BILATERAL TRADE POLICIES AND ISSUES BETWEEN THE UNITED STATES AND CHINA

THURSDAY, AUGUST 2, 2001

U.S.-CHINA SECURITY REVIEW COMMISSION,
Washington, DC.

The Commission met in Room 124, Dirksen Senate Office Building, Washington, D.C., at 8:07 a.m., C. Richard D'Amato (Chairman) and George Becker (Hearing Co-Chairman), presiding.

OPENING REMARKS OF CHAIRMAN C. RICHARD D'AMATO

Chairman D'AMATO. Why don't we just get started. The steel industry rises early and this committee is complying with that.

Mr. GERARD. We just don't want to retire early.

[Laughter.]

Chairman D'AMATO. Today is the U.S.-China Commission's second hearing on U.S.-China Trade and Investment Issues. This Commission was created by Congress last year to examine the growing economic relationship with China and the implications of this relationship on U.S. national security issues. Perhaps no aspect of the U.S.-China economic relationship is as significant to this examination as the implications of China's impending accession to the World Trade Organization.

Many believe China's WTO accession will reap significant economic benefits for the United States in terms of greater access to the Chinese market for U.S. goods and services and that it will bring about positive political and economic reform within China. Others believe the potential benefits to the U.S. economy of China's WTO accession are overstated. Some, in fact, believe it will increase our trade deficit with China and that China will be unable or unwilling to live up to its WTO commitments. Today's hearing, we hope, will help to start shedding some light on this important debate.

The implications for the U.S. economy and U.S. national security interests of the China WTO accession will likely vary sector by sector, economic sector. Today, we will hear from labor and industry representatives from a number of the key sectors that will be impacted. The Commission looks forward to the testimony of these witnesses and to their perspectives on current and future trends regarding our trade and investment relationship with China.

Today's hearing will aid the Commission in carrying out its general mandate to examine the economic factors in the U.S.-China relationship that pose challenges to U.S. national security. Additionally, today's proceedings should help the Commission address the specific mandates in its charter to report to Congress on, first, actions China has taken in the context of the WTO that are adverse or unfavorable to U.S. interests; second, differences between China's trade and investment relationship with the U.S. and its other trading partners; third, the national security implications of the large capital flows between the U.S. and China; and fourth, whether the U.S. should consider invoking Article XXI of the GATT, which allows parties to deviate from their GATT obligations when their national security interests are threatened as a result of any adverse impact on the U.S. arising from its economic relationship with China.

Later this fall, the Commission plans to hold a Third Hearing on Trade and Investment Issues to explore some of these key issues, including trade and financial services and protection of intellectual property rights that are not covered in the first two hearings. The Commission will also hold hearings on export controls, Chinese companies fundraising in the U.S. capital market, Chinese budget, and tomorrow, China's strategic perceptions of the U.S. The current schedule is available on the committee's website.

Now, I would like to turn over to my Co-Chairman, the Honorable Commissioner George Becker, for an opening statement, and he will be running the first panel of our witnesses today.

[The statement follows:]

PREPARED STATEMENT OF CHAIRMAN C. RICHARD D'AMATO

Today is the Commission's second hearing on U.S.-China trade and investment issues.

The Commission was created by Congress to examine our growing economic relationship with China and the implications of this relationship on U.S. national security interests. Perhaps no aspect of the U.S.-China economic relationship is as significant to this examination as the implications of China's impending accession to the World Trade Organization (WTO). Many believe China's WTO accession will reap significant economic benefits for the United States in terms of greater access to the Chinese market for U.S. goods and services, and that it will bring about positive political and economic reform within China. Others believe that the potential benefits to the U.S. economy of China's WTO accession are overstated (some in fact believe it will *increase* our trade deficit with China), and that China will be unable or unwilling to live up to its WTO commitments. Today's hearing should help shed light on this important debate.

