mean?

Both sides of the Atlantic should maintain strict curbs to arms exports to China. The Beijing leadership should not have access to Western military technologies until it respects human rights and democratic control of power sets in the country.

The lasting embargo on arms exports to China will be one of the key arguments for China to carry out reform. The EU and the U.S.A. should also insist on respect for human rights and democratic reform during economic negotiations.

Together, we can assert our commitment to international law and demand that China do the same.

The Beijing 2008 Olympics is another occasion for us to jointly press China to carry out political reform, to release political prisoners and respect fundamental rights and liberties.

Europe and America have to seek joint approach not only to the fight against terrorism, but also to its relations with totalitarian regimes around the world. I believe today's session will help us find answers to some questions and will become the beginning of a lasting dialogue.

Chairman D'AMATO. Thank you very much, Senator Ruml, for that very strong and clear statement. I know we're going to want to discuss these concepts further in our discussion on this panel.

We'd like to turn now to Jiří Schneider, who is the Political Director of the Foreign Ministry of the Czech Republic.

**STATEMENT OF JIŘÍ SCHNEIDER
POLITICAL DIRECTOR OF THE
FOREIGN MINISTRY OF THE CZECH REPUBLIC**

Mr. SCHNEIDER. Thank you, Mr. Chairman, Honorable Commissioners, dear guests. It's a pleasure for me to welcome you on behalf of the Czech Foreign Ministry in Prague.

I think this is a historical event. I'll explain why I see it as a historical event. I would like to see this as a beginning of seeking new modes of consultation and cooperation across the Atlantic which we, because of our historical experience here in Central Europe, consider as vital for Europe, both Europe and the United States, in future. And it's very timely and very topical that we meet here to debate the transatlantic perspective on relations with China because it's here on this very strategic topic where we have differences, and we have to debate these differences.

I would like to make a couple of points which will be, first of all, on structure of this triangle—China, EU, and U.S.—as seen from Central Europe. Then I would like to add a little bit on the EU-China relations because we're approaching the EU-China summit on the 8th of December. So I would like to address some issues, which will be debated there.

And, finally, I would like to make some points on the specific Czech position, how we see our bilateral relations with China and our Asian dimension of foreign policy as it is now in the framework of the European Union policy and relations, external relations in this direction.

First of all, it seems to me that we have a structural problem in this triangle. All angles or poles of this triangle are different, and in the U.S. there is an established and settled way of policymaking with the remarkable role of Congress, which you represent here, and with a known balance and division of powers among administration, presidency, and the Congress.

In Europe, you have the hybrid organization with a major role of national states still, and especially the big players if it concerns big relations like relations with China. Then you have a supra-national level of policymaking in some areas, especially in the area of economy and trade, where there's a lot of powers which are vested to the Commission's hands, and it's up to the Commission to negotiate parameters of economic relations, as you discovered recently in Brussels. So it's a complex creature, for some Americans really difficult to understand.

And then we have China, and I'm not an expert on China, but let me say China is far from being a monolithic country. Politically, economic-wise, and society-wise, it's a complex country.

I've been to China in my capacity as a policy planner recently, and let me speak here from my personal experience. I try to, as I do in every country I was in my position of policy planner, I was in contact with think tanks and institutes which are dealing with foreign policy. So I was trying to visit some of these institutes, and

I have discovered the spectrum, the range of the types and opinions there. I was at the School of the Communist Party Institute where I got a question from one of the professors there when the Soviet troops will leave our territory. It represents a kind of, you know, understanding of the current world. It's there. They are really 15 years back. At least some of them.

Then I visited institutes, which reminded me about institutes of perestroika from the 1980's, progressivists who were trying to reform the system, who were aware of the necessary reforms.

And then I visited institutes which were really up-to-date. They know what's going on around the world, what's going on in the global economy, what's going on in strategic thinking, you know, in security terms.

This is China, and I'm not speaking about other aspects of the broad spectrum of Chinese diversity. This was a narrow part policymaking institutes only. This is my personal experience.

So I've got a sense that there is a feeling in all corners of the Chinese policymaking establishment that China would like to be a force for stability. Stability is a key word for China, and one of the elements of our dialogue with China should be on what principles the stability should be based. What are the principles of stability? And are they coherent with our principles and values? And my experience is that we can go into that dialogue.

There is a broad range of approaches, from dogmatic approaches to pragmatic approaches, and I think we shouldn't forget that in dealing with China. And here I would like to make that circle in the end of my remarks. I think here we can act because of our historical experience. We have undergone the transformation with different features, different timing, but we have a kind of understanding of these psychological traits of transformation of a country which is changing its system. And it has already different elements on its territory.

China has changed. It's not the China of July, August 1989. It hasn't changed so much, but it has changed. It's a different China. That's one of the reasons why there is a growing feeling in Europe that there should be some changes in European policy towards China. And there should be a positive message, there should be an encouragement of the positive changes. And the problem is that there are some interests in Europe which see a future bonanza, economic bonanza in the Chinese market. There are also those who view China in a strategic manner, in global terms. One should not forget that the economic agenda is actually an old and established agenda in the European Union; whereas, the security agenda is relatively new. It's only one year that we have common security strategic in Europe, which, by the way, calls China a strategic partner. But we don't know what strategic partner means in all corners of European Union. Do we have a common understanding what does it mean?

We are big trading partners. China is for EU, as you might have heard, the second after United States. For China, I think EU is the first rank. So we are not talking about marginal relations. We are talking about a massive interest on both sides.

For us, we are marginal in this because if I compare our volume of trade only with a deficit the EU has, I think it shows how mar-

ginal it is. Our volume is something like 3 billion euro a year; whereas the deficit, yearly deficit of the whole European Union is 55 billion. It shows that we are not in the mainstream, we are not a driving force of the economic relations in that respect.

In a security dialogue, we are not as marginal, and due to topics of the security dimension of that relation, I think we are much more influential. What are the topics of the security agenda? First of all, arms trade, arms embargo, and I would like to address this later on. Then proliferation of weapons of mass destruction, terrorism, and some other issues like migration and the security dimension of migration.

All these issues I think will be addressed in the upcoming summit of EU with China December the 8th. To show the scope of European strategic thinking in dialogue with China, I want to just mention that there will be three countries which will be debated in this framework, and this is obviously North Korea, Burma, Iran. I think especially Iran because of the recent activities of European Union vis-à-vis Iran on nuclear issues. I think it might be a very interesting topic for both sides, and it shows that a few years ago there wouldn't be any of these countries on the agenda of EU-China relations. Nowadays we are moving closer to U.S. perspective. I have no doubt that the list of the countries where Chinese and U.S. representatives meet is much longer because of the broader perspectives of both sides.

I'm using this to show the growing ambition but still limited ambition of European Union to address these strategic security issues in the dialogue with China.

Now, for the arms embargo, these are my last points. I'm not sure whether it's completely true what Senator Ruml said about only three countries resisting lifting arms embargo in Europe. I think it's more complex because there are actually three reasons why Europe as a whole is not in a hurry to lift this embargo.

I mentioned that there is a consensus that there should be positive signs, but there is no consensus that this positive gesture towards China should be just lifting arms embargo without any other conditions. First of all, human rights. There are many issues in this human rights dialogue that are linked to the arms embargo. We haven't forgotten that the reason for the embargo was actually Tiananmen, and there was no other reason. So we acknowledge that China nowadays is not the China one month after Tiananmen. But there are still people who were imprisoned after Tiananmen. So let's clean the table if really there is a change.

There are some other issues like ratification of this convention, freedom of speech, freedom of religion, many other aspects in the human rights dialogue. But this is one of the reasons.

The second reason, obviously, is security. We wouldn't like to increase the tension in Taiwan Strait. We would like very carefully to contribute to the peaceful resolution of Taiwan and mainland China. We stick to the policy of one China, but we are very careful and watching very carefully these relations. So there is a strategic consideration. And, therefore, there should be a kind of regime which will actually govern the arms exports after lifting arms embargo, and this is the so-called Code of Conduct, Toolbox, these kind of arrangements which will enable us to monitor exports and

to see whether there is a balance which might be contributing to the peaceful resolution and which will not contribute to the temptation for unilateral actions in this respect. And this is also one of the reasons—one of the aspects that should be taken into consideration.

On the last meeting of the European Foreign Ministers, we agreed that—and this is quote from the conclusions of the Council of External Relations on the 22nd of November: “The Chinese should be given a positive message, but they should also understand that progress would be needed in other areas—code of conduct, human rights, Taiwan—before the embargo could be lifted.” And I think this reflects the common position of European Union nowadays. And it means that until there will be another decision made by European Ministers, the embargo is still in place. But my feeling is that everybody counts, that it’s going to be changed and substituted with this Code of Conduct and Toolbox next year. And we are in the debates about the parameters of that code of conduct.

Finally, let me express my hope that we will be able to overcome the structural problems, especially across the Atlantic. And I think there is a growing awareness in Europe that we need to talk more to the U.S. Congress to actually—to deliver information about how Europe is operating, what are the decisions made in Europe, and what are the European policies, also not only to the U.S. administrator but to the U.S. Congress, maybe to have relations between European Parliament and U.S. Congress as well, and national parliaments, because this is important. This is where policy is made also in Europe. There is a role of national parliaments and European parliaments in European policymaking, and they should be included into this dialogue.

I think this symposium this morning is a modest beginning from our point of view, and I very much like to see it going on.

Thank you very much for coming.

Panel I: Discussion, Questions and Answers

Chairman D’AMATO. Thank you very much, Mr. Jiří Schneider for a very interesting presentation.

I’d like to start off the questions with a broad-ranging question. In the last part of your presentation, you mentioned the role of parliaments and Congress. And it appears to us, at least it appears to me, noting that there have been resolutions passed by several European parliaments and the European Parliament itself, as well as the parliaments of the Netherlands and Germany, on the question of not lifting the embargo on human rights grounds.

There may be a growing division between parliaments and executive branches in terms of the willingness to put human rights at the forefront. I can only mention that my impression of Senator Ruml’s statement is that the priority of human rights needs to be kept at the top of the agenda. And here’s my question.

Language has developed about strategic partnership. This is a dangerous concept in that it means that executive branches in Europe are putting economic relations clearly above human rights considerations? When you talk about a strategic partnership, obviously we cannot have a strategic partnership and the term of shared values because we don’t have any shared values on human

rights. So the only shared values would be the economic relationship.

So is the concept of a strategic partnership an attack on the priority of human rights in the priorities of our governments?

Mr. SCHNEIDER. I would not see that as contradictory, but obviously I think there is as in every country a tension between sticking to values and economic interests. And the only concern is whether the parliament has the mechanisms to actually balance these two things and not to avoid controversy on this and a dialogue and debate on these issues.

In each country it's different. You mentioned the European Parliament. Even a few months ago, it was neglected by European politicians. But they are trying to raise their profile, and the troubles they make to the upcoming Commission—[tape ends]—which might be detrimental to the human rights agenda.

Chairman D'AMATO. Thank you.

Senator Ruml, do you have a comment on that?

Senator RUMML. [Translated from Czech.] I would like to mention the aspect or the role of national parliaments. Despite the fact that the European Union harmonizes its legal system it does not mean that individual states are terminated. In Europe, generally all countries are parliamentary democracies in which the government reports to the parliament and cannot exercise policies other than those politically controlled by the parliament. In my opinion, the comments by my colleague Mr. Schneider are very important; we do need to involve national parliaments into this dialogue with the U.S. Congress; dialogue with the European Parliament; mutual dialogue between individual national parliaments; these questions include strategic, political, security as well as economic issues and we cannot exclude some countries from this dialogue or maintain the dialogue only at government level. In my opinion, parliament diplomacy is of utmost importance and after all, parliaments are always more sensitive to the issue of human rights and freedoms and the issue of relationship with dictatorships in the world—I am now addressing only one dimension of the whole issue, which, in my opinion, is the most important dimension of all—so I think that the parliamentary debate must be much more lively and subsequently it must be reflected in the behavior of governments of individual European countries. Thank you.

Chairman D'AMATO. Thank you very much, Senator.

I know my colleagues have one or two more questions. I would like to make one comment, though, in this respect: It appears to me that the Chinese would like the world to accept a new political/economic model which I think they would model after Singapore, and that is a country which is a globalized economy with more and more market orientation, but a political system that remains a complete straitjacket. And whether or not they can accomplish this model for a big country, which doesn't exist in any big country, maybe depends on whether or not we accept the relationship with them as a strategic relationship and that the strategic relationship in a sense buys into this concept of this model that they seem to be presenting to the world.

I think Commissioner Dreyer has a question.

Commissioner DREYER. I was very interested in Dr. Schneider's view of his visits to these think tanks and finding this wide spectrum of points of view. I believe that differences in views have existed privately for a long time, and the heartening thing is that now people feel able to express these views to a foreign visitor.

But the question that's in my mind as you were speaking is how much do the actual decisionmakers in government listen to these think tanks. My own personal discussions with people in these think tanks is that they feel no one listens to them; that the decisionmakers make their decisions without consulting their advice. So that is one question I would like to ask you: if you think the think tank people feel that they are making a difference?

The idea of cooperation on terrorism is something else I'd like to explore your views on. My own opinion is that so far the Chinese party and government have been using the campaign against terrorism as a cover or a rationalization or an excuse for trampling on human rights. It has always been the case that the Chinese government equates dissidence with subversion; now they can say that dissidence equals subversion equals terrorism. This has been particularly noticeable against the ethnic minorities in China, the Tibetans and the Mongols and the Turkic Muslims, particularly the Uighurs.

So we must ask this question. I would agree with both of you that we need progress in human rights, but we need a way to measure this progress in human rights. Is it fundamental or is it cosmetic? George Bush, Bush 41, was a great believer in what he called "quiet diplomacy," which means one doesn't say anything bad about the Chinese government. The Chinese government would oblige by releasing a dissident just before Bush went to China. Two weeks after he returned from China, they would rearrest the dissident, and perhaps some others.

Finally, your views on stability. Of course, stability is something that every government wants. We want stability even when we change governments; the desire for stability is nearly universal. It's a word that goes by very quickly. But the Chinese Communist party and government have used the word stability in a very different sense, and they tell the people stability is necessary because if we don't have stability, then we have "luan" disorder. There's going to be no food, and chaos. But what many people feel they really mean by stability is holding onto their power, the power of this narrow group over the party and government.

So these are the questions I would like you to address.

Mr. SCHNEIDER. Thank you for the difficult questions. As I said, I'm not an expert who is following China on a day-by-day basis, but the question of the influence of analysts and on the decision-making, I think that if China is opening in terms of economy, flow of exchange of people and these kind of things, at least in some parts, then those who are decisionmakers in Shanghai or these kind of regions, they have a demand for knowledge about how the world economy operates. What is the newest knowledge about running a municipality, a region, whatever, the management expertise in terms of governance, for example. I can imagine that they are seeking knowledge. How to manage this world which is so structured,

it's not centralized, it cannot be centralized, so how can we manage this.

That might be a rising question, and they might see answers in institutes like this. I think it's not lost. I think there might be a growing demand for the knowledge. Of course, those who wouldn't like to adjust to new conditions are not seeking any expertise. They don't need it. They understand the stability as the maintaining of status quo and not changing.

I think stability is a key notion for the Chinese, and we should be more specific what kind of stability we mean. Do we mean internal stability of the system? Do we mean their approach to the stability of the international system, which is a totally different thing? Do we mean stability of energy supply, which might be a more attractive topic for the Chinese, with the growing demand for energy?

I think China might be very attentive to the initiatives, for example, to protect the flow of energy into China, safety of the straits in southeastern Asia against piracy and terrorism on the seas. Definitely they are very much interested in the stability of this kind of business, and it's a common basis, isn't it?

They are also interested in a stability in the Middle East. What does it mean? What kind of stability? I've got the impression the Chinese were terrified by the Iraqi campaign because this was contrary to stability. It was a big, big change. But they might be attentive to address the issues of stabilization of the region because this is a strategic region, which feeds us at least in the energy sector.

Now, terrorism as a cover to dump on subversion, yes, but this is not a specific Chinese problem. And don't ask me to be more specific on this, but I think it's not exclusively a Chinese question. And we witness attempts to use counterterrorism as a cover to dump on, you know, those who are not terrorists and not far from China.

We should be very attentive to this problem, but it's a very delicate problem. How do you draw the line on this, and especially if we do not have a consensus on understanding of the liberties or the protection of basic human dignity and liberties and protection of rights of minorities? It's very difficult if we do not share consensus on this issue. And we see it as a problem even across Atlantic. The debate about the measures which have been adopted after 9/11 in the United States and the reaction in Europe, I think it's clearly an example that this is not exclusively a problem of China. But I see it as a very ex post problem for China, and it should be debated, I'm sure, if Europe is going to embark on negotiating a new agreement, a new framework with China. Then we will have a debate, and a hot debate, about a terrorism clause, which is going to be there, and human rights clause. We have a standard human rights clause in our treaties, European treaties with partners, and there will be a problem with accepting this human rights clause in an agreement with China.

I think that would be at least on the legal level a basis for a dialogue on these issues, how to balance this, terrorism, and human rights. And we will have the basis for that. At least this is the design of the future legal basis for relations with China in the longer term.

Commissioner DREYER. Thank you.

Senator RUML. [Translated from Czech.] I would like to return to the comment made by my esteemed colleague: how do we measure improvement in human rights and freedoms in China, or, in other words, how do we measure this progress? Measures may include the release of all political prisoners, freedom of speech, freedom of religion and so on; in my opinion, only things that create a kind of basic systemic solution to this problem are measurable. That means that we must have some constitutional guarantees—since the 18th century the entire democratic world has been built on such guarantees, on the separation of powers—actually the American Federalists formulated it most precisely. As soon as there is a pluralist system that separates legislative, executive and judicial powers and judicial power becomes independent, we can establish constitutional guarantees for the protection of human rights and freedoms in such country; meaning that this is the basic measure that we will apply to the issue of human rights and freedoms in China. In terms of stability, of course stability has different contexts and can be interpreted in different ways. We visualize democratic system stability as an opportunity for the minority to become a majority and for the majority to become a minority, as well as the fact that the democratic system does not fall apart after each government change—this is stability in the democratic sense; in the dictatorship sense, stability is generally the unchangeability of the system. Such stability is a quantitatively different type of stability as compared to ours; from this viewpoint we want instability in China—we want things to change and develop, we want to see progress in political reform—therefore in terms of China, we wish them instability. Of course from the strategic viewpoint and in terms of security relations, etc., we want stability. In my opinion it is fun to analyze different forms and different concepts of stability, and much can be said on this topic. So this was my answer—thank you.

Chairman D'AMATO. Thank you very much, Senator.

I believe that Commissioner Wortzel has a question.

Commissioner WORTZEL. Thank you. And, gentlemen, I thank both of you for your testimony.

