

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

NOVEMBER 9, 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 the Commission's third Annual Report to the Congress, pursuant to Public Law 106-398 (October 30, 2000), as amended by Division P of P.L. 108-7 (February 20, 2003), responding to the mandate for the Commission "to monitor and investigate and report to Congress on the national security implications of the bilateral trade and economic relationship between the United States and the People's Republic of China." The Commission has again reached a broad and bipartisan consensus, approving the Report by a vote of 11 ayes to 1 nay.

The report includes detailed treatment of our investigations of the areas identified by the Congress for our examination and recommendations in the amendments of 2003. These areas are China's proliferation practices; China's economic and security impacts in Asia (we included a review of the Six-Party Talks to secure a termination of North Korea's nuclear weapons programs); China's economic reforms and U.S. economic transfers to China; China's energy needs; China's impact on the process known as "globalization;" the security implications of Chinese firms' access to U.S. capital markets; U.S. investment in China; U.S.-China bilateral programs and agreements; China's record of compliance with its World Trade Organization (WTO) commitments; and the Chinese government's media control actions.

The Commission conducted its work through an extensive set of 14 hearings, taking testimony from over 150 witnesses from the Congress, the executive branch, industry, academia, policy groups, and other experts. It conducted those hearings in Washington, D.C. and in various other locales—Seattle, Washington; Palo Alto, California; Akron, Ohio; and New York City—to assess China's impact in various sectors, industries, and regions of the United States. Commissioners also conducted official visits to China (hosted by the Chinese Ministry of Foreign Affairs), Japan, Taiwan, Hong Kong, Brussels, and Geneva. In all these visits, the Commission delegation met with the official U.S. government representatives, officials of the host government, representatives of U.S. and foreign business interests, representatives of American news media, and outside local experts. For each of its hearings, the Commission produced a transcript and a letter of transmittal to the Congress containing findings and recommendations. These documents are posted on the Commission's Web site (<http://www.uscc.gov>). The Commission also relied substantially on briefings by the intelligence community, the work of its excellent professional staff, and outside research in specialized areas supported by the Commission.

We believe the level of bipartisan consensus the Commission achieved is noteworthy, given the range of important matters the Congress directed us to investigate, and the growing concern over the general direction of the U.S.-China relationship. We believe that China and the United States are the chief protagonists on the world stage, and will remain so for the foreseeable future. Therefore it is crucial that American policymakers in both branches of government reach a strong national consensus about the approach and policies that must be crafted to address the opportunities and challenges that characterize our relations with China. Certainly the adage that political partisanship should end at the water's edge applies to this important relationship, which is affecting the international economic, political, and strategic systems—not only in Asia but worldwide. It will take all of America's political skills, on a bipartisan basis, not only to meet the challenges China presents but also to transform them into opportunities for the common good.

The Report maintains that over the past year, far too little, if any, progress has been made on balance in addressing the major economic and security issues in play in the U.S.-China relationship.

The Commission has continued to operate on the basis of the central principle of its Congressional mandate: that U.S. economic health and well-being are a fundamental national security matter, and that this includes maintenance of a strong manufacturing base, healthy employment levels and economic growth rates, vigorous research and development activity, strong global competitiveness, and a capacity to field robust military forces. During the year, several events occurred which highlighted the generic linkage between economic health and strategic strength, including the attempted acquisition of the American oil company Unocal by the oil concern CNOOC that is partly owned by the Chinese government. The Commission recommended that Congress oppose this acquisition on national security grounds.

Also during the past year, along the lines of Commission recommendations to Congress, a Congressional consensus emerged over the strategic consequences for the U.S. economy of China's continued manipulation of its currency. Indeed, across the range of important elements of the relationship, from China's rapid modernization of its military forces to its focused and aggressive economic policies, the Congress has become a central and active player in fashioning America's policies toward China. In the economic arena, this activism is most appropriate given the fact that the U.S. Constitution gives exclusive power to the Congress to regulate foreign commerce (Article I, Section 8).

The Commission was established in response to the debate that led the Congress to approve Permanent Normal Trade Relations (PNTR) for China and China's admission to the WTO. During that debate the Administration argued strongly that including China in the world trading system would lead to development of a market economy and to political reform and a more open Chinese society. Unfortunately, during the past year it has become clear that the Chinese leadership will not countenance progress on any important features of political reform, human rights, government openness and transparency, media freedom, building democratic institutions, or implementation of the rule of law. Indeed, the opposite is more

often the case as the regime has tightened up in these areas, especially media freedom. While it is unrealistic to expect the United States to fundamentally transform the beliefs, structure, and governing dynamics of China's authoritarian leadership, the Commission believes the United States should continue to strongly advocate democratic values and institution building, remembering that in the past our nation's efforts of this kind were instrumental in facilitating establishment of democracies elsewhere in Asia, including Japan, South Korea, and Taiwan.

The Report includes over fifty recommendations for Congressional action, ranging from providing for fair dealing in a range of economic arenas, to instituting policies on media openness, to enhancing the security of American interests, alliances, and friendships in the Pacific region. Our ten most important recommendations appear on page 14 at the conclusion of the Executive Summary. Among these are two recommendations for bold U.S. initiatives to engage the Chinese and promote cooperation in both the strategic and economic areas: First, we propose that the Congress encourage U.S. initiation of discussions aimed toward obtaining agreement to develop military confidence building measures (CBMs) in the Pacific region and to create bilateral institutions to regularize interaction of the two nations' military forces and provide a mechanism to manage a crisis if it erupts between them. Second, the Commission recommends that Congress mandate the establishment of a U.S.-China Energy Working Group to facilitate cooperative development of technologies and practices to reduce the dependence of both nations on imported oil; and that Congress encourage Administration efforts to persuade China to end its mercantilist practices of acquiring oil at the wellhead throughout the world, purchase oil on the open market, and involve itself in the International Energy Agency's efforts to manage oil supply disruptions.

We offer this third Annual Report to the Congress in the hope that it will be useful as an updated baseline for assessing progress and challenges in the U.S.-China relationship. We believe the current relationship is still in a relatively early stage and the United States is in a position to help influence China to move in directions that will benefit both its own development and cooperative relations with the United States, the rest of Asia, and the entire world community. We are persuaded that our nation's policies toward China are more likely to succeed if they spring from a bipartisan consensus in both the Congress and the Administration. We offer this Report and the continued work of the Commission in the spirit of facilitating and informing that process.

Yours truly,



C. Richard D'Amato
Chairman



Roger W. Robinson, Jr.
Vice Chairman