The implications for the U.S. economy and U.S. national security interests of China's WTO accession will likely vary by economic sector. Today we will hear from labor and industry representatives from a number of the key sectors that will be impacted. The Commission looks forward to the testimony of these witnesses and to their perspectives on current and future trends regarding our trade and investment relationship with China.

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Later this Fall, the Commission plans to hold a third hearing on trade and investment issues to explore some of the key issues—such as trade in financial services and protection of intellectual property rights—that were not covered in the first two hearings. The Commission will also hold hearings on export controls, Chinese companies' fundraising in the U.S. capital markets, the Chinese budget and, tomorrow, China's strategic perceptions of the U.S. The current schedule is available on the Commission's website.

I would like to turn now to my Co-Chair for this hearing, Commissioner Becker, for an opening statement.

OPENING REMARKS OF COMMISSIONER GEORGE BECKER

Co-Chairman BECKER. It is my pleasure to be Co-Chairing with Dick D'Amato, the Commission's permanent Chairman, a second public hearing of the United States-China Security Review Commission. We will hear testimony today from witnesses representing a broad array of sectors impacted by bilateral and trade policies and the economic relationship between the United States and China, as well as from representatives of the administration. These witnesses will give us their perspectives on what China's WTO accession means to the United States industry and its workers. The subject matter of this hearing and your testimony is of particular interest to the Commission and we want to thank you for your appearance.

We will begin with a panel focusing on the United States steel industry and the impact of China on the world steel market. Our panelists for that topic are Leo Gerard, International President of the United Steelworkers of America, a union I was honored to lead prior to Mr. Gerard's tenure, and Tom Usher, Chairman and CEO of the USX Corporation.

We then have a panel to discuss the important question of China's accession to the World Trade Organization and viewpoints on China's compliance with agreements in both the bilateral and multilateral context. Peter Davidson, General Counsel to the United States Trade Representative; Charles Winwood, Acting Commissioner at the United States Customs Service; and Donald Shruhan, Deputy Assistant Commissioner for International Affairs, will present the administration's perspectives. Gordon Chang, a lawyer with many years' experience in China and author of the book *The Coming Collapse of China*, published just yesterday, will share his views from the private sector.

We will address the impact of China as an emerging influence on the aircraft, aerospace, and automobile industries in the last panel this morning. General John Douglass, President and CEO of the Aerospace Industries Association; Robert Thayer, General Vice President of the International Association of Machinists and Aerospace Workers; and Steve Beckman, Assistant Director of the Government and International Affairs Department at the United Auto Workers, will discuss the challenges and possibilities posed by China's growing role in these industries.

In the afternoon, we begin with a panel looking at the agricultural section and the views of China from our farming communities. On that panel, we have Robbin Johnson, Vice President for Corporate Affairs at Cargill; Henry Jo Von Tungeln, Vice Chairman of the National Association of Wheat Growers; Dwain Ford, First Vice President of the American Soybean Association; and Chuck Lambert, Chief Economist at the National Cattlemen's Beef Association.

We will conclude today's hearings with a discussion of U.S.-China trade in computer electronics and telecommunications sectors. Ed Fire, President of the International Union of Electrical Workers, which has just recently merged with the Communication Workers Union, and David McCurdy, President of the Electronics Industry Alliance, will testify on the specific issues raised by trade in these industries. Merritt Todd Cooke, Commercial Section Chief at the American Institute in Taiwan, will testify on the state of these industries in the context of the U.S.-China-Taiwan relationship.

We obviously have a lot of ground to cover. The Commission again thanks our panelists for coming today and sharing our views.

We have a timer that is set up here allotting seven minutes of testimony for each person. It runs five minutes with a green light, two minutes with a yellow light, and then you get the gong. That is the red light. With the first two panelists that we are going to kick off with on steel, though, since you are the only two for this session here, we won't pay as strict attention to that, if we can. But be cognizant of each other's desire to submit testimony, and I know that you will share it, so we will keep the timer tight with you as you go forward.