Mr. Schneider, you painted a very sophisticated picture of foreign policy and what could amount to a strategic relationship with a lot of elements involved. You didn't mention all of them by name, but, proliferation, terrorism, certainly crime and human trafficking, human rights, investment in economics, science and technology, and culture.

Now, one of the frustrations in the United States, it's very easy to design a single-issue foreign policy. If your sole criteria is some other nation's attitude towards freedom of religion or some other nation's attitude toward the right to bring children into the world and procreate, it's easy to design a foreign policy. But you talked about a balance, and I appreciate that very much.

My question for you is more on mechanism. If you have these different elements either in European Union or in Czech foreign policy, do you choose to pursue them in one package, in a major meeting that discusses them all, or in separate, discrete visits as you go through a given year or administration? What are the tools you use to ensure that each facet is part of a strategic approach?

And then for Senator Ruml, within the Senate, within the legislature, is there a means to pursue the same packet of issues with the National People's Congress of China? Are there regular discussions of the things that Mr. Schneider raised?

Thank you.

Mr. SCHNEIDER. Thank you. This is a weak point, the mechanisms and implementation. Let me say this is a weak point on our Czech level, in the Czech Republic, to perform the coherent foreign policy with balanced all aspects. And it's our disease. You know, we're trying to cure that.

On the European level, it's even more complex because it's not a state structure. It's a hybrid structure. It's a complex structure with different responsibilities. You have a different way how to manage the economic relations. You have a different way how to manage the relations in science, technology. You have different tools to manage justice and [inaudible]. You have different and emerging mechanisms of dealing with things of security and foreign policy like proliferation, terrorism, and other aspects. So it's even more complex.

But you're right that we should be maybe more focused on the mechanisms which should deliver this kind of strategic context.

Maybe that would be a connection to Senator Ruml's point of parliamentarian level of diplomacy. To show you how difficult that was, it's not always that the parliaments are stressing more the human rights dimension or the value dimension. There are also various interests who lobby the members of parliament, and I remember one of the members of the parliament, the lower chamber, who is no longer in the parliament, said publicly that he values more one contract than one prisoner being released somewhere in a distant country. He said it publicly and bluntly, and he was not alone. There are some others who think in these terms, and they are more clever not to say it in public.

Senator RUMML. [Translated from Czech.] I confirm the words of my colleague that such a statement was actually made, in more specific terms it was even said that one trolleybus sold to China weighs more than all human rights together—indeed we even hear such statements on the grounds of the Czech Parliament. I would like to answer the question of how the parliament co-operates with the government in creating foreign policy. It is very difficult; of course the parliament has certain sovereignty in this matter; apart from having respective committees, our Constitution stipulates that a number of international issues cannot be addressed without the involvement of the parliament. This primarily includes the very sensitive area of the stay of foreign troops in our territory during different exercises, such as those of North Atlantic Alliance and of course the highly sensitive issue of sending troops to areas of conflict such as Afghanistan, Iran or the Balkans. Here, it is always very important that the government clearly formulates its opinion and the parliament has the final say. It is often very difficult to achieve consensus in the parliament; however, in key issues we may say that parliamentary foreign policy and government foreign policy are generally united. Considering the constitutionally guaranteed position of the parliament, a different policy in these sensitive issues would not even be possible. There are of course dif-

ferent accents to it, but in terms of the basic foreign policy orientation, the government acts hand-in-hand with parliament.

Chairman D'AMATO. Thank you, Senator Ruml.

Vice Chairman Robinson?

Vice Chairman ROBINSON. Thank you, Mr. Chairman, and thank you both, gentlemen. This is exactly the kind of illuminating discussion that we had hoped to have here, and we're underway in an exceedingly positive manner.

That said, we're focusing now on the question of transatlantic security relations, but also a subject that Senator Ruml has been a leader on, on the human rights portfolio.

Obviously, the U.S. Government has been over to brief our European allies as well as Central European allies on the stakes and complexities with respect to the lifting of the embargo. Commissioner Wortzel is a military expert and can talk about some of the specifics in terms of what is on the Chinese shopping list in terms of sensors, command and control, communications networks, radar, and various sophisticated component parts that could fit nicely into China's offensive weapons systems, much of it directed toward interdicting a U.S. force should it come to the rescue of Taiwan in the event of a future conflict.

Leave it to say that the Congress shares the Bush administration's view generally that this is a highly lethal business we're talking about that has American forces in harm's way as the most likely targets of those weapons systems. The Japanese are likewise quite robust in opposing the lifting of the embargo, I think appropriately, and have acknowledged that this is a dangerous situation for them, as well. We can debate the likely timing of this EU action, whether it's going to be April or May, which is our current best guess, under the Luxembourg presidency, and what measures are going to be offered up, the strengthening of the Code of Conduct, the Toolbox, arguably even strengthened export controls to justify the lifting of the embargo. Are they real? Will they make a sustainable difference?

These questions remain, but it's not what you'd call a positive trend line on the security front. Similarly, on the human rights front, in part also evidenced by the embargo lifting, we seem to be witnessing a new ill-advised pragmatism here in the Czech Republic, as well as in Europe more broadly, that tends to be increasingly giving primacy to commercial relationships over human rights. And given the political evolution even in this country and what we can expect within the next year in terms of the political alignment here, that kind of pragmatism will likely become an increasingly dominant force.

So, on the one hand, I'm interested in whether Senator Ruml concurs with this view as to the fact that human rights, even in a post-communist region such as this one, which has been so recently suffered under authoritarian rule and is so acutely alert to human liberty and its fragility, that we may be on a slippery slope toward economic and commercial relations, *uber alles*, so to speak. By the same token on the security side, are we really coming to more common ground or less? Proliferation is on the May 8th summit agenda for an agreement with the Chinese on remedial measures. It sounds good. And you'd think that there would be common

ground that could be built upon, much like promoting the free flow of oil, and others. We should be looking for such things. There's only one problem. China remains a serial proliferator of components for weapons of mass destruction and ballistic missiles. That is proceeding largely unabated as we speak. So, of course, it begs the question as to the value of some of these highly ceremonial and highly visible agreements.

We all hope for the best, but I'm also interested in your view on the security side and whether on a transatlantic basis we're getting closer in this critical area or is that, too, possibly on a slippery slope?

Thank you.

Senator RUMEL. [Translated from Czech.] I hope that we are not on slippery slope and that the Euro-Atlantic world will be able to give clear answers to these questions because, in fact, the relationship of the government towards its own citizens represents a criterion for trustworthiness of any country in terms of security. And I strongly believe that terrorism has its roots in lack of freedom, and therefore think that the issue of human rights and freedoms is crucial; that this dimension is universal and we must never abandon it because otherwise we would really be on a slippery slope. I wanted to comment on the embargo; what to export, in what quality, how to control it, etc. These are problems. I am not an expert on arms systems but I can imagine that a defensive arms system can quickly and easily be converted into an active offensive system. The difference is only the angle from which we are looking at it, nothing else. Here in the Czech Republic we had a problem with the Tamara radio locators. One firm obtained a license from the Ministry to export this defensive passive system to China; later the government cancelled the license—under both international and domestic pressure, etc.—however, is the Tamara radio locator really a purely passive defense system? In the—purely hypothetical—event that a retaliatory strike must be directed at Chinese territory, for the purpose of defense, in such retaliatory strike this radio locator would immediately change from a passive to an active tool. So we must be able to make this distinction in terms of possible arms export to China. I hope that the embargo will last until China becomes a trustworthy country as far as security is concerned.

Mr. SCHNEIDER. Let me say on the proliferation issue, well, China is a player in this field, and I think we should try to make it helpful rather than unhelpful. And I think Iran is going to be a test case for Europe because we are already, you know, active there. We cannot hide away from that, so we'll see.

Of course, we are aware of the facts you mentioned. But let me say one thing that I consider very, very important. There is less strategic awareness in Europe generally than in the United States in decision-making establishment. That's the reason why I think here the United States is making a mistake. The United States should be more active in a public diplomacy field in Europe to explain more its strategic views, because if these views are channeled only through the diplomatic channels and not publicly, they are not shared by the large number of people, and those who understand

the point are under heavy pressure from those who simply do not capture the strategic view.

Here I think there is a big deficit to address the European public and to try to change. European leaders are trying to pretend that Europe is poised to be a global player. You know that. It's in slogans and it's in speeches. Well, if Europe really is poised to be a global player, then it should be globally aware. And it includes strategic perspective. So it includes also strategic dialogue on a public level. The public should know this. And it plays a role. It plays a remarkable role, because for them it's not just the representatives of the public who say that they value more business than anything else. I think they reflect a kind of mentality that is, we don't care what's going to happen in faraway places. We don't care. We care what's going to happen in our immediate neighborhood.

Europe is, in fact, concerned about its neighborhood in broader terms, but it includes, in maximum, Middle East but not East Asian. I think this is what is the European concern in reality.

On the other hand, in economic terms European companies, multinationals operating in Europe, aspire to the global role. So we have here a disconnection, which we have to address together, and I think this is the major point, not the specific issues, but I think this in my view is a general source of these misunderstandings.

Chairman D'AMATO. Thank you very much. I think we take that point that the United States in your view should engage much more consistently and effectively in public diplomacy in terms of articulating the security concerns that we have.

We're going to open the microphone up here to the audience in just one moment, but I'd like to make one more point to Senator Ruml. That is, you made a very important point in your presentation of the need for the U.S. and Europe to seek common answers and common approaches. You also made the point that the Olympic Games provides us with an opportunity to put pressure together on China to make progress, and that makes the assumption, I think, that pressure is needed to achieve progress on human rights in China. Outside pressure is needed. Am I right in that assumption, that this is not going to occur by itself in China, but that pressure from the West is absolutely necessary for this kind of improvement in human rights in China?

I'd like to now open to the audience for five or ten minutes. Anyone who has questions in the audience, there are microphones right in the aisle, and we'd be glad to take any comments or questions from anyone in the audience on the issues of this particular panel today on the security dimensions of the relationship. Anyone have any comments? Go ahead, yes. Could you identify yourself?

Open Microphone

QUESTIONER. Good morning. My name is Martin Haller (ph), and I'd like to go back to the concept of strategic partnership that Chairman D'Amato has raised. I think it's a concept that deserves to be quite critically deconstructed, but if I remember correctly, it was actually long before Europe. It was President Clinton who proclaimed strategic partnership with China during his visit in 1998.

And even before him, it was actually Russia that has been talking about strategic partnership with China since the mid-1990s.

The American strategic partnership with China, of course, didn't last very long, at least not the concept, only until the next elections when it was redefined as strategic competition. But it seems that since 9/11, there has again been a shift towards something which very much looks like a silent strategic partnership, and previous concerns of human rights and democracy have actually been to a large degree de-emphasized in view of the new security concerns.

So I'd like to hear what is the position of this Commission on strategic partnership or competition, or whatever it is, with China. Thank you.

Chairman D'AMATO. Well, thank you very much. I could just start off by saying in terms of looking at what are the internals of a strategic partnership, for example, let's take proliferation, we find no strategic partnership in the area of proliferation that's worth anything. In fact, we're concerned about Chinese behavior in proliferation. So that's one aspect.

Another aspect would be in terrorism. We find the record mixed. The lack of progress on terrorism between the United States and China I think is fairly clear. We're concerned about the Chinese using the concept of 9/11, security, and anti-terrorism as an excuse to pursue an agenda in the western regions that we do not necessarily share. So I think we have to look at the ingredients of what this strategic partnership is. So far I think the ingredients are fairly thin in terms of an overall architecture as to the relationship. My colleagues may have a different view of this.

Commissioner DREYER. I would add that when President Clinton articulated this so-called strategic partnership, it was extremely controversial in the United States. Many people thought the strategic partnership was an effort by Clinton to take attention away from his domestic problems—and I mean not just domestic within the United States but within his own home—problems with his girlfriends. And it very quickly disappeared as a concept.

One of the nice things about being a congressional commission is that we do not have to defend the official position of our government, and we don't, most of us in this instance. We feel that the Chinese have been attempting to use the idea of a strategic partnership. As Chairman D'Amato said, the cooperation that the United States would like from China has been minimal. And certainly we have concerns about proliferation with regard to Iran, as our distinguished guests have mentioned.

When you hear somebody like Colin Powell, who is not going to be our Secretary of State much longer, say something like this, it's regarded as a rhetorical device without too much content behind it. So that's where I would leave it.

Vice Chairman ROBINSON. If I may, you have raised a broad set of questions there that gives us an opportunity to discuss some of the specific elements, and I think that's very useful. We've talked about the tests that are coming up. Jiří was very good about pointing out that Chinese behavior vis-à-vis Iran in this rather perilous nuclear window is going to be something that we should all be attentive to.

It is the fact that Chinese oil interests are expanding very substantially their activities in Iran as we speak, to the tune of deals valued at tens of billions of dollars, some of them newly announced on the part of Sinopec, China National Petroleum, and others. That's not what we had in mind in terms of rewards for Tehran at the very moment when we're pivoting between whether they're going to continue to pursue nuclear weapons or not.

Similarly, on North Korea, China should be using its unique leverage to defuse that nuclear crisis on a more robust basis. Ninety percent of the fuel, 40 percent of the food, 35 percent of its foreign aid budget, strong military to military ties—[tape ends].

—none of the above are being tabled for use as leverage at the present time, just the hosting of the six-party talks and more diplo-speak. That's not what the situation requires at this stage, in our view, and that's our collective Commission view.

Sudan—China's 40 percent of the oil interests of that country. Do we need to talk about the implications of that further from a human rights perspective, two million killed, four million displaced, with Khartoum's third round of genocide underway. It's not encouraging in terms of the insensitivity by China on display. They are no strategic partner of ours. And while we're witnessing the revelations of massive fraud under the Iraqi Oil-for-Food scheme, one of the largest in human history under UN auspices, which nation is the largest recipient of Saddam Hussein's vouchers that permitted their nationals to purchase oil but with a kickback to Saddam Hussein's regime? It may turn out to be China, perhaps not. One thing for sure is that their kickbacks help enable weapons production and to reward terrorists' families of suicide bombers and the other malevolent activities.

So this is just another way of underscoring the fact that we have a lot of ground to cover here before the term "strategic partnership" toward China becomes anything but a rhetorical and, I think, counterproductive slogan. Using this description of the relationship wins points for contracts and it certainly makes for more harmonious cocktail conversations, but we hope our European friends are considerably more rigorous and serious when it uses this term, particularly on an official basis, than what appears to be the case now.

Thank you.

Chairman D'AMATO. Thank you.

We have time for one more question if there's another person in the audience that would like to address the panel. And, incidentally, I might also mention, the Vice Chairman mentioned the report of the Commission. We have copies of that back here if anyone would like copies of our report.

Yes?

Mr. CERNY. Olympic Watch Committee was mentioned here very briefly several times, and so I have a question for Mr. Ruml. Would you please elaborate on this? When did it originate? Who does it consist of? What does it do? Thank you

Senator RUMML. [Translated from Czech.] The full name of this committee is the Committee for the 2008 Olympics in a Free and Democratic Country. The Committee was established 3 years ago. My colleague Zantovský, who is now Czech Ambassador to Israel, and I have established the Committee and I agreed to assume the

chairmanship after him. It is an international committee. It consists of well-known people from all over the world. For example the U.S. is represented by the former Ambassador Mr. Shattuck, Mr. Moravčík. There are also a number of European Parliamentary Deputies, Czech Republic public officials etc.

The goal of this committee is to create what I mentioned before: international pressure on China and the Chinese regime to use the time remaining until the Olympics and perform certain political reforms and release political prisoners. We work together with various institutions that monitor the issue of human rights and freedoms in China and our goal is to involve the entire international community in this struggle for freedom and democracy in China. Of course, our results are still very insignificant—therefore we must use it now—2004 is here and 2005 is coming—now is the decisive time when we must use the opportunity of the upcoming Olympic Games and exert significant pressure on China. I would certainly appreciate it if our Committee could stay in touch with your Commission in the future. I would like for us to know about each other and to share information and mutually support each other because after all we all have a common goal. Thank you.

Chairman D'AMATO. Senator Ruml, thank you for that explanation, and I think I can certainly be confident in speaking for the Commission that we would like to work with you on that. Certainly the opportunity to bring concerted pressure using the leverage of the Olympic Games shouldn't be lost given the need for concerted pressure to any kind of improvement in China.

This concludes our first panel, and we're going to have a short coffee break so we can continue this discussion, and then we'll begin our second panel in about ten minutes. Thank you.

[Recess.]

PANEL II: PERSPECTIVES ON SECURITY DIMENSIONS OF THE RELATIONSHIP II

Chairman D'AMATO. Welcome to our morning session on security dimensions of the relationship. We are pleased to have our two panelists: Senator Josef Jarab, Chairman of the Senate Committee on International Affairs, Defense and Security, Czech Republic; and Dr. Jean-Pierre Cabestan, Senior Researcher, the French National Center for Scientific Research at the University of Paris in France.

The overall focus of this panel is on the strategic relationship growing between the EU, Central Europe, and China. As this relationship matures, develops, there are bound to be impacts on the United States-EU relationship. So there are many trends that could occur, and this panel is to look at what may be the impact on the United States-EU relationship.

We will ask each of our panelists to give his remarks, seven to ten minutes, and then we'll open it up to questions. Again, we'll have an open mike at the end of the panel for any of those in the audience that would like to address questions to the panel.

So why don't we start, and who would like to go first? Senator, why don't you go ahead.

**STATEMENT OF SENATOR JOSEF JARAB
CHAIRMAN, SENATE COMMITTEE ON INTERNATIONAL AFFAIRS
DEFENSE AND SECURITY, CZECH REPUBLIC**

Senator JARAB. Thank you very much, Mr. Chairman. It's a privilege and an honor to have your Commission here in the Senate, which I'm sure is very happy and privileged to host this particular symposium.

Let me say to begin with that what has been said in the general view of the situation in China by my Czech predecessor speakers here I will not repeat and will not contend. So this is more or less what I also see the same way or very, very similarly.

I thought that I'd use, at least for my initial remarks, my personal experience and observations from the position that I happen to keep at this moment, Chairman of Internal Affairs, Defense and Security in the Senate.

Those observations are not firsthand observations from China. I've never visited the country. They are, rather, secondhand-first-hand observations from meeting Chinese delegations. Chinese delegations, when I say so, that means parliamentary delegations from Mainland China and from Taiwan, and comparing these talks we had and consequential ideas, feelings that I have had and was recently asked to give to a leading Chinese newspaper who asked me for an interview, and I would like to tell you a little bit in the end of my intervention about this experience as well.

So indeed, we would believe that China is different 15 years after Tiananmen Square. It was exactly on the anniversary of the event in China that we were asked to receive the Chinese delegation at the Committee on International Affairs here in Prague last June.

The very first observation I think is minute but still of some meaning. The delegation arrived at the Senate, but the Ambassador got stuck in the traffic. So we could not even start welcoming the delegation before the Chinese Ambassador came. You can read it whatever way, but I think that there is one reading that is quite clear to me, and that means the executive, or whatever the power, is still sort of very, very central.

Then I was not a very nice host. During the lunchtime, I thought that meeting of the day of the anniversary I would have to ask what is the reading of the events on Tiananmen Square today after 15 years have passed and after China is claiming opening up not only the market and opening up as a country, opening up its politics, et cetera.

I will not take too much time describing it because it was very interesting, even in minute detail, but I had to repeat during the lunch—and I realized how impolite that was—three times the same question. For the third question only did I get an answer.

I presented my question with: Is it still a counter-revolutionary event? Was it something else in the meantime? Or are you ready to thank the young people for opening up and help you open up to the world? Only after the third question I did get the answer, and the answer shocked me. I nearly fell off off the table: There was no violence. All the coverage is still believed as having been the product of Western press. And there was nothing more serious than a traffic jam that had to be cleared.

I expressed my great disappointment with this particular sort of answer, and here is the last remark on this event: When leaving the room, one of the members of the delegation said, "We may need another 20 years to see it differently."

I think that is quite telling. I thought I would share that with you, and I believe that it, in fact, reflects the complexity of what's happening.

Now, I have received two years ago, I think it is a year and a half ago, for the first time a delegation from the Taiwan parliament, and two, three months ago another one. And we talked with the people in some depth about the relationship, about the dangers here, and in a sort of half-jocular way, when they were saying is there a way of playing a role of a mediator, I said I'm willing to win the Nobel Prize for that, so I'm ready and I'm available.

However, I would think that it would be a stronger, probably, mediator that would be needed, like the United States of America, for instance.

Immediately after that, I got the invitation for an interview by a Chinese reporter, and I welcomed that, and we did very frankly talk for an hour. And two, three days later, he sent me an English translation of our interview. It is very objective. It's probably fuller coverage and fairer coverage of an interview than I get from Czech press, which is usually too long or simply too complicated or too sophisticated, or whatever, so it has to be brought closer to the reader. I have two questions to myself that I'll answer. And I can share that English translation of that with you, whether this is really the English translation of what the Chinese text was, and maybe our friends from China or Taiwan could help me find out, or whether this very frank interview can now be published, and the question now is anything can be published, but does it really have any leverage? Does it really have the effect? And so these are two unanswered questions that I do have.

In line with what has been said here before, I do think that what I've heard earlier, yes, the parliamentary role in the discussion is different from the governmental. -Or, it can be different from the governmental, not in contradicting it but to keeping the balance, as has been said, keeping somehow even the governmental policy under control, parliamentary control, let's say, but it can also extend it. It can go beyond because you can be franker, in fact, more sincere in questions that you do ask. And this is what my committee has been practicing on various countries—Russia, China, Korea, and other countries as well.

So I believe indeed that it is a complex question. I would still see that the hierarchy of these issues, complex as it is, should be settled, and the hierarchy for me is still the human rights, freedom, et cetera, as number one, and not as some people representing this country would silently sort of press it as a footnote or maybe a sort of afterthought. It is not an afterthought. It is and it should remain a priority.

Why do I say so? Because I believe that only the pressure that we can exert along the enthusiasm, which sometimes I feel a personal reservation about, the enthusiasm about the dynamic, explosive growth of Chinese market and industry and simply economic

results should not make us blind. As a matter of fact—and that may be my skepticism—they should give us another warning.

And here it is not only, as it has been mentioned, some governments in Europe. I believe that this is also very, very important to keep in mind in the United States of America. This is a question to the Commission. Do they feel that there are not quarters or forces in America guilty of not seeing it in this hierarchy, seeing the importance of economic and trade relations, you know, as more important than the human rights situation? This is one thing.

And, last, because I am taking probably too much time, the last issue that I would like to discuss a little bit or talk about it what is it really that we are talking about when we try to exert pressure about the human rights situation in China, because this is exactly the question I heard from the Chinese delegation and from the Chinese newspaperman. What do you mean by human rights?

My colleague, Ruml, mentioned already the U.N. Convention on Civil and Political Rights, so I mentioned that, and they say that we make progress on this and we may even sign it not too far into the future. But then what do you really mean by that? And I said, well, human rights, like one of the basic human rights is the right to life. And there was a very puzzled reaction to my reference to the death penalty. I know this is a controversial issue not only for China, and yet I'm mentioning it. And I have really welcomed the discussion, and our Taiwanese friends would probably be able to tell us what has happened with the recently proposed human rights basic law, including death penalty cancellation, abolishment in Taiwan, and other human rights like legalizing gay marriage, et cetera, in Taiwan. And I like the idea that I have mentioned a few times to our Chinese friends. The human rights basic law is, as they said, a sort of model not only for Taiwan, but also a model for Asia and especially for China at large.

This is something that I have mentioned in this article also with the Chinese newspaperman. The other things are Olympic Games. It has been mentioned here. I'm not only appealing—and I think we should not only appeal to China as organizers, but also to the international Olympic organizers and committee. How is it possible that a person from Taiwan who did win the Gold Medal in Athens did not hear his anthem and did not see his flag? I mean, what is it really in the Olympic international idea that prevented this particular sort of athlete this privilege that anyone else had? The Chinese organizers in the future guaranteeing that this would not happen anymore?

I know this is a symbolic gesture, but not only that, there is, of course, a human rights element in it and anti-discriminatory or discriminatory, whichever way you see that. So, yes, I think the Olympic Games should be a target, a very, very important target that we start to negotiate and exert as a pressure point for China.

Of course, the reaction is they may give in, you know, and attack, let's say, Taiwan when they declare autonomy immediately the first week after the Olympic Games are over. Someone even said more skeptically, maybe they do that a week before the Olympic Games, because all the money, et cetera, already has been in. I don't know. This is what I would leave for prognostics to decide.

I do believe, however, that the Olympic Games are a very important item on the agenda that we should follow.

Another one is—I'm starting to be too controversial. Another one is the Kyoto Protocol. Again, here in the Council of Europe where I'm a member of the assembly, we discussed the Kyoto Protocol, and I have learned there only that China, the producer of so much pollution, being compared to any other sort of—and probably even larger is absolved so far because it is a developing country. Oh, indeed, is this a developing country? And it's developing very fast, fine, but it is developing with a great deal of pollution that accompanies this development.

Now, again, part of China, one China, two systems, that means Taiwan, is trying to get into the Kyoto treaty and is not recognized. So the world is quite happy to have, you know, even Taiwan produce more pollution than they would if they entered or were allowed to enter the Kyoto Protocol.

Another one, World Health Organization. SARS and now AIDS, all these phenomena, and this part of China is asking for membership now, for observer, that means for access to fight, to challenge these epidemics. Not allowed, no support. In this Senate, I have to say, about—well, 45 percent of the Senators have signed twice already a petition to support this. Again, I think this particular thing could be supported and get support probably across Europe and maybe the United States as well.

I have not said much about security though all these things are part of it in the larger sense.

The last I would say now, human rights and the lifting of arms trade with China, the sanctions, the question was why did we—or would we, would I insist on the sanctions, and I said because of the human rights situation, et cetera, and the danger that, in fact, you know, China would [inaudible]. And I had to ask the Chinese representatives, both of press and the parliament, what danger is there to China. Is Taiwan a danger to China? And they had to admit no. They said no. United States, they said, is the danger to China.

With all the investment and everything, I asked, really, is it the United States, and they had to sort of soft it, you know, and they said probably not. So why do you, in fact, need the strengthening of the rockets that are already sort of very, very forceful, or too forceful there in the Strait, anyway? So we practically did agree with the newspaperman that maybe there is no need.

I don't want to put him into a difficult position back home, but I still had to repeat that we do feel that strengthening the Chinese armament would not be in the interest of peace in the region, in the interest of peace and security of us, you know, et cetera. Security. The question we have to ask: Whose security and from whom? I have partly sort of touched upon that, and that goes back to the stability, and stability or instability that my friend and colleague Ruml was talking about. And I do agree with him, yes, we have to sort of seek also the instability of the system that is [inaudible] in China.

Last, but not least, Tibet. And having spoken to Mr. Harry Wu, the dissident from China, for some time and having had the opportunity to speak to Mr. Sandhong Rinpoche, the Prime Minister of

the exile government, and to His Holiness himself, the Dalai Lama, here is a very, very serious concern. As the Dalai Lama said, in the early '50s and '60s, when the military crush came, it was manageable. The spirit of the Tibetans was still capable of surviving. When the cultural and political sort of measures started being used later in the decades, it was more difficult, but still manageable. When the commercial and economic measures are being used, these gentlemen are afraid that Tibet is really in danger.

This is to be taken as an epitome of what's happening in China where—and this is—I repeat what Mr. Harry Wu was saying. When the political elite, if this is the right word-[inaudible], a Czech philosopher, had for that [inaudible] bourgeoisie, he was calling it. This political elite are becoming the new capitalists of China. Are we better off? Are all the people in China better off? And this remains the question.

Thank you very much.

Chairman D'AMATO. Thank you very much, Senator, for a very provocative statement. I know there will be lots of questions.

Let's move now to Dr. Jean-Pierre Cabestan.

**STATEMENT OF JEAN-PIERRE CABESTAN
SENIOR RESEARCHER, FRENCH NATIONAL CENTER FOR
SCIENTIFIC RESEARCH (CNRS), UNIVERSITY OF PARIS, FRANCE**

Dr. CABESTAN. Thank you, Chairman.

Thank you very much for giving me the occasion to speak before the U.S.-China Commission and also to be here in Prague, which is my first occasion in this part of Europe, which is sometimes perceived as new Europe, but I think in mentioning this dichotomy between New and Old Europe, I would like to say that actually there is much more in common between the Eastern part of the Europe and the Western part of Europe vis-à-vis China than we may think, with one exception that I will deal with a bit, which is my own country. So when I will speak about the EU-China policy, I will not speak in the name of my government, but I will speak in the name of an independent observer who is intrigued by the differences of views which have emerged in the last few years regarding China, and with a special attention to the French case, which is maybe in many ways special, including within Old Europe.

Mr. Schneider earlier today has mentioned the complexity of the decision-making mechanisms, and that's part of the difficulties of Europe to put together a coherent and comprehensive China policy. You will see my written statement near the door. I will very briefly sum up some of the ideas which I included in it, and maybe discuss a bit more what are the implications for EU relations in particular as far as China is concerned.

As you know, for a number of years—and there is nothing new about it—China has been a priority for the EU. A number of policy documents have been drafted, adopted by the EU Commission, by the bureaucracy of the EU, with the consent of every member states, the latest document being in 2003, a document which qualifies the relationship as “strategic.” Here I think that the meaning of “strategic” in the European view is something which is much vaguer than in the Chinese language. The Chinese language is much more military or there is a much stronger military dimension

than in the Western European languages, and particularly in English.

At the same time, if you look at the document, the way it's worded, the idea is to create a strategic partnership to safeguard and promote sustainable development, peace, and stability. So it means that the relationship is global, is perceived as global, not only in the economic and trade relationship, which is booming, which is very strong, but at the same time that we as Europeans have an ambition to have some say on peace and stability in East Asia as well. Now, can we meet our ambitions is another question, but clearly that's the ambition of these documents and the way the EU as such sees its relationship with China.

Beyond the trade and commercial relations which are expanding very quickly, I think the whole idea of the EU—and there are some similarities with the U.S. in its policy towards China—is the fact that it's based on the prospect of a smooth expansion of the Chinese economy towards more market and more freedom. And it's also based on the idea, the expectation that the Chinese communist regime will gradually evolve towards more freedom and eventually democratize. But also there is something more specific with the EU's current ambitions, which is to have more say in Asian affairs and to be more active in Asian affairs, in a way trying to adjust with our economic and trade relations with Asia, which have been developing very quickly in the last two decades or so. And the idea is that the politicians and the decisionmakers have to come up with some sort of coherent policy. One of the illustrations of this policy is the setting up of the ASEM, you know, the Asia-European meetings, which is a forum for discussing not only trade and commercial issues, but also political, human rights, and strategic issues as well with Asian partners, including, of course, China.

Now, on the Chinese side, very briefly, at least at the government level, there has been a very strong interest in Europe with the promulgation of an unprecedented document last year in 2003 regarding China's relations with Europe or China's policy towards Europe. And it's unprecedented because in the history of the PRC's foreign policy, there has never been such a document devoted to one particular area in the world and what sort of policy should be developed toward that part of the world. The idea is to, of course, put Europe, at least in principle, at the top of foreign policy agenda, but also to set a list of demands to the Europeans in order to improve relations between China and Europe. And here there is an ironic dimension in this document, which is on the surface very friendly, boosting European actual influence, but, on the other hand, making a number of demands which are quite constraining for the European side if they are met.

Now, beyond the closer relationship, I think Europe as many, we would say, free nations, I'm thinking of the U.S. but also Japan and Australia, is facing with China a number of problems, and I think there are five of them; four at least are common with the other parts of the world I just mentioned.

First is the trade imbalance, and I think it's been mentioned that it's a real problem because we suffer a growing deficit with China, which is half of the U.S. deficit and was half of the U.S. deficit last year, \$66 billion, and with the appreciation of the euro, it's going

to be higher this year. So I think we're going to narrow the gap with the U.S. in terms of deficit with China.

Now, it raises a question of can we meet China's demands for being considered a market economy. I think the deficit problems, intellectual property protections problems in the market mechanisms in China will continue to impede any change of status of the Chinese economy in Europe. I think it's going to be very hard to convince the EU governments to change China's non-market economic status because that will feed the deficit and sort of weaken the protections we've set in Europe against antidumping practices, for instance.

The second problem is what I would call multipolar ambivalence, and here there is something more specific to Europe, and that goes to some extent beyond the French policy of trying to boost Europeans' status in the world and to use Europe as leverage in order to increase the French influence. But that goes beyond that idea because there is also a common ambition in Europe to have more say in world affairs, and not only, as was mentioned earlier by Mr. Schneider, within the European continent or in the vicinity of the continent, but also where we have more trade and political relations, so it means also in Asia.

But the trouble is that the French view, particularly President Chirac's view on a multipolar world, which seems to create some additional convergence with China, is a more divisive factor within Europe than a factor of consensus. And it's very hard to believe that this worldview can be transformed into EU policy. So EU as a counterweight to American influence, that's not something which is going to be bought by the majority of the EU states, be they from Eastern Europe, Central Europe, or Western Europe. I think it's a French idea, one specific policy in the French political spectrum, and we're going to live with it I think for a long time. At the same time it's not going to be a [inaudible] view.

Now, on the arms embargo, we'll just say I think you have two views on the arms embargo. One is a very diplomatic view, which is to say this arms embargo was decided upon human rights consideration, we should just look at human rights, the human rights environment in China today to decide if we should keep it or lift it. Of course, China has changed, and there is a good argument to put—actually, the human rights environment is part of the infringements we know, all of us. Today it's quite different from 1989.

Now, my argument is that there have been other factors which have actually prolonged the embargo much longer than other sanctions vis-à-vis China. As you look at the early 1990s, all the sanctions were lifted one after the other, and in the high-level meeting and so on and so forth, were all lifted. The only sanction which wasn't lifted was the arms embargo. And my argument is that actually there is one big change, and that Mr. Schneider mentioned earlier today, was the tension in the Taiwan Strait. I think in 1989 there was no tension in the Taiwan Strait. Both side were actually disarming the Taiwan Strait rather than rearming. And this trend was totally changed after the demise of the Soviet Union and the decision by China to move forces to the southern part of the country and to put more military pressure on Taiwan starting in the

'92-'93 period of time. So, since then, we have to face a new strategic environment in the Taiwan Strait and around China. So we can't just ignore this factor and base any decision regarding lifting of arms embargo just on human rights. And I think we have these two factors at least to take into consideration. That makes things more complicated. That's why there is a big debate of how can we strengthen the Code of Conduct to make it more binding. But for the time being, there is no consensus how to work out all these things.

Having said that, my conclusion is because of the majority view in the EU and because there has been a bad effect on smaller countries, the arms embargo as such may be lifted in the foreseeable future, in maybe one or two years. That's how I see it. But, in return, it will be a more binding Code of Conduct, and I think there will be also a concern in Europe to take into account not only the U.S. strategic interests in the region but also the strategic interests of other nations, particularly in Asia, I'm thinking particularly of Japan, which has showed a strong concern on this issue.

The fourth issue which is linked to the arms embargo is Taiwan, and I think here that there has been a very—at least at the EU level, a very proactive policy to prevent the Taiwanese leaders to come to Europe and a very timid policy towards Taiwan on the whole. I'm talking of the executive branch rather than the parliaments, who have been more willing to have contacts with the Taiwanese authorities.

There is a new trend, which is in my view concerning as well, which is the readiness of Paris and Berlin in particular to endorse China's view and one country's consistent formula regarding Taiwan. There have been some statements that have fed this fear, and while these statements—the problem with these statements is that they don't correspond to the EU policy on Taiwan. The EU policy on Taiwan actually is very similar to the U.S. policy, which is, first, one-China policy, second, peaceful resolution of the Taiwan issue; and, third, I would add that the EU, as the U.S., wouldn't accept a solution which would be opposed by the Taiwanese people. So I think these three conditions are still there and constitute the basis of our Taiwanese Cross-strait policy. And I think here the trouble is there are some variations from these principles, which have become more frequent in the last few years.

Finally, human rights. I think here differences with the U.S. have more to do with strategy rather than content or substance. We're all in favor of improvement of the human rights situation in China, the major difference being should we cooperate while putting pressure on China, should we stop, for instance, trying to raise the human rights issue before the UN Human Rights Committee, as the U.S. is still doing, and avoiding a debate in the UN on human rights and put priority on it rather than cooperation. My view is that we should do both, but the mainstream view of the EU now is to stop putting pressure on China in the UN on this issue.

So what are the implications, very briefly, for EU-U.S. Relations. I think the new EU common policy towards China can both—[tape ends].

[The statement follows.]

**Prepared Statement of Jean-Pierre Cabestan
Senior Researcher, French National Center for Scientific Research (CNRS)
University of Paris, France**

One preliminary distinction must be made between the European Union (EU)'s China policy and its various member states' China policy. China does not have the same degree of importance for France, Germany or the United Kingdom as in Denmark, Poland or Greece's foreign policy. Here, we will mainly discuss the China policy made and implemented by the EU's Council of Minister and European Commission and will address some of its member states's China policy when the latter differs from the former.