Mr. Usher, we will start with you.

[The statement follows:]

PREPARED STATEMENT OF COMMISSIONER GEORGE BECKER

It is my pleasure to be co-chairing today's important hearing on bilateral trade policies and issues between the United States and China. We will hear testimony from witnesses representing a broad array of sectors impacted by U.S.-China trade, as well as from representatives of the Administration. These witnesses will give us their perspectives on what China's WTO accession means for U.S. industry and U.S. workers. The topic of this hearing is particularly timely, so the Commission thanks all our panelists for their appearance here today.

We will begin with a panel focusing on the United States steel industry and the impact of China on the world steel market. Our panelists for that topic are Leo Gerard, President of the United Steelworkers of America, an organization I was honored to lead prior to Mr. Gerard's tenure, and Thomas Usher, Chairman and CEO of USX Corporation.

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PANEL I: CHINA AND THE U.S. STEEL INDUSTRY

STATEMENT OF THOMAS J. USHER, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, USX CORPORATION AND UNITED STATES STEEL LLC

Mr. USHER. Well, George, I guess the gong is better than the hook. I would hate to be dragged out physically.

Mr. Chairman, members of the Commission, I am Tom Usher, Chairman and Chief Executive Officer of USX Corporation and United States Steel. United States Steel is the largest integrated steel maker in the United States and the largest producer of flat rolled steel. I appreciate this opportunity to appear before you today to address the growing challenge posed to our industry by China.

In 1996, China became the world's largest producer of crude steel. The Chinese government has a stated objective of making China completely self-sufficient in steel by 2010. World Steel Dynamics, which recently completed a major study on the Chinese industry, reports that a huge expansion is underway in the steel sector, with an addition of 20 million metric tons of hot rolling capacity by the year 2006. They predict that the Chinese steel industry by 2010 is sure to become the dominant steel making group in the world.

The consequences of the global capacity glut for our own steel industry have been disastrous. We have experienced massive recurrent surges of low-priced illegal imports in this market since 1998, which have depressed prices and destroyed profitability. Since 1998, producers representing over 20 percent of the U.S. steel industry's crude steel capacity have entered bankruptcy proceedings.

Thus far, given its sheer size, the Chinese steel industry has played a comparatively modest role in export markets. In both 1998 and 1999, for example, it exported a smaller volume of steel than Taiwan. However, we have already learned that when China directs its large and growing steel making capacity to the export market, the results can be dramatic.

In 1993, China did not ship any cut-to-length plate to the U.S. market. However, only three years later, China had become the largest single foreign supplier of this product to the U.S., accounting for over 18 percent of all cut-to-length plate imports.

As Chinese capacity continues to expand, the prospects for a repetition of the plate episode increase. Given the size of China's industry, if domestic demand falters due to recession or other factors, the result could be an export surge comparable in scale and disruptive power to that which we saw from Russia in 1998. Significantly, the Chinese government has demonstrated that it will employ special tax rebates and other export incentives to stimulate exports.

Confronting China, our industry faces a competitive challenge from enterprises organized under an economic system which is fundamentally unlike our own. The Chinese industry has access to low-cost abundant capital from the government. The government owns the principal steel enterprises and is committed to creating an environment in which profits, and therefore income tax receipts, are good. Government administered import restrictions and production controls have enabled Chinese mills to achieve domestic prices which are among the highest in the world for both flat and long products.

Since the end of World War II, the United States has sought to promote an open liberal world trading order through the establishment of multilateral rules and institutions, including GATT and the WTO. Through this process, multilateral rules have been established which prohibit or circumscribe precisely the kinds of trade and industrial policy measures China is using to promote its steel industry.

The critical question which we face today is the extent to which these rules will apply to China in a manner in which compliance can be monitored and, where necessary, enforced. If China fully adheres to its WTO commitments upon accession, most of the principal restrictions which limit access to the Chinese market will be eliminated. The U.S. and its trading partners have a shared interest in ensuring that China complies with its commitments on market access.