EU-China Policy

China is currently a priority for the EU's common foreign and security policy

- Since 1998, not less than three long policy documents (1998, 2001 and 2003) have been published by the European Commission, defining the EU's main political and economic agenda vis-a-vis China (and five since 1995).
- In 1998, the EU Commission decided to build a 'comprehensive partnership' with China, acceding in so doing to Beijing's wish since the mid-1990s to establish 'partnerships,' or privileged, economically cooperative and politically non-confrontational relations, with key nations. This partnership includes a multi-faceted programme of economic, scientific and technological, educational and legal cooperation. This programme is aimed in particular at strengthening bilateral political contacts and trade relations as well as better controlling pollution, alleviating poverty and favouring the establishment of a modern government system ruled by law in China. In 2003, the EU Commission went even further and stated that "the EU and China have an ever-greater interest to work together as *strategic partners* to safeguard and promote sustainable development, peace and stability."¹ This policy has received support from the Beijing authorities who themselves made public in October 2003 an unprecedented official policy document regarding their relationship with the EU (see below).

EU-China booming trade relations

- According to Chinese statistics, in 2003, China's imports from the EU amounted to 53.1 billion dollars (up 37.7% from a year earlier), representing 12.9% of its total imports, while China's exports to the EU reached 72.15 billion dollars (up 49.7% from 2002), representing 16.5% of its total exports. EU-China's two way trade reached that year 125.25 billion dollars, making the EU China's third partner behind Japan (134 billion) and just behind the U.S. (126.3 billion).

Led by France, that had concluded a 'global partnership' (as opposed to the China-Russia more explicit 'strategic partnership' concluded in 1996) with China a year earlier, in 1997, and Germany, this policy of engagement has been largely based both on three factors:

- The prospect of a smooth expansion of the Chinese economy and market;
- The willingness of Paris to promote a more multipolar world in which the EU would constitute an important and independent pole; and
- The expectation that the communist regime would gradually democratise.

China's EU Policy

- Since the mid-1990s, the EU has become a priority target of China's foreign policy. In October 2003, the Beijing authorities published an unprecedented official policy document regarding their relationship with the EU. Such policy documents have never been drafted before in the realm of foreign policy. This document needs to be briefly presented. It is an amazing and paradoxical text first glorifying the EU's power and influence and the world. Then it goes on stressing the converging views between China and the EU, their lack of conflicts of interest and their supposedly shared willingness to fight for a more democratic (a democratization that must however stop at China's borders) and multipolar world as if the EU was a real political and military pole, a prerequisite that does not yet seem to be met, at least in this author's opinion. Then, more interestingly, this document lists a series of order-looking demands on Taiwan, Tibet, human rights and the lifting of the arms' embargo that can but hurt the Europeans' self-esteem. For instance, it states that "it is important" that the EU does not let Taiwanese political personalities to have whatever activities in the EU, have any official contacts with Taiwan or sell not only weapons but also

¹All italics are ours.

dual technologies to the island-state. On Tibet, the tone is even harder: the document states: “China *demand*s that the European part does not have any contact with the so-called ‘Tibetan government in exile’ nor facilitates the separatist activities of the Daila Lama clique.” And without any word of conclusion, the document closes on the following sentence: “the EU must lift as soon as possible its arms embargo against China in order to eliminate the obstacles preventing EU-China cooperation in the military industry and technologies sectors.” One can only conclude from this document that China is taking advantage of the EU’s soft belly and political weakness to push further its envelope.

Problems in the EU-China Relationship

However, a closer EU-China relationship is not without problems:

1. **Trade imbalance.** EU imports from China represent today more than 5% of the EU’s global imports (114 billion dollars in 2003) and its trade deficit (US\$66 billion dollars) with this country is much bigger than the Chinese statistics, which exclude re-exports through Hong Kong, indicate (19 billion). In 2003, the EU only exported 48 billion dollars to China.² Moreover, ironically, France’s bilateral trade with China has constantly remained three times smaller than Germany’s and lags behind that of the United Kingdom and Italy. China’s accession to the WTO in December 2001 as well as the particular agreement it reached with the EU earlier have therefore more benefited the former than the latter. Though twice smaller than the U.S. deficit with China, this trade imbalance has fed an increasing number of EU complains about China’s lack of compliance with WTO commitments, its cheap currency and its totally inadequate protection of intellectual property rights. While in the eyes of many European manufacturers the EU commission attitude has remained too indulgent, Beijing has rapidly learned how to utilise to its advantage the WTO mechanisms, launching also an even more rapidly growing number of anti-protectionist procedures against the former and increasing its pressure on the EU commission to be granted a market economy status. In May 2004, when visiting the EU headquarters in Brussels, Premier Wen Jiabao repeated this demand. However, a month later, echoing the concern of many EU industries, the European Commission turned it down, indicating that it could not accept China’s estimates of costs and prices at face value because the Chinese government exerted too much influence on business through export restrictions and price controls and that corporate governance, property rights and banking industry in China did not meet free market standards. To be sure, when Beijing joined the WTO, it had agreed to be considered a non-market economy for 15 years, but it has more recently sought to have this overturned through a special procedure in order to decrease EU’s imposed duties on its products and circumvent more often EU’s anti-dumping procedures against them. True, as Pascal Lamy, former EU trade commissioner, indicated earlier this year, these procedures concerned only 0.5% of all China’s exports to the EU. Nevertheless, Beijing is eager to get a status it has already been granted by Singapore, Malaysia and New Zealand and more recently by the ASEAN, Brazil and Argentina, hoping that it will put additional pressure on the U.S. to eventually also grant it to her.

China’s status as a non-market economy means that the European Union does not have to rely on cost figures given by Chinese exporters when determining if goods are being sold in the EU below cost. The Union can instead consider cost and price data from other countries when it decides whether to employ duties on Chinese exports in defence of domestic producers or launch an anti-dumping procedure.

2. **Multipolar ambivalence.** Although Paris has managed to convince Germany to emphasise the EU’s converging interests with China, other EU members are less than enthusiastic about endorsing a French ‘multipolar strategy’ (demonstrated starkly in divisions during the Iraq crisis). At the same time, the overall priority given by Beijing to its relations with Washington—and hence its very mild criticism of the Iraq invasion—have led to Chinese leaders strongly toning down their own multipolarity, gradually substituted to it the much less anti-U.S. concept of multilateralism. Sponsored by China, the six-country talks on North Korea military nuclear program are a good illustration of this new approach.

²By comparison, U.S. customs registered in 2003 a Sino-American trade amounting to 180 billion dollars, including 152 billion of Chinese exports and 28 billion of Chinese imports. The U.S.’s trade deficit with China amounted to 124 billion (23% of the U.S. overall trade deficit). Japan registered the same year a bilateral trade amounting to 145 billion dollars, including 62.5 billion of Chinese exports and 82.4 billion of Chinese imports.

3. **Arms embargo issue.** The Franco-German plan to lift, under Beijing's pressure, the EU arms embargo imposed upon China in the aftermath of Tiananmen has been another dividing issue within the EU, and has attracted more and more vocal criticism from Washington:

- Although some EU members, such as the Netherlands have recently rallied to the view that the human right situation had globally improved since 1989, others, such as the Scandinavian nations, are less convinced that the registered improvements are clear enough to allow such move.
- Others, closer to and under a strong pressure from the United States such as the United Kingdom (that has actually discreetly provided military radar technology to China in the 1990s) avoided for a long time heralding any clear-cut position on this issue, hoping that Washington would eventually accept to trade off the lifting of the EU embargo against establishing a much stronger and less ambiguous code of conduct on arms sales to non-democratic countries and zones of tensions than the one adopted by the EU in 1998.
- For a long time dominated by human right considerations, the EU debate on lifting the arms embargo towards China has taken since early 2004, probably because of U.S.'s pressure, a more strategic one. Even in countries favoring the lifting of the embargo, some political voices have been heard mentioning the possible impact of any end of the embargo on the cross-Taiwan Strait situation. For instance, Joska Fischer, the German Foreign Minister, pressured by his Green Party militants, unexpectedly made this point, creating a potential disagreement within the German government on this issue.

The transatlantic as well as intra-EU negotiations on dual technology exports to China will probably be delicate ones, in view in particular of the programs in which this latter country has already been invited to participate by the EU. For instance, it is the EU that proposed that China invest in the civilian facet of the Galileo satellite program in 2003, opening the way to unreasonable but expected Chinese demands for an access to its military observation dimension. True, the EU's expansion in May 2004 has probably made more difficult any collective lifting of the arms embargo to China, in particular if the United States decides to exert strong pressures on the EU's new members, often closer to Washington than Paris or Berlin on several security and international issues. However, within two years, it is highly probable that the EU will eventually agree upon lifting the 1989 arms embargo to China because the EU small or new members do not seem ready to turn this issue into a major point of contention with the EU bigger (and arms exporting) members. This decision's implications in terms of EU arms sales to China remain difficult to assess. But the EU members states that have a weapon industry will obviously be tempted, in spite of a probably somewhat more biding code of conduct, to meet the most attractive demands made in arms acquisition by the Beijing authorities.

4. **Taiwan.** The Chinese pressure over the arms embargo is aimed not only at achieving the complete re-normalization of its relations with the West since Tiananmen but also at strengthening its strategic posture in the Taiwan Strait. Taiwan is a further difficult issue for the EU. While the European Parliament has in the last few years adopted several resolutions denouncing China's military intimidation of Taiwan and supporting the consolidation of the island's democracy, major EU states—such as France, Germany and even to some extent the United Kingdom—have embarked on a conciliatory policy towards China:

- They have been pro-active in preventing Taiwanese leaders from visiting the EU, while Washington has repeatedly let president Chen Shui-bian transit through the United States since his election in 2000.
- They have not supported in Spring 2004 Taiwan's entry into the World Health Organization as a quasi-state entity as the U.S., and Japan did but proposed to give it an NGO's status obviously inadequate to Taiwan's reality.
- Paris and Berlin in particular have been tempted to espouse Beijing's view about Taiwan's status and reunification. When visiting China in December 2003, German Chancellor Gerhard Schroeder not only reasserted that his country would continue not to sell any 'sensitive materials' (weapons) to Taiwan but also compared China's division to Germany's before 1990 as if Taiwan had much in common with the now-defunct German Democratic Republic. When receiving his Chinese counterpart Hu Jintao in January 2004, French President Jacques Chirac went so far as to describe as "irresponsible," "aggressive" and "dangerous for everybody" Chen's *revised* (under U.S. pressure) referendum initiative on how to address China's missile threat and open peace negotiations with Beijing.

Such views from large member states underscore the difficulty the EU has in developing a strong, credible and clear strategic vision in the Asia-Pacific region. In such a context, the EU-China dialogue on human rights has been able to but yield meager results. Promoted by China in order to diminish tensions with the West and convince it not to sanction her at the UN Human Right Committee in Geneva, this dialogue has not favored any substantial improvement of the human right situation on the ground. How many political prisoners the EU or its member states have contributed to free in the past decade? Maybe one or two. While this timid approach has fed a growing resentment within the EU—and in particular the European Parliament and among NGOs—it remains extremely unlikely that the EU will alter it in the foreseeable future and for instance submit again (as before 1997) a resolution *just asking to discuss* the human right situation in China at the UN Human Right Committee meeting in Geneva.

Though China policy remains problematic and divisive for the Union, the EU's mainstream view is that China is important and should be a priority of its common foreign and security policy. Differences between the EU and China therefore, though acknowledged, should not hinder the development of EU-China relations because engaging China is perceived as the best strategy to integrate her into the world community and help her to succeed its economic reform and development and thus eventually its legal and political modernization. What are the implications of EU's China policy and EU-China relations for EU-U.S. relations?

Implications for EU-U.S. Relations

The EU's common policy towards China as well as its main members' China policy can both narrow and widen the gap between the EU and the U.S.

Among the factors that can narrow EU-U.S. differences, are a common will to carry on a policy of engagement towards China, a shared recognition that this country's economy and regional influence will continue to grow in the coming years as well as a joint hope that, as she is becoming stronger, China will act more and more as a responsible member of the international community and eventually accept to apply to its domestic stage the democratic principles that she heralds outside, favoring a gradual change of its political system. There is also a largely common view on the Taiwan issue based on an acceptance of the "one China policy," a support for a "peaceful resolution" of the differences between Beijing and Taipei and also an opposition to any move that could destabilize the status quo. At the same time, as the U.S., the EU would not welcome a solution that would not be acceptable to the Taiwanese. Finally, on WTO, in spite of noticeable conflicting commercial interests, both the EU and the U.S. are pushing for a better respect by China of its international commitments, in particular in terms of market access and administrative and legal transparency.

But there are differences that can complicate the EU-U.S. relations. Disagreements about human rights and the best strategy that should be applied in the UN towards China are not going to have a major impact on these relations. The fact that the EU as such, because it generally agrees upon the smallest common denominator, will probably not be in a position to put pressure on Beijing on the Taiwan issue either.

France's, Germany's and other EU member states' tendency to endorse Beijing's reunification policy (and one country, two system formula) can become more troublesome for the U.S. since it can but contribute to strengthening China's hand in any future talks with the U.S. on Taiwan's status (e.g. the negotiation of an interim agreement with an American guarantee).

More importantly, the EU as a whole has not enough realized the implications of China's growing regional influence and ambitions for the security and the stability of the Asia-Pacific region, opening the door to major differences of perception between Washington and several important European capitals, such as Paris, Berlin, Madrid and even to some extent London. On non-proliferation, the EU has focused on welcoming China's positive changes (such as the ratification of the NPT in 1992), underestimating the remaining problems. Similarly, the EU tends to minimize the security (and commercial) consequences of its transfer of sensitive technologies to China. The growing military pressure exerted by the PLA on Taiwan is a subject rarely raised by EU leaders when they meet their Chinese counterparts. And in spite of the evolution mentioned above, the debate on lifting the arms embargo does not give enough consideration to the Taiwan factor, the U.S.'s strategic posture in the Asia-Pacific region or the concern of other Asian countries (such as Japan). Trade and business considerations seem to have taken the lead in the EU's China policy. And in the case of France, this explanation is not sufficient: a willingness to counterbalance the U.S.'s global influence seems to be the driving force of

French President Jacques Chirac's multipolar diplomacy, relegating to the second place the political values shared by France and the U.S.

Having said that, France's China policy has few chances to become the EU's joint policy towards this country. While the lifting of the arms embargo, when it is decided, will contribute to sour the Transatlantic relationship, EU's actual weapon sales to China will probably continue to take into account the U.S.'s security interests. And more generally, the EU's growing economic and political presence (through the ASEM) in East Asia will force Brussels to adopt a more mature, responsible, security-conscious and concerted China policy.

In view of all these factors therefore, a more regular dialogue and a better coordination between the EU and the U.S. will not only be welcome, but also felt by most EU member states as more and more necessary in the years to come. And these closer dialogue and coordination will probably be conducive to better managing the differences between the EU's and the U.S.'s China policy.

Panel II: Discussion, Questions and Answers

Chairman D'AMATO. —talk about the WTO. They want to be declared a market economy right away, getting Brazil to declare them a market economy and so on and so forth. So it would be very interesting if they would now agree to become a member of the Kyoto Protocol. And this is of great interest to the United States because the major Senate resolution in the United States on the question of American participation in Kyoto, there were two conditions in that resolution which were to be satisfied before the Senate were to agree to join the protocol. And one of those conditions was to include China as a member of the treaty organization. It wasn't referred to as China, but it was a "major developing emitting country," which is China and India. So that was a very important factor in the decision of the Senate to defer American participation in that treaty, because I think we have too much politics and too little science in these decisions, because without Chinese participation in the Kyoto accords, of course, they would be unsuccessful.

Second, you had a question for us. I know the Vice Chairman and I are both eager to answer that question, whether there were forces in the United States that regard commercial factors to be more important than human rights. Unfortunately, that is the case, in our view, and it is an unfortunate situation that there is a rather narrow-minded view on the part of many economic actors in the United States to the exclusion of what I think is a much broader and more important policy. I suppose that those industries would say, well, human rights is the business of government and not industry. But my view is that that is a copout. That is a copout.

I think the Vice Chairman wanted to say something on that as well.

Vice Chairman ROBINSON. I would only echo the Chairman's view. I think that this is one of the features of our Commission that has been one of the most satisfying personally for me over the three and a half years or four years that I've had the privilege to serve on it, that there is this rather consistent bipartisanship in our assessments. I would just mention for the record, for those that may not be familiar with the Commission, that our first annual report to Congress had an 11-1 vote of Commissioners on what was a very robust, realistic, hard-headed view of China that was not altogether appreciated in Beijing. It was, however, much appreciated on Capitol Hill. In addition, we achieved a unanimous consensus and vote on this past year's report that we issued in mid-June.

That said, this is an area where that consensus has held rather firmly, at least with the vast majority of Commissioners. What is affectionately termed in the United States the “China lobby” does exist, and is the most vocal faction of the policy positions toward China, very influential with the Executive Branch, independent of which party is in power. You would think that there would be marked differences between the parties, but ironically there are not. I think that those that place human rights and security-related concerns at the top of the agenda from a policy-making perspective are a minority voice at this juncture. This problem is arguably growing worse.

Instead, the U.S. should be serving as the greatest advocate of human rights, and particularly national security concerns, as we have the most forces forward-deployed in the region. It’s not to say that there aren’t scenarios where security trumps trade, that something outrageous like the Tiananmen Square massacre isn’t going to bring human rights to the forefront, but as a consistent policy priority so that we’re just not sending consistently the right kind of messages to Beijing with respect to security-minded discipline, transparency, disclosure, and accountability on all fronts. That kind of consistency is in relatively short supply.

Chairman D’AMATO. Thank you, Vice Chairman.

Commissioner Dreyer?

Commissioner DREYER. With regard to the Senator’s comments about the forces in the United States seeing the importance of economic and trade relations as more important than human rights, my fellow countrymen have a tendency to define this problem out of existence, and this is something which the Commission unanimously concurs is not right. They say that, as economic relations mature, implying, of course, the United States should establish as strong economic relations as possible, this will necessarily engender political pluralism. That is, economic pluralism will give rise to political pluralism, and at that point human rights problems just disappear. This is poppycock, as the Commission agrees.

What do we mean by human rights? The Chinese have this facile ability to say, well, we believe in positive human rights, the right to a job, which, of course, they’re not living up to, and the right to an education, which, of course, in rural areas they’re not living up to, and the right to good medical care, which they’re not living up to at all, as the response to SARS showed. We should stress that what we mean by political rights is to release political prisoners and to stop suppressing dissent. Meanwhile, what we’re engaging in is double-talk, and that’s the politest word for it.

On the right to life, here, again, I think we really have differences of opinion. Right to life meaning in this case the death penalty, is used very sparingly in the United States, too sparingly, in my opinion, but the idea of reserving it for truly heinous crimes like killing large numbers of people premeditatively is something I would concur with. We could probably also agree that using it to silence political prisoners and the suppression of dissent is unacceptable. About the right to life meaning the abortion issue, I have to be sympathetic with the Chinese government on the family planning issue because it is the government who is responsible for feeding all of these extra mouths in a deteriorating environment. So

the idea that people should restrain their procreative impulses is actually something I can agree with.