At present, the Chinese steel industry is one of the most heavily subsidized steel industries in the world. The government has provided massive assistance in the form of debt forgiveness to China's steel industry, estimated at $10.8 billion in 1999–2000 and has approved loans at subsidized interest rates worth $4.6 billion to over 80 steel projects. Additional large-scale subsidies are provided to Chinese steel makers by regional and local governments, and the Chinese government gives export tax rebates on a preferential basis to domestic steel producers.

Under current Department of Commerce rules, given China's non-market economy status, U.S. countervailing duty law does not apply to Chinese exports. Given China's historical and current reliance on export subsidies, it is important that the current WTO ban on export subsidies be made fully applicable to China after accession. In addition, U.S. countervailing duty laws should be fully applicable to Chinese export subsidies whether or not a remedy is available under WTO dispute resolution procedures.

The Commission has expressed interest in the extent to which China will be able to live up to the bilateral trade obligations it is assuming with regard to the U.S. as it joins the WTO. To date, the record is mixed. Based on this experience, it is important that the U.S. Government closely monitor China's adherence to its WTO commitments, particularly in sectors like steel, which are the subjects of intensive government promotional efforts.

If China breaches its WTO commitments, the United States has recourse through WTO dispute resolution procedures and should utilize procedures in appropriate cases. At the same time, we must bear in mind that, to date, these procedures have not proven fully effective in enforcing U.S. rights under the GATT and the WTO has not yet demonstrated that it can handle cases in which complex factual issues are in dispute, as is likely with respect to China.

Accordingly, the U.S. must remain ready to act unilaterally where necessary in defense of its rights, consistent with its obligations under the WTO. As a practical matter, this will entail the application of antidumping and countervailing duty measures, as well as remedies available under other statutes.

An important element in China's emergence as a major power is the rapid development of a strategic industry like steel. China clearly regards the existence of a strong indigenous steel industry as essential to its broader national aspirations, including its military capacity. By the same reasoning, we should implement trade and other policy measures necessary to prevent the further erosion of our own steel industry.

President Bush recent launched an initiative to respond to the crisis confronting the U.S. steel industry. No arm of the U.S. Government should take action which undermines the objective of the President's program. I am referring specifically to the proposals by the U.S. Export-Import Bank to provide loans to finance expansion of steel making capacity abroad at the same time that the President is trying to reduce capacity. It is irrational for the Ex-Im Bank to finance the construction of additional steel making capacity abroad for products which are already in global oversupply.

Last year, the Ex-Im Bank approved a loan to the Benxi Iron and Steel Company in China which would help finance the expansion of Benxi's capacity for hot rolled flat products by 1.5 million tons. This episode underscores the need for some additional guiding principles for Ex-Im financing.

First, the Ex-Im Bank should not finance investments that would increase capacity for a commodity product which is already in massive global oversupply, and second, no loan should be extended to countries where companies have been found to be dumping in the U.S. market or while an antidumping investigation is pending. And finally, the U.S. Government should engage other governments in a dialogue to ensure that no country extends export financing for capacity expansion in steel, which would aggravate the existing surplus.

I want to thank you again for inviting me to participate today and I look forward to the question and answer session.

[The statement follows:]

PREPARED STATEMENT OF THOMAS J. USHER

Mr. Chairman and members of the Commission, I am Thomas J. Usher, Chairman and Chief Executive Officer of USX Corporation and United States Steel LLC. United States Steel is the largest integrated steelmaker in the United States and the largest producer of flat-rolled steel in the U.S. I appreciate this opportunity to appear before you today to address the growing challenge posed to our industry by China.

In 1996 China became the world's largest producer of crude steel. While much of its industry consists of inefficient mills producing steel of relatively low quality, the Chinese government is devoting massive resources to upgrading the industry. The Chinese government has a stated objective of making China completely self-sufficient in steel by 2010. There is little doubt that China is quite capable of achieving this goal. World Steel Dynamics, which recently completed a major study on the Chinese industry, reports that "a huge expansion" is under way in the steel sector, with an addition of 20 million metric tons of hot-rolling capacity seen by the year 2006.[1]

—Some Chinese mills, like Baoshan in Shanghai, now produce high quality cold-rolled and corrosion-resistant flat products.

[1] WSD, Chinese steel: Unique, Unbridled, Unstoppable, Case Report vvv (June 2001), p. vvv–1–7.

—The U.S. Department of Commerce reported last year that the Chinese government will spend $6 billion during the next several years to “upgrade and transform” the steel industry.
—Commerce predicted that the central government will direct local governments to give the steel industry priority with respect to land use, raw materials, transport, raw material, equipment, and water and power supplies.[2]

World Steel Dynamics predicts that “the Chinese steel industry by 2010 is sure to become the dominant steelmaking group in the world.”

The expansion of the Chinese steel industry must be viewed against the crisis which confronts the global steel industry today. China is undertaking massive capacity expansion at a time when the world steel industry already suffers from an enormous overhang of surplus capacity. The capacity surplus has already led to depressed prices, chronic dumping and trade friction around the world. While the numbers may vary by source depending on the definition of “overcapacity,” the dimensions of the problem are monumental:

—The OECD estimates that 275 million tons of surplus crude steelmaking capacity exists worldwide, or about two times the annual consumption of the United States and more than the entire world consumed annually during the decade of the 1950s.
—In the year 2000, over 75 million tons of the world’s effective capacity for hot-rolled flat products was not utilized at all, more than double the amount needed to supply the U.S. market for a year.[3]

The consequences of the global capacity glut for our own steel industry have been disastrous. We have experienced massive, recurrent surges of low-priced imports in this market since 1998 which have depressed prices and destroyed profitability. Since 1998 producers representing over 20 percent of the U.S. steel industry’s crude steel capacity have entered bankruptcy proceedings.

Chinese Steel—The Experience to Date

What role has China played in this process? To date, the biggest impact of China’s steel policies on our industry has been indirect, reflecting the progressive closure of the Chinese market through a series of government measures which have been implemented since 1994.

—In 1993, according to statistics published by the International Iron and Steel Institute, China imported over 36.7 million metric tons of semi-finished and finished steel products, more than twice the volume imported by the U.S. in that year (17.9 million).
—By 1998, the situation had more than reversed itself—the United States absorbed 37.9 million tons, over 2½ times the 13.1 million tons imported by China in that year.[4] Chinese import restrictions largely foreclosed a traditional major export outlet for countries like Russia and Japan. Steel from these and other sources that would have gone to China ten years ago has come to the United States instead. In addition, Chinese import restrictions have meant the loss of an export market for us—U.S. exports of finished steel to China fell from an average of 109.8 thousand net tons in 1992–95 to 18.5 thousand net tons in 1997–99.[5]

Thus far, given its sheer size, the Chinese steel industry has played a comparatively modest role in export markets. In both 1998 and 1999, for example, it exported a smaller total volume of steel than Taiwan.[6] However, we have already learned that when China directs its large and growing steelmaking capacity to the export market, the results can be dramatic:

—In 1993 China did not ship any cut-to-length plate (CTL) to the U.S. market.
—Only three years later, China had become the largest single foreign supplier of this product to the U.S., accounting for over 18 percent of all CTL imports. Dumping margins were found by the Commerce Department ranging from 17.33 percent to 128.59 percent.