I think your idea about the Olympics being used as a lever is wonderful. Something else I would suggest is reforming the Red Cross. Here I refer to something which is so horrible that I've never gotten over it. There was a terrible earthquake in Taiwan on September 21, 1999, and the Red Cross said it was not going to give equipment and aid to Taiwan unless the People's Republic of China gave its permission. If there were ever a need for immediate aid this was it. People were lying underneath buildings dying. I think there should be a boycott on the Red Cross until it agrees that everyone, everywhere, regardless of political affiliation, deserves help in an emergency. Its behavior here was shocking.

Tibet. I have been discussing this question with Tibetans, and what they suggest is that they would like to seek a middle way. They understand that culture changes of necessity, no matter who is in charge. What they would like, and what we would like to see, is Tibetans controlling the change of their culture rather than Han Chinese in Beijing doing it. I don't know whether you're aware, but the Committee for Tibet in the United States has had a number of very successful concerts to help Tibet. They all feature famous rock groups performing en groupe with chanting monks from Tibet. It's quite charming to see these young monks in traditional robes dancing to the beat of the Beastie Boys, the Smashing Pumpkins and other rock groups.

Finally, and this really is my last comment, with regard to Jean-Pierre's saying that the human rights environment has changed; my French son-in-law tells me that Americans have sayings that French don't use, even though they're in French. One of them is, "Plusque ca change, plus c'est la meme chose." The more things change, the more they're the same. I would argue that the human rights climate until May 20, 1989, i.e., before martial law was declared in Beijing, was actually the freest it's ever been in the PRC and it's never been as free since then. People's Liberation Army colonels were holding seminars saying shocking things like Lin Biao was actually a very great military commander who was better than Mao Zedong, and that Chiang Kai-shek really wasn't such a bad guy after all. Ironically, Chiang Kai-shek was more popular at the time in Beijing than he is in Taipei, where nobody likes him anymore. Then there was a major crackdown. Now what you have is more subtle methods, but there's still tremendous suppression. Perry Link has referred to these methods as the anaconda in the chandelier. You can see that there's a chandelier and you can see there's a big snake in it ready to strike. You're looking up at it and it's looking down at you, but you don't know when it's going to strike. So you tailor your position. In other words, these methods induce self-censorship. I can also argue about the disappearance of the young Panchen Lama, whose "crime" was being favored by the Dalai Lama. So I personally don't think human rights has actually gotten that much better.

Chairman D'AMATO. Thank you, Commissioner.

I do have a question for Dr. Cabestan. In terms of your perception, this Commission recommended recently that the United States take a more active role in the Taiwan Straits to facilitate—

instead of being actually a mediator, but to facilitate mediation and dialogue between the two parties.

What is the position, as you understand it, of the French and the EU in terms of taking a more active role in the Straits to defuse the question and bringing about the development of a dialogue between the two parties?

Dr. CABESTAN. Can I just say a few words of answer to June?

Chairman D'AMATO. Sure.

Dr. CABESTAN. I was referring to the EU's view on human rights, which I tend not to agree with. Having said that, there have been a number of changes in the realm of the legal system since Tiananmen until since late 1990s, and I would argue that there have been some reforms which have had an impact on the human rights situation in China proper. I'm not talking about Tibet, Xinjiang, because since 9/11 in Xinjiang repression is even fiercer than before. But at the same time, I think the society in China, to put it very simply and briefly, is somewhat better equipped to defend itself than even before Tiananmen against human rights abuse on the part of the government.

I'm not saying that it's satisfactory, as you know, but there is a growing pressure coming from the society on the government, and the society itself has better weapons in order to defend itself. And I think this pressure is growing, and somehow the authorities have to accommodate this pressure. So there's been a change.

The other thing is the society is segmented. There's so many different pockets now that if you are a member of the elite in China, or one of the elites, economic elite, political elite, or intellectual elite, you are freer than the rest of society. You have more access to Internet. You have more access to freedom of speech. If you look at the freedom of speech within the campuses, it may be bigger than in the 1980s. But it's limited on the campus. As long as you're an intellectual, you have access to English, you can say much more than you could say ten years ago. But, again, as long as it remains of the public space, and as far as the public debate is concerned, it's still very, very much constrained. We know all the time the press is—and the most outspoken newspaper right now Nanfang Zhoumo are facing today.

Now, the question of Chairman D'Amato regarding the role that you could play in the Taiwan-China rift, I think on the whole there is a lack of—well, until very recently there's been a lack of interest in this issue among EU diplomats. The mainstream view has been to adopt a somewhat [inaudible] policy vis-à-vis the tension in the Strait, and what I mentioned in my written statement is that the growing military tension is rarely addressed as an issue when we have meetings with Chinese.

Now, there is a new trend within Europe of people, including in the governments, who would like to see Europe being more active on this issue as well. I don't see it as very powerful for the moment. I don't see it as being able to really use what the EU could use, and that's a very personal opinion. I think in Europe we have a toolbox, which would help both sides to agree upon some sort of idea and go beyond the dispute on sovereignty they're having today. But I think it's too early to say that the formula which the EU could help both sides to agree upon or define together, it's too

early to say that we're ready to have an impact on this for the moment.

Chairman D'AMATO. Thank you very much. I actually think that that is certainly one area where a more intense transatlantic dialogue could reach some progress in the near future.

I think we're a little bit late in getting to our luncheon engagement. I did want to mention to you that we have additional time this afternoon from 1:30 to 2 o'clock. So if you two gentlemen are free to come back, we could spend a little more time at that time, spend another half-hour before we begin our afternoon session. We would like to invite you to do that.

This concludes the morning session. We will be back here at 1:30 after lunch. Thank you very much.

[Luncheon recess.]

AFTERNOON SESSION, 2:00 P.M., THURSDAY, DECEMBER 2, 2004

PANEL III: INDUSTRY AND LABOR PERSPECTIVES ON CHINA'S ECONOMIC AND TRADE POLICIES

Chairman D'AMATO. The Commission will come to order, the symposium will come to order. This is the beginning of our afternoon session, Panel III, industry and labor perspectives on China's economic and trade policies.

This panel has been designed to examine the economic relationship between China and Central Europe. There are also growing concerns over the deficits these countries have with China and the need to seek a more balanced relationship, meaning more exports to China. The Czech machine tool manufacturer Tajmac, we have a representative from them-but he's not here yet. But that tool manufacturer had a Chinese joint venture that initially appeared to be very lucrative, but then in September 2004 this apparently was on the verge of a collapse because the Chinese apparently restructured the joint venture company. So that's a story that we'd be interested in hearing.

We also have representatives of the Škoda Auto plant, which will be opening a plant in China to produce cars. It will begin manufacturing automobiles in southern China in 2005, next year. Skoda plans to build a factory in Shenzhen, across the border from Hong Kong, apparently, and in addition to the Chinese market, Skoda will target Southeast Asian markets.

What we'd like to do is ask each of our panelists to give us some remarks, seven to ten minutes, and then when all the panelists are finished, we will have some questions and answers, if that's acceptable.

Let me start from left to right, if that's possible. Mr. Jan Musil, CEO of Škoda Energo, Czech Republic, why don't you go ahead. You can start, Mr. Musil, and if you can give us a few remarks, we would appreciate that.

**STATEMENT OF JAN MUSIL
CEO, ŠKODA ENERGO A.S., PLAZEN, CZECH REPUBLIC**

Mr. MUSIL. Czech or English?

Chairman D'AMATO. If it's more comfortable for you to go in Czech, we can have that translated.

Mr. MUSIL. Czech?

Chairman D'AMATO. Czech is fine.

Mr. MUSIL. [Translated from Czech.] Let me introduce myself. I represent the company Skoda Energo, part of Skoda Holdings and I would like to briefly introduce the situation of our firm with regard to China. We have traditionally delivered products to China, the tradition goes back 70–80 years, primarily in the area of steel-making products, the power-generation sector, transport systems and machine tools. Currently Skoda Holdings focuses on two areas, the first being the traditional energy industry sector and the second is transport systems.

What is our present situation in terms of China? As we all know, generally Czech industry and the Czech economy have a huge deficit; the trade balance between China and the Czech Republic is—1.7 billion dollars—and this must be addressed not only by corporations, this must be primarily addressed at the level of governments of both countries. Skoda contributes, as I said before, in the area of transport systems and the energy industry. Together with other Czech subjects, Skoda Prague and Skoda export, we have delivered products totaling 5–6 billion CZK to China during the last 10 years. Currently we are in the final stages of constructing a 2 x 500 MW power station in Shen Tou, China. We, Skoda Energo, have established a joint venture in Guangzhou with Guangzhou Enterprise, an engineering company that for us represents a bridge to China.

It is impossible to come to China, in two or three weeks put together contacts and negotiate a contract—it does not work that way. China is a big country and as big as the country itself and the Chinese Wall are, so great is the patience and so slow, patient and consistent is the work it requires. I believe that we are succeeding. Our joint venture in Guangzhou (the Canton Province) is an engineering enterprise. We in the power industry have one strategic territory—and it is China. China has a great future potential—every year it needs to build approximately 37 GW; local subjects are able to build 18 GW, meaning that there is a gap of 19—this is the gap that can be delivered from abroad, and of course companies such as the U.S. GE Power System, the Japanese Mitsubishi and Toshiba corporations as well as European global firms such as Siemens have an eye on this gap. But there is enough room even for smaller players, such as Skoda.

There is a chance for all energy equipment suppliers and therefore the attention of the entire energy industry world is today focused on China. China needs to build; its economy needs it; they have their future Expo, they have their Olympic Games and all that requires human energy. Our joint venture works on the following principle: we deliver technological know-how, we will move part of our production to China and then together with the Chinese we will supply to the Chinese territory and further to India.

On the other hand China provides us with research and development specialists. Another possibility is that we will move some parts of our design and production to China. We have ongoing discussions about our idea of support by the Czech government and parliament and the Chinese state representation. Of course we know how such things are addressed on a political level. I would take inspiration from the United States—you exercise wise policy.

Of course as a big country you define the rules of the game—then you bring such rules to others.

On the other hand you know how immediately to bring businessmen together with such rules and then these business people can start working on contracts. Germany also does a good job. In my opinion, the situation in our country is rather contradictory; in this country we must fine-tune the situation and reach an agreement: do we want to do business in China? If so, then the state representation must clearly express itself and this country to China—if not then the chance becomes extinct. I think that we can talk about it more in the discussion. I just wanted to explain what kind of business we do in China. Other colleagues are also here and so in the discussion let's talk about where we see problems and obstacles to our operations in China. Thank you.

Chairman D'AMATO. Thank you very much, Mr. Musil. I'm sure there will be lots of discussion and questions in terms of your energy operations in China.

Now let me turn to Dr. Oldrich Schwarz, who is the director of a private company doing business in China known as Experta, also known as Libra. So can you please explain to us what you're doing? Thank you.

**STATEMENT OF OLDRICH SCHWARZ
DIRECTOR, LIBRA MANAGEMENT GROUP LIMITED
PRAGUE, CZECH REPUBLIC**

Dr. SCHWARZ. Ladies and gentlemen, I will speak English because I am actually connected with a British company, Libra Management Group. This is a business educational firm using the services of certain members of the faculty of London Business School. We have been operating in this country since 1992. About 2,000 managers have attended our seminars and courses, and in 1995, we have decided to also run conferences and seminars on China. Our London management, which is very well connected in Britain, supplied us with first-class experts on China, and so we started to prepare excursions in hopes of gaining more knowledge about China. From 1999, we have brought to China about 100 Czech and Slovak entrepreneurs in small groups. They met the partners. They saw the country. They have done very little business, which is, of course, a problem.

I am of the opinion, because I just had a word with my colleague here, that it's not actually a question only of governmental support, Czech governmental support, that it's a question of the incompetency of Czech industry. This is actually a new country market economy, and it's natural, and we had some very large industrial representatives coming with us to China. They have done this because they thought the Chinese are stupid, and they have to actually accept any ideas which are out of date and they are 20 years behind. So I wouldn't support the idea that it's a question of policies. It's a question of understanding China. We are now running a small course for 15 people with the support of the Association of Industry and Commerce and with the support of certain specialists from the Ministry of Industry and Commerce, and we insist they have to know about the basics in China. Unless they know the basics, they can't get any results.

According to the information which we actually amassed, there are certain special features of the development in China. We have a lot of information also from the United States, especially from the bank of Morgan Stanley where the chief analyst, Stephen Roach, is a source for us because my son is working at the bank. So we know quite a lot about that. The basics of the Chinese turnaround after Deng Xiaoping came to power is in three points:

The first is opening China to the world and involving the 40 million overseas Chinese to help them to actually reorganize the country. These were people from Hong Kong, from Taiwan, and from America, from many places. This was a very sound idea and helped to speed up development.

The second point, which we regard as the most important, is putting economics before ideology. If you put forward economics, ideology is not that important. This was a very successful development as far as China is concerned.

And the third point, which is typical for China, is the leading role of the Communist Party. [inaudible] have the Communist Party which is nowadays 70 million members, not the old members, mainly new members. They could never organize in such a vast country with such results as they have reached. These are the basics.

Of course, there is actually a question of what will follow. I am of the opinion that there will be two scenarios, as certain people say. One is optimistic and one is pessimistic. The pessimistic one actually leads to a decision on the basis of force, which I hope won't happen. And the other is that it will follow on the basis of mutual understanding.

As far as force is concerned, China is a very strong country. You can't actually deal with this country as you would with a small banana republic or even with Serbia or Croatia. They are poor. They don't have much influence. But China is rich. Actually we learned they have [inaudible] reserves in the region of over \$500 billion. If they want to give to somebody money, they give it. They have given now—promising in South America, in Latin America, to Brazil, \$20 billion. They had to acknowledge China, which is mentioned in your documents, as a market economy. It's not the main thing that they have to do. Then they went to Argentina, which is in a very poor condition, and they wanted also \$20 billion, but they also had to acknowledge that China is a market economy and then there will be a big exchange of goods, which is connected with the decision. So they are using as a very strong tool, they are using economics, not even towards Latin America but towards countries like actually Australia. Australia is very much involved in supplying China. They have now invested \$1.5 billion into the third largest company on minerals and other things that they need.

Japan is doing big business with China, even if they are not loving each other, because there are still the memories of the Second World War and the years before. They were very cruel to the Chinese. But even so, the exports of Japan to China increased twice in two years and are amounting to \$211 billion, the whole economy and the prosperity of the country is influenced by that. And a similar situation is also going on with other places.

So actually my guess is that the best way to deal with China is through economics. As Stephen Roach claims, there are two engines running the world. One is China, and the other is the United States. Together on purchase power parity they account for 34 percent of the global product of the whole world. So if there is disagreement on the commercial side, it will have terrible consequences for other countries.

So we are actually hoping that China will develop a system gradually, as economics are concerned, towards a market economy in the real sense, and that it will reduce the leading role of the Communist Party because it will replace the entire command economy from the side of the government. According to our analysis, they will go the way of Keynesian economics, though they don't know much about Keynes, but they know about Japan, they know about actually the Asian tigers, and they know about Singapore. One of the main advisers to China is well-known former Prime Minister Lee Kuan Yew, and Singapore was following this way, so they are actually seeking patterns and [inaudible] will be a pattern of narrow Keynesian economies even if Keynes wasn't known to China and they didn't hear much of him.

So what I would see, because there is now a notion that China, there are these prognostics who talk a lot, that China will be the strongest country in the world within, I don't know, 40 years, and that it will overcome the economic force of the Germanys and Japans and United States, and will have [inaudible] role. I don't think it's necessary, I feel, that through analyzing the economic forces that should be, and could be, leading countries in the world. And there is a possibility because China is so dependent on the United States, so dependent to find ways how there would be two, three, or four leading countries actually having competition as far as the world economy is concerned.

I have quite a lot of ideas how this should be done, or we have had many things—I must say that as far as the Chinese are concerned, they have nothing against Americans. They don't like the British because there are still the memories of the opium wars and of the years between the two wars where they were sitting in their residences in Shanghai and not behaving too well towards the Chinese. But as far as Americans, Americans have never occupied China. And when I spoke to normal folk, you would find that they are actually finding a lot of examples as far as “Americans” are concerned. They would like to live in a certain way as Americans. So there is a great chance to solve these problems.

So these are my remarks. I will gladly answer questions. And if there would be an interest in more written materials, we have amassed a terrific amount of analysis, coming mainly from the West and from our contacts in China, so we would be glad to pass them over to you at any time you ask us for it. Thank you very much for your attention.

[The statement follows:]

**Prepared Statement of Oldrich Schwarz
Director, Libra Management Group Limited, Prague, Czech Republic**

Our company, the British owned firm Libra Management Group, has been teaching Effective Western Management covering Czech Republic and Slovak Republic since 1992. Over 2,000 senior managers and company owners attended our seminars

and conferences. In 1995 we started to organize conferences on modern China. Since 1999 we organized eight ten-day excursions bringing over 80 Czech and Slovak business people to China and meeting Chinese partners.

What are the results of our practical and theoretical research?

The Chinese Miracle is based on three principles forced upon the Chinese Communist Party by Teng Xiaoping, the successor of Mao Zedong:

- A. Opening China to the world.
- B. Positioning the economy into the driving seat of politics.
- C. Using long term planning and development strategy based on regulated economy backed by the Communist Party of China.

Many foreigners ask questions related to practical consequences of present China policies:

1. Will China try to export its communist principles by military force?
2. Will China transform its political system into a western type of democracy in the future?
3. Will China abandon its regulated economy in favour of a liberal economic approach?

Based on practical experience from dealings with our Chinese partners, supported by publication research and last but not least knowledge acquired from cooperations with leading experts such as Sir Alan Donald, lecturer and former British ambassador to China, or Ken Simmonds, professor at London Business School—both lecturing on behalf of the British government in China frequently—

OUR ANSWER TO ALL THREE ABOVE QUESTIONS IS NO!

Sir Alan Donald insists that the country faces such important economic problems needing to be solved first at home that it will not be interested in a neocolonial expansion using military force. Moreover, neocolonial ventures have not even been the Chinese way centuries ago when it was a powerful imperial superpower. As far as Taiwan is concerned it is to be expected that the issue will be eventually solved on the basis of mutual economic interests, in a similar way as it happened with Hong Kong.

All experts on China, even Chinese dissidents lecturing on western universities, Lee Kuan Yew, the former western oriented prime minister of Singapore, do not regard the western political system as suitable for China. This has been confirmed at the recent session of the central committee of C.P. of China by the new party leadership and the government.

Deng Xiaoping's main paradigm was: PRACTICE will be the criterion of TRUTH of all THEORIES. As long as development of China will be successful nobody can expect China to abandon its present methods.

There is, of course, another important problem: China declared publicly its aim to complete its political transition by going to declare SOCIALISM WITH CHINESE CHARACTERISTICS by 2049, one hundred years after creating the Peoples Republic of China.

It is hard to assess what will happen in China in 45 years from now. However, the Chinese socialism is quite different from the former Soviet Union socialism and far away from Karl Marx theories promoted in mid 19th century.

The basic principle of Chinese socialism has been explained by Deng Xiaoping like this: The nature of socialism is to emancipate and develop productive forces, to eliminate exploitation and polarisation, and finally to achieve the goal of common affluence. (To be rich is fine, poverty is unacceptable as a feature of socialism).

No doubt, such a vision is highly attractive for developing countries coping a long time with many unsuccessful schemes how to overcome poverty. Moreover, Chinese market has a great attraction even for highly developed countries helping them to overcome the present economic recession. This applies to countries like France, Germany, Australia, even Japan, Israel, Scandinavian countries, Latin America, the ASEAN group affiliating with China and India in an effort to create the largest COMMON MARKET in the world with over 2 billion inhabitants. ...

U.S. politicians should analyze this situation without any prejudice and find ways how to compete with China in the field of economics. ... Two engines drive the world nowadays: China as supplier and creditor, U.S. as consumer—and debtor (Stephen Roach, chief analyst of the investment bank Morgan Stanley).

As far as the Czech Republic is concerned we are nearly at the end of the long queue of more than 160 nations trying to trade with China. The foreign trade balance with China shows 10% exports to and 90% imports from China. ... With the help of some government agencies and professional bodies we are organizing tuition of Czech companies planning to approach the Chinese market in 2005–2008.

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RICHARD EVANS: DENG XIAOPING AND THE MAKING OF MODERN CHINA, Penguin Books, Ltd., Middlesex, UK, 1995

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p. 277–278, Talk with President George Bush

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LEE KUAN YEW: FROM THIRD WORLD TO FIRST, Harper Collins Publishers 2000, p. 500 to page 660

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FURTHER:

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Chairman D'AMATO. Thank you very much, Dr. Schwarz. I know that a lot of people have some questions for you when we finish our remarks here.

Who would like to go? Mr. Matousek? Mr. Matousek is the head of the International Department, Czech-Moravian Confederation of Trade Unions in Prague.

**STATEMENT OF VLADIMIR MATOUSEK, HEAD
INTERNATIONAL DEPARTMENT, CZECH-MORAVIAN CONFEDERATION
OF TRADE UNIONS, PRAGUE, CZECH REPUBLIC**

Mr. MATOUSEK. Good afternoon. Thank you. I was told one week ago that this meeting will be held only in English, and, therefore, I'm sorry, I have to use my poor spoken English and also in the written form that I have prepared.

As you heard, I'm from the society of trade unions. It means we, of course, are interested in normal working conditions, labor standards, and employment and such things which interest practically nobody, but in the real life when someone becomes unemployed and so on, then these topics are very interesting in daily life.

Of course, there are some export sectors in the Czech Republic, in the European Union, in the USA and so on that are successful in the world, and they are not so exposed to the competition of countries which use their competitive advantage of cheap labor and other advantages which we can never compete.

I would like to say a few words on the sector which is very affected, and it is the textile, clothing, and leather industry. Worldwide, it is in Europe and, of course, in my country, too. On January 1st next year all existing quotas on international trade in textiles and clothing will be eliminated. When we see and look to the last years, the last ten years since this decision was made, and that

was made by members of the WTO, European industry and its employees have been preparing for this day. Many thousands of companies have diversified into new innovative products and processes. But others have indeed closed, as increased competitive pressures and stagnating consumption have forced the painful rationalization which has been accompanied by productivity gains. And that led to job losses in excess of one million over these past ten years with several social implications.

This development is notable also in the Czech Republic. We, the association of employers in textiles, clothing, and so on, have focused on—and trade unions—this question that we have been in common, and we have asked the government to take some measures to improve the position of the textile industry in the country.

The long-term situation in the textile and clothing industry and the future expectations have been assessed under the Council of Economic and Social Agreement. It means in the Czech tripartite body, the textile and clothing industries will remain important parts of the Czech economy. Now, all possible means have been used in the past to protect this endangered sector—sectors. The nearing problems should be resolved on the basis of synergy with partners, alliances in the European Union framework. Also the role of core labor standards has been mentioned. Textiles will have a place in the beginning—now in December or so—the Congress and these issues will be tackled.

The textile and clothing sectors were never among higher-level priorities of the government in the Czech Republic, despite its significance for employment of women workers, regional distribution of capacities, and the linkage with a cultural tradition and design in the country. Previous waves of liberalization and openings of the Czech market and import and worsening conditions for exports affected these sectors in a very hard way. In 1990, the textile, clothing, and leather industries employed 280,000 employees. Nowadays it is hardly 100,000. After 1st January, when the quota system will be abolished, then the textile, clothing, leather industries will lose additional 40,000 workers will disappear.

What to do? What can be done to help us? Trade unions are not interested in the restriction of imports from abroad, but are concerned about: reaching fair and equal conditions, knowing that the country of origin subsidizes its own producers, they need not pay for electricity, they have practically minimal taxes, they pay not for social insurance and fair wages and violate the most basic human workers and trade union rights. The solution should be found not only for textiles, but also for other sectors. Every week, in particular nowadays before Christmas, we can read in newspapers about toys and electrical appliances for households causing potential and real danger for health, safety, and creates dangers for children. And I'm not speaking on misleading customers when offering products where brand marks are names are misused.

The recent accession of China to the WTO has added a new and serious dimension to the quota phase-out. As Chinese exports to the EU have grown in some liberalized products [inaudible] by three or more times, the prices have [inaudible] by only 75 percent. It is not normal trade and cannot be explained by any logical combination of economic or social conditions as far as the exporting

companies are concerned. Similar but more devastating damage to European textile and clothing industry must not be permitted when quotas are eliminated on 1st January 2005, especially in the light of the overvalued currency compared with the U.S. and the undervalued Chinese currency.

The trade unions on the European and Czech levels welcome the EU Commission's [inaudible] as a major step, and the first step to implement the recommendations of the high-level group. These recommendations form a set of proactive trade, industry, social, and regional measures to meet the challenges facing the European textile and clothing industries and should be implemented as soon as possible. But it takes time, and it also takes money. It is costly, these measures.

We know how difficult in the case of the Czech Republic, the restructuring in the textile industry was difficult when establishing or changing the production orientation of some textile companies to design, to industrial textiles and [inaudible] textiles which need more research and more skill. It is not so easy, and, therefore, it is not possible to expect advances in the near future.

On this basis, the Czech trade unions join together with the enlarged EU textile and clothing industry in asking that before January 1st the possibility that the imports are effectively monitored in real time in terms of both quantities and prices in each country and that this is done by the European Commission's clear guidance, and that guidelines and criteria are established to enable [inaudible] safeguards or other forms of action to be taken in any product categories in which abnormal increases in volume or prices, reductions could occur. The EU as a whole commits itself to use appropriate instruments to combat unfair trade practices, and when the need arises and that it pay particular attention to the grave risk of diversion of trade in the wake of U.S. safeguard measures currently under consideration or already decided. The EU hopes, which we also supported very heavily, to enforce core labor standards in all countries, and, therefore, also in China, and more generally to ensure sustainable development that also takes into account social and environmental standards to achieve a greater degree of reciprocity, and hopes to similarly ensure improved transparency and verification in respect of the origin of products.

It pursues an active policy of increasing market access outside the European Union by promoting comparable levels of tariffs to those of the EU together with the elimination of nontariff barriers, which undoubtedly hinder our exports, exports of European countries. Such activities are not intended against the workers in China or others in the textile and clothing industry, but they should be a call for action by the member states and the Commission to direct towards those companies in China and elsewhere whose state and social practices are manifestly unfair and threaten the stability of the European textile and clothing sector and hundreds of thousands of jobs, including those in the new member countries.

Thank you for your attention.

[The statement follows:]

**Prepared Statement of Vladimir Matousek
Head, International Department
Czech-Moravian Confederation of Trade Unions, Prague, Czech Republic**

Industry and Labor Perspectives on China's Economic and Trade Policies

On January 1, 2005 will be eliminated all existing quotas on international trade in textiles and clothing.

Over the past ten years, since this decision was made by the members of WTO, European industry and its employees have been preparing for this day. Many thousands of companies have diversified into new innovative products and processes, or indeed closed, as increased competitive pressures and stagnating consumption have forced painful rationalizations, which, accompanied by productivity gains, have led to job losses in excess of one million over the past ten years, with severe social implications. This development is notable also in the Czech Republic.

The textile and clothing sectors were never among higher level priorities of the governments in the Czech Republic despite of its significance for employment of women workers, regional distribution of capacities and linkage with the culture, tradition and design in the country. Previous waves of liberalization and openings of the Czech market for import and worsening conditions for exports affected this sectors in very hard way. In 1990 worked in textile, clothing and leather industries 280,000 employees, nowadays hardly 100,000.

The long term situation in the textile and clothing industry and future expectations have been assessed on the Council of the Economic and Social Agreement (Czech tripartite body). The textile and clothing industries still remain important parts of the Czech economy—despite of losses in capacities and employment in previous decades. Not all possible means have been used to restructure this endangered sectors and defend them in the time of transformation of the economy against harsh dumping.

The near future and perspective should be solved on the base of synergy with partners—alliances in the European Union framework. Also the role of human rights, core labor standards, non-market treatment in favor of exporters like from China, etc., have been stressed.

What after 1 January 2005? When quota system will be abolished then only in the textile, clothing, leather—additional 40,000 workplace will disappear. What to do against it? Trade unions are not interested in restriction of imports from abroad but in reaching fair and equal conditions. Knowing that the country of origin subsidizes own producers, they need not to pay for electricity, they have tax levies, they pay not for social insurance and fair wages and violate the most basic—human, workers and trade union rights, this countries should not fully enjoy advantages (or weaknesses) of the world trading system.

The solution should be found not only for textiles but also for another sectors. Every week, in particular nowadays before Christmas we can read in newspapers on toys, electrical appliances for households causing potential and real danger for health, safety—and creates danger for children. Not speaking on bluffing customers when offering products where brand marks or names are misused. The origin of this production is mostly known.

The recent accession of China to WTO has added a new and serious dimension to the quota phase-out. As Chinese exports to the EU have grown, in some liberalized product areas by three or more times, its prices have plummeted by up to 75%. This is not normal trade, and cannot be explained by any logical combination of economic or social conditions in the exporting companies concerned. Similar but more devastating damage to Europe's textile and clothing industry must not be permitted when quotas are eliminated on January 1, 2005, especially in the light of the overvalued Euro as compared to the US\$ and the undervalued Chinese currency.

The trade unions on European and Czech level welcome the EU Commission's Communication on "The Future of Textile and Clothing After 2005" of October 13, 2004 as a major first step to implement the recommendations of the High-Level Group; these recommendations form a set of proactive trade, industrial, social and regional measures to meet the challenges facing the European textile and clothing industries, and should be implemented as soon as possible.

On this basis, the Czech Trade unions join to requirements of the enlarged EU textile and clothing industry of 2.5 million workers in 170,000 companies call upon all member-states in close cooperation with the European Commission to ensure that before January 1, 2005:

- Imports are effectively monitored in real time in terms of both quantities and prices in each country and by the Commission.

- Clear guidelines and criteria are established to enable prompt safeguard or other forms of action to be taken in any product categories in which abnormal increases in volume or price reductions should occur.
- The EU as a whole commits itself to use appropriate instruments to combat unfair trade practices as and when the need arises, and pays particular attention to the grave risk of diversion of trade in the wake of U.S. safeguard measures currently under consideration, or already decided.
- The EU increases its efforts in order to enforce core labor standards in all countries (and therefore in China), and more generally, strives to ensure sustainable development that also takes basic social and environmental standards into account to achieve a greater degree of reciprocity. Similarly the EU should ensure improved transparency and verification in respect of the origin of products.
- It pursues an active policy of access to markets outside the EU by achieving comparable levels of tariff to those of the EU on third markets, together with the elimination of non-tariff barriers, which undoubtedly hinder European exports.

Such activities are not to be perceived as regulation and are not intended against the workers in Chinese textile and clothing industry, but they should be a call for action by the member states and the Commission to directed towards those companies in China and indeed elsewhere whose trade and social practices are manifestly unfair and threaten the stability of the European textile and clothing sector and hundreds of thousands of jobs, including those in the new member states.

Chairman D'AMATO. Thank you very much, Mr. Matousek. I think that we're very interested in the textile situation as it's evolution after the quotas come off. We're going to want to explore some of that with you.

Let me turn now to Mr. Riemann, who is the head of the Purchasing Department at Skoda Auto, Czech Republic. Thank you.

**STATEMENT OF VOLKER RIEMANN, HEAD
PURCHASING DEPARTMENT, SKODA AUTO A.S.
MLADA BOLESLAV, CZECH REPUBLIC**

Mr. RIEMANN. Good afternoon. I have prepared a small presentation for you. There's two parts: first of all, a small background as to where is Skoda coming from, for a better understanding of what Skoda is planning in China. Go to the next slide, please?

Skoda is part of the VW Group, 100 percent part of VW Group. And you all know VW has been in China since the early '80s, with two factories. The first was in Shanghai, the second is in the north, in [inaudible] -shung. Go to the next slide, please?

VW started with Skoda in the early '90's and obtained a 100 percent share in May 2000. So where's Skoda coming from? Since the early '90's you can see Skoda was a car manufacturer mainly for the domestic market, and after the launch of the first Octavia in 1996, but then changed to a more export-oriented company. At the end, we had last year an export short of 84 percent. To show what that means, we are exporting in 80 countries of the world. And you see China is a part of this. But we are planning to stop more or less the exportation to China, and we produce our new Octavia in China in a part of the VW Group factory in Shanghai. Like Dr. Schwarz said some minutes ago, to know the basics in China is very important. And that's the reason why Skoda doesn't want to go alone to China. We will use the knowledge of the VW Group, which has more than 20 years in China.

You can see on this slide that the exports for cars in China is not very successful for a brand like Skoda. We have 31 dealers and we exported to China in the year 2004 only 2,100 cars. That's nothing for a country like China. So for a car manufacturer, it doesn't

make sense only to export to China, and that's the reason why all of the named car manufacturers are established in China, all Japanese or Korean, the American, and two weeks ago, the last of the big components, Daimler-Chrysler, signed contracts for production in China.

What are our next steps? At the moment we are in process of negotiation with Shanghai Volkswagen in participation of the VW Group China to make the license agreement, trademark agreement to establish a new brand in China, and complete the knockdown delivery agreement. The plan from Skoda is to produce in China approximately 100,000 Octavia a year exclusively for the Chinese market.

What is the concept of Škoda for the Chinese market? Go to the next slide, please. First of all, a pre-launch campaign for the export of the new cars, to set a dealership network before the launch date, to set up a service network, to define an international organizational structure, and to set up systems and processes like Skoda here in the Czech Republic. We started with the Chinese this year, it's the second of our Asian projects. Our first is India. We have in our company a philosophy to produce cars, and if you see the history of Skoda, we have to do it step-by-step. And if you see the development since 1996, we think it's the right time now for us to go to China and produce our cars there and to sell the Skoda brand in the Chinese market. I think others things we can cover in the discussion afterwards.

Thanks.

Chairman D'AMATO. Thank you, Mr. Riemann.

Now we have Mr. Michele Tajariol, Sales Director of Tajmac-ZPS, Czech Republic. Please, go ahead and make some remarks and then we'll open the floor to discussion.

**STATEMENT OF MICHELE TAJARIOL
SALES DIRECTOR, TAJMAC-ZPS, A.S.
ZLIN-MALENOVICE, CZECH REPUBLIC**

Mr. TAJARIOL. Good afternoon and sorry for the delay. I should explain a little bit about the Tajmac-ZPS company and myself because we are not as well known as all the other people at this table.

The Czech Republic is one of the leading countries in the production of machine tools. Even if it's a small country, you will find dozens of companies specializing in the production of almost all the machine tools required in any kind of industry.

Tajmac-ZPS is one of these companies. We are the leader in the production of multi-spindle automatic machine, machining centres and lathes. Our products are sold, I would say, almost worldwide, but mostly in Europe, the U.S., and Russia. Unfortunately, China is not yet one of our markets.

We have over a thousand employees located in Malenovice—that's near [inaudible]—and the company was founded over 100 years ago by Mr. Bata. Four and a half years ago, an Italian company named Tajmac purchased the old ZPS company, and named it Tajmac-ZPS, and I'm part of the family that now owns both the companies. That probably explains to you why I'm so young at this table.

Going to the discussion of this meeting, the machine tool industry is strictly related to all the other industries present in the market, especially, I would say, automotive, power generation, general real estate, and aerospace. The higher the demands of these industries, the higher the consumption of machine tools.

China became, because of the boom of the industry in China, the highest consumer of machine tools in the world. Unfortunately, the majority of the machine tools bought by the Chinese come from Taiwan or from Japan. I would say that the first reason is the location and the second reason is also the quality of their equipment.

Tajmac-ZPS, as with all the other producers of machine tools in the Czech Republic, are looking for ways to get a part of this huge market presence in China. Unfortunately, because of the dimensions of the machine tool builder in the Czech Republic, the idea of a huge investment in China for the production of our machines is almost impossible. This is something that can be done mostly by Japanese corporations or huge German corporations, not by small and medium-size machine tool builders in the Czech Republic.

A few years ago, we contacted a Chinese producer of machine tools named Shanghai No. 3. This company is part of Shanghai Electric. That is a huge corporation that has approximately half a million employees in China.

Our first contact was in '98 occasionally at the trade shows, and then we bought our company in 2000 and we got in contact with Shanghai No. 3 again in 2002. And we started discussions about technical cooperation. The basis of the corporation was to transfer our technology in the production of machine tools into China. The reason was for the Chinese company to have more modern and updated equipment without having the investment needed to develop it and without losing the time to develop it and to produce a reliable product already sold on European market.

The advantage that we had was to introduce our technology in the Chinese market. In fact, the collaboration was based on the selling of the machine with the names of the two companies stamped on the machine, and, of course, a royalty based on production of machine tools that they plan to build in the next five years.

The advantage of the collaboration was a very low initial investment and a very fast product production introduction. The collaboration went on for a few years. We had trained the Chinese people in our facilities from every aspect, production, service, technical development, application. And we went over to China with a staff of assembly people for the first two prototypes of one of our models of a machining center.

After this experience, there were some changes in the main organization of Shanghai Electric, and an all-new management team came to the company. Since that time we have had no response from the Chinese on any of our requirements. Basically they completely stopped communicating.