As Chinese capacity continues to expand, the prospects for a repetition of the plate episode increase. Given the size of China’s industry, if domestic demand falters due to recession or other factors, the result could be an export surge comparable in scale and disruptive power to that which we saw from Russia in 1998. Signifi-

[2] U.S. Department of Commerce, Report to the president: Global Steel Trade (July 2000), p. 146.
[3] Metal Bulletin Research, April 2001.
[4] IISI, Steel Statistical Yearbook 2000.
[5] American Iron and Steel Institute.
[6] IISI Steel Statistical Yearbook 2000, Table 30.

cantly, the Chinese government has demonstrated that it will employ special tax rebates and other export incentives in order to stimulate exports.

Trade Policy Implications of China's Steel Policies

While Chinese industrial policies in steel have already had substantial effects on our industry and market, they have more serious implications for the future. Confronting China, our industry faces a competitive challenge from enterprises organized under an economic system which is fundamentally unlike our own. The recent study by World Steel Dynamics cites some of these systemic differences in support of its predication that the Chinese steel industry is "sure" to become the dominant producer in the world within ten years. It notes, for example—

—*Subsidies.*—The Chinese industry has access to "low-cost, abundant capital" from the government. WSD asks "why be fearful [of high levels of debt] when the central government may never permit any of the companies to go out of business and is willing to exchange debt for equity when necessary?" [7]

—*State ownership.*—The government owns the principal steel enterprises and is "committed to creating an environment in which profits, and, therefore, income tax receipts, are good." "All of the [main Chinese steel] companies belong to the government. There are no exceptions. If the government approves, the companies get the help that they need." Top executives of Chinese steel companies are members of the Communist Party.[8]

—*Market controls.*—Government-administered import restrictions and production controls have enabled Chinese mills to achieve domestic prices which are among the highest in the world for both flat and long products—for example, $314 per metric ton for hot-rolled bands in the first quarter of 2001 [9] (versus about $270 per ton in the U.S. during the same period).

Comparable promotional measures in many other countries have played a major role in the erosion of the U.S. steel industry. Their presence on a huge scale in what is now the world's largest steel industry must constitute a major cause for concern.

Since the end of World War II, the United States has sought to promote an open, liberal world trading order through the establishment of multilateral rules and institutions, such as, most notably, the General Agreement on Tariffs and Trade (GATT) and, more recently, the World Trade Organization (WTO). Through this process, multilateral rules have been established which prohibit or circumscribe precisely the kinds of trade and industrial policy measures China is using to promote its steel industry. The critical question which we face today is the extent to which these rules will apply to China in a manner in which compliance can be monitored and, where necessary, enforced.

The U.S. government has negotiated a bilateral agreement with China with respect to WTO accession which goes a long way toward satisfying some of our principal concerns about the potential effect of Chinese policies on our industry. The extent to which China will comply with its obligations is an open question. The effectiveness of subsequent monitoring and enforcement will depend on the degree of effort and level of resources committed to the task by this and subsequent administrations. With all of these variables, it is premature to assess the impact of China's WTO entry on the U.S. steel industry. Nevertheless, it is useful to review the most important issues.

Antidumping—Non-Market Economy Rules

U.S. antidumping law provides that in cases involving exports to the U.S. from "non-market economies" (NMEs) the Department of Commerce is to determine "normal market value" of the product under investigation by calculating the costs of production for NME producers. Because prices in NMEs are distorted by pervasive government controls, Commerce calculates costs by reference to a surrogate market economy which is a significant producer of comparable products and which is at a level of development comparable to that of the NME under investigation.

The U.S.-China Agreement provides that Commerce may continue using NME methodology in antidumping investigations involving China for 15 years following China's WTO accession. China has indicated it will seek to eliminate use of the NME provisions of U.S. antidumping law given its progress towards becoming a market economy. However, State ownership and pervasive control of strategic industries like steel are expected to continue for the foreseeable future, and are cited by industry analysts as a major source of competitive advantage.

[7] WSD, Chinese Steel (op. Cit.) p. vvv–2–3.
[8] WSD, Chinese Steel (op. Cit.) p. vvv–2–3, vvv–4–1, vvv–2–1.
[9] WSD, *Chinese steel*, op. Cit., p. vvv–3–4.