In the meantime, we were developing a new machine for them based on the fact that they were asking for an machine that was easier to produce in China. In fact, even if everybody thinks that the labor cost is really low in China, that's correct. But if you don't have the right technology for the production of specific components, you will not be as cheap as some of the Europeans. As a matter

of fact, moving our product into China was making the machine almost more expensive. For this reason, we were starting a new machine for each production that was suitable for the Chinese factory that would be producing it.

Again, it has been a year since we received feedback from this Chinese company. It's really difficult to explain the reason. Maybe new management, maybe new structure, but nothing justified the attitude that the Chinese had against our company. Luckily, this was only one of a few projects that we have going on, so we simply stopped concentrating on this one and we started concentrating on other projects in Europe. And thanks to the low investment costs that were required, our company has not been hurt. Of course, our prospectives to access to Chinese markets have disappeared at this moment, but we have to look for a new way to enter in the Chinese market.

I can say that I have found a positive side of what happened, and it's that companies of medium and small sizes like we are, need to understand that the Chinese market is really far away from where we are, and it requires a huge organization to follow any kind of cooperation with the Chinese. "Organization" means to have a structure inside your company that is able to follow the developments in your Chinese operations. But "organization" is also the support of the state or trade organization that needs to help you and make sure that the partner you are dealing with is a safe one. If not, the only risk that you take is to losing time.

Nevertheless, I have to say that the market is still there and it is really big for any machine tool producer, so we have to find a way how to enter the market. [inaudible] said before, applying to build machinery there, and the machine tool builder has to follow most of the automotive industry. So wherever they go, we have to go. We have to be present. We have to be present with surveys, technicians, and people to provide everything that is required for our product.

I was very happy to be invited here to explain what happened in our experience with the Chinese, but more to understand how the other companies and the other organizations are handling this programmatic switching of the production from the Czech Republic to China or how they handle the sales from the Czech Republic into the Chinese market.

Thank you very much.
[The statement follows:]

**Prepared Statement of Michele Tajariol
Sales Director, Tajmac-ZPS, a.s., Zlin-Malenovice, Czech Republic**

Good afternoon to all the participants of this symposium:

Before explaining the reason of my presence at this table, I prefer to introduce the company I represent and myself because we are not as known as all the other members at this table.

As many of you probably know, Czech Republic is one of the leader country for the production of machines tools, with a tradition of more than 100 years.

Dozens of companies specialize in the production of almost every type of machine tool that the industry can require are present today in the Czech country.

Tajmac-ZPS is one of this company, leader in the production of multi-spindle automatic machine, machining centre and lathes. Our products are sold worldwide, Europe, Russia and U.S. are our biggest markets.

With over a thousand employees, the company was established by Mr. Bata and has a history of 101 years. Four and half years ago the company was purchased by an

Italian group (Tajmac) and I'm member of the family that own the Italian holding. This will probably clear all your doubts about my young age and my presence over here.

But back to the main argument of this meeting.

The machine tool industry is strictly related with many of the other industry (such as automotive, power generator, real estate, airspace), higher are the demands of this industries = higher consumptions of machines tools.

China became, few years ago, the country with the highest consumption of machines tools.

Majority of this machines are coming from country as Japan and Taiwan.

Tajmac-ZPS, as many of the other Czech producer, as wonder for many years in which way to enter the China market with his own product.

For this reason we got in contact with a Chinese producer of machine tools name Shanghai N°3.

Shanghai N°3 is part of SMTW (Shanghai Machine Tool Work Group), part of Shanghai Electric, a huge Chinese corporation with more than 500,000 employees.

Some history of this collaboration:

1. The first contact—1998

The original ZPS has participated in standard machine tool show in Shanghai in the 1998 in order to locate a possible agent/distributor of machining centre on the Chinese market. Contact on the show was made purely accidentally with Shanghai Machine Tool Works Group.

2. May 2002

After the acquisition of ZPS by Tajmac, was made new contact with Shanghai Machine Tool Works Group beginning of the year 2002. Trip and first meeting between the Parties took place in May 2002 in Shanghai.

This meeting resulted in agreed meeting on technical cooperation.

This cooperation was based on transfer of technology from Tajmac-ZPS to China and manufacture and sourcing of components and parts. The transfer of the technology is accompanied by License Agreement providing the Chinese company to use Tajmac-ZPS technology for the given purpose and pay royalty fees to T/ZPS from each machine tool produced.

Every machines produce by Shanghai N°3, have to be sold on the market with the name Tajmac-ZPS/Shanghai.

The principle of the agreement was for Shanghai to update their old technology with a modern and reliable machine with a very small investment and in a short period of time. For Tajmac-ZPS was: to obtain a certain profit from the production done in China (royalty) and to start creating its own name on the market using Shanghai sales network.

3. July 2002

One month detailed training on the design, production of components, assembly, technical control, service and maintenance was provided by Tajmac-ZPS to Shanghai Machine Work.

4. October 2002

One prototype of full VMC 1260 was exported to Shanghai for participation on trade fair in November in Shanghai to show to public and industry the future product.

5. November 2002

Full contract for the license production was signed between the Parties.

6. February 2003

Two VMC components packets were exported to Shanghai in order to check their ability and costing of such cooperation and verify the quality of the cooperation product.

7. July 2003

Via Tajmac-ZPS technical team the two VMC assemblies were completed in Shanghai Machine Works facility.

Simultaneously it was agreed to upgrade the technical features of the machine in order to make it more cost effective.

Even with a very cheap labor cost, because of the old technology in production, Shanghai N°3 was not able of producing the machine at a reasonable cost without having Tajmac-ZPS redesign the machine for a easier production.

This work took few months work by our designers, with cost that were unexpected at the beginning of the collaboration.

Before the end of 2003, new detailed technical drawing were submitted to Shanghai in order to check the production cost of the new, improved product and invited to Czech for new technical meeting and next procedures in the cooperation agreement.

In the main time several changes were done inside Shanghai Machine Tool Works Group, including new managements.

Since that time our partner is not responding to any invitation and letters.

I still do not consider the project finish, this is also why I'm here today, and we are trying to political way to try to understand what happen.

More than the good prospective that the collaboration could have, I'm disappointed by the attitude and I'm upset by the idea of having lot of time waste by my technicians and managers.

The Chinese project was only one of several we have going on in Tajmac-ZPS and, because of the low investment, will not hurt the company but this does not justify their attitude.

If I have to found one positive side of this adventure is that I understood that also Tajmac-ZPS is not ready for this kind of cooperation in China.

In order to follow properly cooperation like this one, you need to be very well organized inside, high skill managements is required, and you need the support of some state organization or trade organization, that can help you in following and valuating the partner you are working with.

We are still missing a system how to establish cooperation and, more important, we are missing information. The language barrier and the distance are making everything even more complicate.

China is still there and is still consuming more machines tool that any other country in the world.

We are still here and we still think of how to get part of that market.

But the next time, before move in a new adventure, we have to be more prepare.

If we are not ready is better to stay in Europe and follow the development of other country, like Russia and the new Europe, where we know how to do business.

Thanks.

Panel III: Discussion, Questions and Answers

Chairman D'AMATO. Thank you very much. It sounds a little bit like the American Wild West, the experiences you were having with machine tools.

Vice Chairman Robinson has a question.

Vice Chairman ROBINSON. I applaud your restraint, Mr. Tajariol. That was an exceedingly elegant and polite version of what struck us as a pretty dramatic story. Yes, it's a matter of learning curve and, yes, one can take lessons away and, yes, your initial investment was modest, but it certainly sounds a lot like fraud, or, at minimum, what can go wrong in this somewhat unregulated, non-transparent marketplace.

Machine tools are a sensitive item as well, which adds to the complexity. As you know, depending on the nature of the machine tools, they can have a dual-use quality for military production as well. So my first question is: Do you have any evidence that you were in a dual-use technology circumstance here where it's possible that there was some military utility to your machinery? Or was it sufficiently low-end that that was much less likely?

The second issue is your impressions as to whether you got extremely unlucky due to the nature of a somewhat corrupt Chinese entity with which you chose to partner or a lack of adequate preparation and due diligence on your side? I know it's hard for you to extrapolate on your experience as to what's the likelihood of something like this happening to others. What is your level of confidence that this experience will not be repeated in future business dealings with China?

Thank you.

Mr. TAJARIOL. Well, answering the first question, when we started the collaboration with this Chinese company, we decided to integrate in their production our basic machine, what we call entry-level equipment. We delivered a machine tool two years ago [inaudible] example, and that was highly sophisticated equipment that could be used with military production. This machine has a very low level of sophistication, if you look at Europe, and a medium level if you look at China, but it is mostly used for production of [inaudible] industry for autos. So I'm not worried about the machine being used for military production. We have other machines like in our range that will suit more for that kind of product.

What I've been hurt from this collaboration is the waste of time, more than the investment, and as I say, it was very little for the way it was established, the collaboration—is that you dedicate time of your personnel, technician, who, in the meantime, can not follow something else, and at the end everything is an empty box. So this is only to answer the first question.

We [inaudible] for example, equipment in India, and it is for the production of aerospace industry. And, of course, we go through some different due diligence with the Indian government and through organizations here in the Czech Republic. So this case was handled much better than the old one, probably based also on the experience that we had with the Chinese.

The next was . . . ?

Vice Chairman ROBINSON. That about does it. Thank you.

Chairman D'AMATO. Thank you. I have a question for Mr. Matousek. Mr. Matousek, as I understand your testimony, when the quotas are eliminated in January, is it true that you estimate the impact on the Czech textile industry to be a 40-percent cut; from 100,000 you would lose 40 percent of your labor force? And if that is the case, have you examined other kinds of relief measures such as the safeguards provisions in the WTO, whether you were prepared to try to mitigate those losses somehow? We're interested because this is a situation worldwide, these kinds of losses are being anticipated. I think everyone is searching around to see how they can avoid the kind of losses that look like they're going to occur.

Mr. MATOUSEK. [Translated from Czech.] Thank you for the question. I would like to say that during the period of transformation, i.e. since 1990, we have experienced such a high reduction in the number of jobs as I mentioned earlier—from 280 thousand to 100 thousand. And now we expect this 100 thousand to be reduced by another 40 thousand. This means that unless something changes, if the liberalization process remains the way it was set up, employment in the Czech textile industry will be 60 thousand people. We discussed this problem with the government many years ago and we are not alone. In this particular issue the trade unions and employers association have the same opinion. We do have the same opinion.

Of course, when we look at unemployment in the Czech Republic, only in the last few years has it risen slightly more, around 9-10%; this means that the workers who were let go were absorbed. But as you certainly know, restructuring took place in many industries.

In the past the Czech Republic had very extensive heavy industry and we were still able to generally absorb the released workforce. The reason is that we did not have enough services, not only services as such, but the whole small business sector was missing—there were no small or medium-sized businesses. This sector has come into existence, which is positive. However, we have not yet been able to reach an agreement with the government on the method and measures to be adopted in resolving this potential threat in the case of textile industry.

Chairman D'AMATO. Well, thank you very much for that. Let me just follow that up with a question. Have you discussed with the government emergency safeguard measures that would be available to you under the WTO, or is that not considered to be a feasible solution at this point?

Mr. MATOUSEK. [Translated from Czech.] I think that thus far the government has not shown the will to deal with these matters in depth. This was demonstrated during the last tripartite meeting in October that focused directly on textiles. This is due to the fact that the textile industry is not among the government's priorities; it is not an industry in which the Czech Republic is expected to become competitive, etc., considering the Lisbon Strategy and the planned development of the European Union.

Chairman D'AMATO. Yes, I understand what you're saying. Perhaps it's because you have been so good and successful in the past in being able to relocate the tremendous number of textile workers that lost their jobs that you've been so successful in that. But I can tell you that in the United States there is now a very serious consideration as to using the special safeguard measures under the WTO because of the anticipated losses in the American textiles. That may be something that you will also wish to take a look at. Thank you very much.

Commissioner Dreyer, did you have a question?

Commissioner DREYER. For Mr. Riemann, it sounds as if you have a very intelligent strategy to manufacture cars in China. I would ask you if you have seen the 2004 report of the American United Metalworkers Union. It has a section on the Chinese automobile industry. If you have not taken a look at it, I think you might want to. They predict a great deal of expansion and overcapacity in the Chinese auto production industry, and I, of course, hope that people will buy Skoda cars before they buy others, but you might want to take a look at this before you proceed further.

For Mr. Matousek, also a comment. The Chinese textile industry has been driving all other textile industries out of business, including in my own country. This Commission held field hearings in South Carolina and heard many, many, many sad stories.

The cotton that China uses for its textiles comes disproportionately from northwest province of Xinjiang. You might just want to keep in mind for your own purposes that this region has been so overexploited ecologically that the cotton industry is on the verge of environmental disaster. So you may wish to keep this in the back of your mind.

For Dr. Schwarz, you, of course, start out correctly by saying that there are optimists and there are pessimists here. But when I

heard you elaborate, you seemed to elaborate the optimist point of view, and since I'm a pessimist, I think I ought to say something.

In particular, your comment that the Chinese know what happened to Japan, know how Japan was able to succeed. The Chinese, because they are clever people, they also know why Japan has failed in the last 15 years. And to me, the Chinese economy is structurally far weaker than the Japanese economy was in 1989. In China you have a population that keeps on growing. The Chinese government itself does not trust its own statistics because people don't report the truth. They underreport the actual birthrate. You also have a severe imbalance in the genders. Many more boys are being born than girls. This is going to cause social instability in that historically men who cannot find women become very nasty.

The financial system is very unstable. The safety net in terms of health and pensions is very rudimentary. We have mentioned the ecological problem in Xinjiang. It's not just in Xinjiang, but in many other areas. You have groups within the population who are increasingly willing to demonstrate, sometimes to riot. The party and the government are aware of this and know that restructuring is necessary. But the problem is that the social cost of restructuring is so huge that it's political dynamite to do it. It's very dangerous. You can restructure, but this will throw more people out of work.

I forgot to mention that the economic boom is in the eastern half of the country, which is falling further behind, not the western half of the country. They have a very nice plan on paper to increase prosperity in the western part of the country, but it's not working.

So there's my pessimistic point of view. Thank you.

Chairman D'AMATO. Do any of the panelists wish to respond to Commissioner Dreyer's comments? Go ahead.

Mr. RIEMANN. Let me try to answer. You are right, we have too much capacity in China for the car manufacturers. But what happens at the moment for our group doesn't make sense. It's a never-ending price fight because all car manufacturers at the moment are in China. All manufacturers are reducing the prices more or less weekly. So our group, Skoda, launched in Western Europe as an attractive car in a lower price segment. And at the same time we tried to do it in China. That's easier with the other brands, when Audi or VW are in the price fight as are our competitors. So we try to make an attractive car in China and launch it in the same area like in Europe. That means a little bit under VW and down from Audi. And so we think that's more successful than with the existing cars in China to have the price fight.

Commissioner DREYER. That sounds like a very clever business strategy, and I wish you success.

Chairman D'AMATO. Any other responses?

Dr. SCHWARZ. Well, the information was correct as far as the problems in China are concerned. Therefore, they don't want to leave the dominant role of the party because without the dominant role of the party, it will go to pieces. And this is one feature which will work for a certain time.

By the way, I don't think that there will be an increase in unemployment. They have big projects—I don't know whether you know

about them—involving Hong Kong, involving the whole southwest part of the country, and they are actually reaching terrific results. I don't know whether you know the figures. But actually when Mao, the big [inaudible], died, they had 60 percent of the population living on less than \$1 a day. Now they have 5 percent or 6 percent. This is a success which has no parallel in the world. This has to be taken into account because it's [inaudible]. And, of course, this is [inaudible] discussed this human rights business, you know—Mr. Ruml—so I discussed it already yesterday with him. They say when we have turned around the horrible poverty which was there when Mr. Mao died in such a way, it's a great contribution to the human rights of China. And, of course, on the other hand, when we are discussing—or as our President Klaus was when he was in China in April, and he put forward this question, [inaudible] said, “yes, we've got a lot of bad things in human rights, but we are working hard and there is a commission, so join them. They are extremely clever people. You are underestimating them. You are very much underestimating them.”

For example, with your question, the comment on military use of equipment, you would have to abolish Israel, if you don't know it, if you—

Commissioner DREYER. Politically impossible.

Dr. SCHWARZ. —richest people in the world, [inaudible], was dealing only in arms which they got from the United States.

Commissioner DREYER. [inaudible] Eisenberg (ph).

Dr. SCHWARZ. During the period of—you cannot prevent these things very easily. The same thing is you are now hoping you will succeed in this business with actually regulating textiles. Last week was already a meeting in Sao Paulo, and most of the participants have said you don't need to actually abolish any quotas, when this starts to work it will be changed again. You cannot prevent cheap production which you have introduced to the Chinese. You have 110,000 factories that are much better equipped than the Czech factories because you were outsourcing the production of textiles to China.

So they are very well equipped, and they have said they will sell to the United States [inaudible] for \$1. But the only way, because I know textiles in this country very well because I was the director of a department store and I was dealing with them all over the country during the Communist period. And they were relying completely on the [inaudible] situation in Russia because they would buy anything. They had never tried to actually improve their profiles because if we wouldn't buy something for the whole market, they say go to hell, we'll sell it to Russia. There was such a situation and it was terrible. And they haven't understood from these 280,000 they have to change their program. I would recommend to go very strongly into other types of textile products which won't be supplied in this mass production, how it's called, [inaudible] international, succeeded them in China two years ago with [inaudible]. And the Chinese young girls and ladies are buying bras ten times as expensive because they are sexy. So you have to see it on a commercial basis, and you can't [inaudible] anything because if the multinationals [inaudible] other people won't get it through the Czech Republic, they will get it from outside. They will buy because

it's cheap Chinese stuff. So we would have to look at this whether it's not a possibility to improve the program. I know the equipment is old. The designers are [inaudible]. It's very difficult. But don't rely on regulation of this type to save the Czech textile industry. On our course, we have two people who are from the textile industry, one is a distributor and the other one is now going over to a specialized type of textile which is not covered, of course, by this program, and he wants to enter the market in a small way. There are some technical experts which are already sold to China. So it's all about commerce. I don't know why a country which has such a high standard of market doesn't understand these questions that they have to be dealt with on a business level, not by regulations, and the Chinese are extremely clever. This is the basic problem.

Commissioner DREYER. I would not ever deny that the Chinese government has been very clever. I think they have been very clever. But I think that restructuring in such a way as to make the economy more competitive is going to increase unemployment and incur high social costs.

In closing, I would caution you not to trust those statistics about the 5 percent and the poverty line. We can discuss that later.

Chairman D'AMATO. We're going to take a break for five or ten minutes. We've got some coffee in the other room, and then we'll reconvene to finish up.

[Recess.]

Chairman D'AMATO. [In progress.] I assume that Škoda has probably a better assessment than most other manufacturers, having been there longer than anyone else about this issue. Can you tell me something about that?

Mr. RIEMANN. I think most of the joint ventures are there for production only for the local market. What happened if the Chinese would produce alone, that's another point. I think then they will export also.

The VW Group looked for it, for the export, but for total cars, that doesn't make sense because the costs from China for a complete car to Europe is very high. At the moment we are looking to buy parts in China. But even parts you have to calculate [inaudible], and it makes sense against Eastern Europe concerning the very high logistic costs. It's a long way. If you want to do this, you need a very big stock in Europe because you can't wait for the next shipment and stop your production here. And if you calculate all these costs, you find not so much parts, you can [inaudible] in China for the automotive industry for Europe.

So mostly we will produce there for the Chinese market, maybe we have to look what happened that we can deliver from China to India, from India to China, but that might be possible in the future. But to Europe, at the moment I can't believe it.

Chairman D'AMATO. You think the transportation problems to the United States and Europe are too formidable? Well, that's good to know. Thank you.

Vice Chairman Robinson?

Vice Chairman ROBINSON. Thank you, Mr. Chairman.

Mr. Musil, we have heard a good deal about experiences from companies on both sides of the Atlantic that are in the business of consumer goods, like Wal-Mart, who are huge importers and have

a number of particular considerations in doing business with China. You represent the other side of the equation. You're in a different sector, heavy manufacturing. These are long-term, capital-intensive deals, more often than not conducted with state-owned enterprises and ministries. There is an entirely different, I would argue, set of considerations that you face from, say, somebody that is purchasing Chinese toys for the consumer market.

A number of those considerations I would assume also are at a political level, as there's a considerable stretch of time between the opening of negotiations and signing a contract. So if you don't mind, you might just share with us a few of the strategic considerations and business realities that you face as a heavy industry supplier to China and the particular type of challenges, including the political considerations, that you face in making a sale.

Thank you.

Mr. MUSIL. During my first speech, I explained that in the power generation sector, China has big demand [inaudible] environments, and domestic subjects like Shanghai Electric don't [inaudible] has eroding capacity that now they need to have from abroad. But our business is totally different from other businesses.

For example, when I started with my people a discussion about the [inaudible] offer, and when I signed the contract, we need two years. And it's a very long time between the first and the last contract, two years means to have very good contract, very good political stability, and we discussed many, many subjects with our government, [inaudible] insurance. We have discussions with representatives from Beijing, like the Ministry of Industry, like State Commission for Reconstruction and Development. And we need good, reliable, fair contracts, and the right message eventually between China's government and our government.

For example, back to last, if we discussed about, for example, Tamar [inaudible] locator, you know this story or this issue, and after a final decision, China's government stopped it with us, negotiation about our new project. And this is a typical case, and we need—let me repeat again—good contracts and good relationships between our government and the Chinese government. China doesn't need us. We need China. China has excellent core capabilities. They know to produce not only vegetables, but they have special [inaudible] fusion program. They have excellent IT technologies. Now they left from China's market and they go to India, to Europe. They can win by very good prices and with excellent technical parameters. And for us, not only for us but for U.S. companies as well, we must go by same way.

And let me ask you four questions, please. You know, like U.S. people, U.S. government, U.S. subjects, you define good laws, good rules and requirements, and then you will go with your businessman and to go to China, and you create good agreements. Can you describe the situation and behavior from your side? Because you can help us, and you can give good promotion. You can give good procedure, and you can help our state representatives.

Vice Chairman ROBINSON. I would say with some humility that that question would be better directed toward Jacques Chirac than ourselves. But that said, it is true that the U.S. tries, like a lot of large industrial democracies, to work in a public-private sector

partnership from time to time. For example, we have our Commerce Department Secretary lead delegations of American firms to China periodically in the hope that the American flag, if you will, wrapped around some of these deals might improve their prospects for success.

You're also correct that the U.S. Government Secretary involved would try to reinforce messages as to what the United States is prepared to sell and what it's not necessarily prepared to sell in terms of dual-use technology or militarily-sensitive technologies. The President may ask a Cabinet member to deliver the mail, so to speak, on a number of different issues while in Beijing besides just the trade promotion message.

So it's not just a straight promotional effort. U.S. policy positions in various areas are communicated from our side and then discussed with the Chinese. I would say that we don't do this as aggressively as our friends in France and Germany. I think that there's a more robust promotional effort underway in Europe than in the U.S. On the other hand, we do have one hard-to-quantify advantage, which is that we are the United States of America, and because of our somewhat unusual position in the world, the Chinese sometimes have special reasons of their own to seek an improved relationship with us from time to time, in which case our companies might receive some modest advantage.

Chairman D'AMATO. Thank you very much.

I guess the main problem is when you think that you need the Chinese more than they need you, you must have some way to figure out to convince them that they really need you. You're better off that way.

Commissioner Dreyer?

Commissioner DREYER. Yes, we have been talking about the United States setting the rules of the game, it doesn't seem to us that that's what we do at all. I think we see in large part that China sets the rules of the game because the Chinese economy is so large and because Beijing can do a certain amount of rule setting. But within that large scope, there is significant area for maneuver in that, although the Czech Republic may need China more than China needs the Czech Republic, in fact, there's a great deal of economic decentralization going on, and non-Chinese companies have found that they can, in fact, be more wanted by local areas in China, enabling them to set the rules. They can bargain about costs and other similar things.

So that might be a better niche to look for to what small areas within China you can compete in. Once you are established in there, you will find that they will want to protect you from others because you provide jobs for local people and taxes for their government.

Chairman D'AMATO. I have a question for Dr. Schwarz, and maybe others can join in on this, too, because it's actually a very, very important question. It's a question you asked in your testimony. Number two, will China transform its political system into a Western type of democracy in the future? And that is a question that did underlie the debate in the United States at the time when we debated giving China permanent most-favored-nation trading status, which was part of their accession to the WTO. And the ad-

ministration at that time under President Clinton made the argument to the Congress, in trying to persuade the Congress to adopt and to approve that, that economic transformation and a market economy would inevitably lead to and be—would have to have high levels of free-flowing information, and that free-flowing information would then transform and spill over into the political arena and would actually have the effect of transforming China into a democracy.

I think that if the administration were to say that the answer to that question is no at that time and that we cannot in the foreseeable future ever expect China to be anything other than a brutal dictatorship, the Congress would not have voted to give that status to China.

So that's a very important question because it did underlie where we were going, where we anticipated China going. I think there's a bit of an alarm in the United States at this point of those who expected this reform to occur rather early that it has not occurred, and the concern that if China becomes very powerful economically, they will make it more and more difficult to actually transform its political system.

So there is some question—you answered the question no, but if you can explain why you answered the—why did you answer the question no?

Dr. SCHWARZ. Yes, well, I have studied in detail actually the development of political systems in China going far beyond, and I have studied actually also the comments of Lee Kuan Yew, who knows it very well. And also this Ambassador to China, Alan Donald, who is very much—a British Ambassador, who is very much knowledgeable about China, they all were of the opinion that the traditions are so different to the development of the ruling system that it's difficult to accept that a type of democracy—because the American and the British type of democracy are not the only types of government—that they could be accepted by the Chinese leadership in the near future. This is the question. There are really different starting points. Also in Britain, Dick Wilson has stressed that the democracy in Britain has developed 700 years. The democracy in the United States was also in connection with the development of the United States. And so he always asked why do you actually expect the Chinese, who are as a model, actually, obligations. I very much love actually the book by Pearl Buck on China, which she has got the Nobel Prize for that, and this expressed quite a lot of things which are from the old China. There is also the authority of the parents. You are not allowed to argue. You must actually be another relation to the power. There is still in China—it was quite recently—this *guanxi* business where instead of having an appropriate legal system, you have to do something which in the United States would be corruption.

So it's a question of longer development. The only things which they have done—I don't know whether it was because of WTO—is that they started certain elections on the local level. They have already a type of—but they will go up, and I think they will end in eventually a presidential system of the type of Singapore because Lee Kuan Yew was also the democratic [inaudible] very large book, and he had conflicts.

So it's always about the traditional, about the system, and it has to be taken into account. And I think the American system is one of the other systems they will live by. Confrontation [inaudible] won't help but by actually development of [inaudible] economics. It may have a very big influence on adjustments. But even there is a wonderful book that I have noted from Merle Goldman who is at Harvard Business School and who interviewed all the dissidents who are coming to the United States. And they always [inaudible] the system in the [inaudible] is not a solution for them in the ruling system.

So this is my opinion, which is out of certain things I was told, so that [inaudible] like that, and I can't say what obligations China has taken when they were accepted to enter the WTO. This I don't know.

Chairman D'AMATO. Well, they accepted obligations, but they did not accept an obligation to become a Western-style democracy.

Does anyone else have anything to add on that question? I was thinking of our panelists. Do you see the development of the free flow of information into a more—

Dr. SCHWARZ. Lately I was just in a certain part of Southwest China. They made arrangements with business people much large—you have this Internet. You cannot stop the information flow. If you consider that you can't stop it, I think that in China these things will have to be faced, even if they don't like it.

Chairman D'AMATO. Well, that's an interesting proposition. Of course, the Chinese government is making every effort to control information flows, despite the Internet.

Anyone else have a comment on that? Commissioner Dreyer?

Commissioner DREYER. You have to keep mind that Lee Kuan Yew has his own agenda there. Lee Kuan Yew is the person who says democracy isn't right for Asia; "we have Asian values." He was immediately jumped on by the President of Korea and the President of Taiwan, who have rather different opinions. And I would certainly hesitate to call Singapore a democracy. Singapore—

Dr. SCHWARZ. In the Western sense, no.

Commissioner DREYER. No. Well, what Singapore is at the moment and has been for some years is an autocracy run by the Lee family. But, anyway, I do agree with your basic point that democracies develop in their own ways. You would never say that Japan is an American-style democracy, but it is nonetheless a democracy. And hopefully China will find its way, but I think the village elections—which were originally designed to take the heat off the central government, because there was such dissatisfaction with the party in China's villages, have now reached the point where the government sees some successes, but it also sees a lot of failures, such as the revival of the clan system and the local bosses and so on. So village elections are, from the Beijing government's point of view, quite imperfect.

By the way, Merle Goldman is not at the Harvard Business School. She teaches at Boston University, and she's an associate of the Fairbank Center at Harvard.

Chairman D'AMATO. Does anyone else have a comment? Yes?

Mr. MATOUSEK. [Translated from Czech.] I would like to add one more comment if I may. In our country, i.e. in a western-style de-

mocracy, the entire structure of a civil society is developing. I am speaking from the trade unions standpoint. We often meet the representatives of Japanese trade unions and South Korean trade unions and we find common points, we understand each other. Until now we have not had many opportunities to meet with the Chinese trade unions. My personal observation is that wherever I am in the world, if I go to a Chinese supermarket or a Chinese store or to a Chinatown, I see the same pictures, the same banners, etc. So obviously, the relationship is very close and centralized and not understandable for us.

Chairman D'AMATO. Thank you very much. Our impression is that if there were to have the development of trade unions in China, that would be a giant step toward the creation of a democratic system because trade unions have always been a very big piece of democratic systems and their evolution.

Is there any other comment?

Dr. SCHWARZ. Could I ask why you don't have any trade unions at Wal-Mart?

Chairman D'AMATO. Yes, that's a good question, but I don't run Wal-Mart so I don't have the answer to that. But all I can say is that the trade union movement in the past would have been strong enough to organize Wal-Mart. And I think it's a testimony that trade unions today are not as strong as they were at one time in our country. What's that?

Ms. BORK. But they are legal. They're allowed.

Chairman D'AMATO. Yes, but they don't organize. That's the question.

[Inaudible comments off microphone.]

Chairman D'AMATO. Trade unions are not allowed in China by the government, but the question is why trade unions did not organize Wal-Mart, and my answer is they weren't strong enough to organize Wal-Mart even though it was legal for them to do so.

Commissioner DREYER. I would say the reason the trade union movement has lost momentum in the United States is that the trade unions were not perceived by workers as delivering the goods, and that is why they declined.

Chairman D'AMATO. I think what we would like to do now is open the microphone up, if there's any questions that anyone in the audience has, or any further comment about the panel—to any member of the panel or the Commissioners, the microphones are there in the aisle. Anyone who has a question or comment, certainly now is the time that they're available to be used.

[No response.]

Chairman D'AMATO. If everyone is mesmerized into sitting in their seats, we're going to terminate the panel at this time and leave it open for informal comment, and I want to at this point thank the panelists for their presentations and for answering our questions, and we will be providing the Congress with a report on our proceedings, and it will include the presentations you all have made and questions and answers. We'll probably be back to you with our transcript so that you can do whatever editing you need to do. But at this point, I thank the panel and I thank Vice Chairman Robinson and Commissioner Dreyer for their attendance today. Thank you very much.

This concludes the afternoon session.

Commissioner DREYER. We hope we can keep in touch with you. We are here because we want to establish some kind of collaborative dialogue, and if anyone has been too shy to speak up, we would be pleased to receive your e-mails and your comments.

Thank you.

[Whereupon, the proceedings were concluded.]

**STATUTORY MANDATE OF THE U.S.-CHINA ECONOMIC AND SECURITY
REVIEW COMMISSION**

Pursuant to Public Law 108-7, Division P, enacted February 20, 2003

RESPONSIBILITIES OF THE COMMISSION.—The United States-China Commission shall focus, in lieu of any other areas of work or study, on the following:

PROLIFERATION PRACTICES.—The Commission shall analyze and assess the Chinese role in the proliferation of weapons of mass destruction and other weapons (including dual use technologies) to terrorist-sponsoring states, and suggest possible steps which the United States might take, including economic sanctions, to encourage the Chinese to stop such practices.

ECONOMIC REFORMS AND UNITED STATES ECONOMIC TRANSFERS.—The Commission shall analyze and assess the qualitative and quantitative nature of the shift of United States production activities to China, including the relocation of high-technology, manufacturing, and R&D facilities; the impact of these transfers on United States national security, including political influence by the Chinese government over American firms, dependence of the United States national security industrial base on Chinese imports, the adequacy of United States export control laws, and the effect of these transfers on United States economic security, employment, and the standard of living of the American people; analyze China's national budget and assess China's fiscal strength to address internal instability problems and assess the likelihood of externalization of such problems.

ENERGY.—The Commission shall evaluate and assess how China's large and growing economy will impact upon world energy supplies and the role the United States can play, including joint R&D efforts and technological assistance, in influencing China's energy policy.

UNITED STATES CAPITAL MARKETS.—The Commission shall evaluate the extent of Chinese access to, and use of United States capital markets, and whether the existing disclosure and transparency rules are adequate to identify Chinese companies which are active in United States markets and are also engaged in proliferation activities or other activities harmful to United States security interests.

CORPORATE REPORTING.—The Commission shall assess United States trade and investment relationship with China, including the need for corporate reporting on United States investments in China and incentives that China may be offering to United States corporations to relocate production and R&D to China.

REGIONAL ECONOMIC AND SECURITY IMPACTS.—The Commission shall assess the extent of China’s “hollowing-out” of Asian manufacturing economies, and the impact on United States economic and security interests in the region; review the triangular economic and security relationship among the United States, Taipei and Beijing, including Beijing’s military modernization and force deployments aimed at Taipei, and the adequacy of United States executive branch coordination and consultation with Congress on United States arms sales and defense relationship with Taipei.

UNITED STATES-CHINA BILATERAL PROGRAMS.—The Commission shall assess science and technology programs to evaluate if the United States is developing an adequate coordinating mechanism with appropriate review by the intelligence community with Congress; assess the degree of non-compliance by China and [with] United States-China agreements on prison labor imports and intellectual property rights; evaluate United States enforcement policies; and recommend what new measures the United States Government might take to strengthen our laws and enforcement activities and to encourage compliance by the Chinese.

WORLD TRADE ORGANIZATION COMPLIANCE.—The Commission shall review China’s record of compliance to date with its accession agreement to the WTO, and explore what incentives and policy initiatives should be pursued to promote further compliance by China.

MEDIA CONTROL.—The Commission shall evaluate Chinese government efforts to influence and control perceptions of the United States and its policies through the internet, the Chinese print and electronic media, and Chinese internal propaganda.

LIST OF WITNESSES, COMMUNICATIONS, AND PREPARED STATEMENTS

	Page
Amersfoort, Philippe van, Administrator, European Commission Directorate General for External Relations, Human Rights and Democratisation Unit ...	113
Prepared statement	116
Cabestan, Jean-Pierre, Senior Researcher, French National Center for Sci- entific Research (CNRS), University of Paris, France	168
Prepared statement	172
Cloos, Jim, Director, General Secretariat of the Council of the European Union	108
Prepared statement	111
D'Amato, Chairman C. Richard	
Opening remarks of	1,140
Prepared statement	3,142
Ferdinand, Peter, Director, Centre for Studies in Democratisation, Depart- ment of Politics and International Studies, University of Warwick, Cov- entry, United Kingdom	51
Prepared statement	56
Geest, Willem van der, Director, European Institute for Asia Studies	88
Prepared statement	91
Jarab, Senator Josef, Chairman, Senate Committee on International Affairs, Defense and Security, Czech Republic	164
Marchi, Francesco, Director of Economic Affairs, European Apparel and Tex- tile Organization	16
Prepared statement	18
Matousek, Vladimir, Head, International Department, Czech-Moravian Con- federation of Trade Unions, Prague, Czech Republic	186
Prepared statement	189
Monks, John, General Secretary, European Trade Union Confederation	6
Musil, Jan, CEO, Skoda Energo a.s., Plazeň, Czech Republic	180
Nightingale, Peter, Chairman, Euro-China Business Association	9
Prepared statement	13
Riemann, Volker, Head, Purchasing Department, Skoda Auto a.s., Mladá Boleslav, Czech Republic	190
Robinson, Vice Chairman Roger W., Jr.	
Opening remarks of	4,143
Prepared statement	5,144
Ruml, Jan, Vice President, Senate of the Czech Republic, Chairman of the Olympic Watch Committee	145
Prepared statement	147
Schneider, Jiří, Political Director of the Foreign Ministry of the Czech Repub- lic	149
Schwarz, Oldrich, Director, Libra Management Group Limited, Prague, Czech Republic	182
Prepared statement	184
Speyer, Bernhard, Director, Head of Banking, Financial Markets, Regulation, Deutsche Bank Research/Economics, Frankfurt, Germany	60
Prepared statement	64
Tajariol, Michele, Sales Director, Tajmac-ZPS, a.s., Zlin-Malenovice, Czech Republic	191
Prepared statement	193
Tannock, Charles, Member of European Parliament, Vice Chairman, Euro- pean Parliament's Subcommittee on Human Rights	101
Prepared statement	104

II

	Page
Umbach, Frank, Resident Fellow, Head of the Asia-Pacific Program, and Co-Chair, CSCAP Europe, Research Institute of the German Council on Foreign Relations (DGAP), Berlin, Germany	76
Prepared statement	82