—The Chinese government makes and guides prices in the crude oil and natural gas sectors, power supply, coal, transportation, and in the steel industry itself.[10]

—In the state steel sector, wage rates are not determined by free bargaining or other market-based methods—overemployment is endemic and a de facto form of social welfare, with the costs ultimately absorbed by the state. One Chinese mill, Shougang, employs more workers than the entire U.S. steel industry.[11]

Accordingly, in the final Protocol of Accession and in implementing U.S. legislation, the right of the U.S. to continue to apply the NME provisions of its Antidumping Law to China for the full 15 years must be preserved.

Safeguards

The U.S.-China Agreement provides that the U.S. can apply product-specific safeguard measures solely against China in situations in which imports occur in such an increased quantity and are imported under such conditions that they constitute a "significant cause of material injury, or threat of material injury" to a competing U.S. industry. This provision, which will remain in effect for 12 years following China's accession to the WTO, contains lower causation and injury standards than ordinarily would apply between WTO members in safeguard cases. These special safeguard rules are appropriate given China's status as an economy in transition, the sheer size of some of its manufacturing sectors, including steel, and the potential for domestic market disruption in the wake of trade liberalization. Congress must enact legislation fully implementing this provision, and it will be important for the Executive to exercise this right vigorously in appropriate cases.

Market Access

In October 1992, China signed a Memorandum of Understanding (MOU) with United States committing (1) to eliminate all quotas and import licensing on steel imports, and (2) not to pursue import substitution policies, e.g. measures designed to displace imports with domestic production. Notwithstanding these commitments, China has pursued an explicit policy of import substitution in steel using a system of *de facto* import licensing to quantitatively restrict steel imports:

—The State Administration of the Metallurgical (SAMI) has repeatedly stated its objective of "replacing [steel] imports with domestic products." In 1998 the government implemented the Steel Import Substitution Program (SISP), which provided VAT rebates to steel consumers who used domestic steel and would otherwise use imported steel.[12]

—A Chinese official publication, *Liaowang*, stated in 2000 that despite the commitments in the 1992 MOU, China still maintained quotas on steel imports and subjected imports to registration requirements.[13] The U.S. Department of Commerce concluded in 2000 that "ample anecdotal evidence and various reports indicate the existence of a steel import quota."[14]

In addition to quotas, China maintains an array of other import restrictions, including restrictions on import trading rights, the prohibition of distribution of steel by foreign firms within China, the requirement that foreign firms importing steel post security deposits, and tariffs which range from 10 to 40 percent.

If China fully adheres to its WTO commitments upon accession, most of the principal restrictions which limit access to the Chinese market will be eliminated—most importantly, the quota/licensing system. The result will be an increase in imports from nearby Asian countries as well as producers in the former Soviet Union. This will relieve pressure on the U.S. market and will subject inefficient Chinese producers to intensified competition. The U.S. and its trading partners have a shared interest in ensuring that China complies with its commitments on market access.

Subsidies

At present the Chinese steel industry is one of the most heavily-subsidized steel industries in the world.

—The government has provided massive assistance, in the form of debt forgiveness to China's steel industry, estimated at $10.8 billion in 1999–2000. Some

[10] "China Controls Public Utilities Prices," Beijing Xinhua Domestic Service (April 26, 1998); "Energy Situation, Utilization Strategy," Neijing Zhongguo Nengyuan (February 1, 1999); "State Sets Minimum Price for Steel Products," South China Morning Post (September 1, 1998).

[11] U.S. Department of Commerce, Reports to the President: *Global Steel Trade* (July 2000).

[12] "The State Bureau of Metallurgical Industry Seeks to Continue to do a Good Job of Controlling Total Production Output," Xinhua (Chinese Language Version) (July 22, 1999); U.S. Department of Commerce, Global Steel Trade op. Cit. P. 154; "PRC Sets Metallurgical Restructuring Objectives for 2000," *Xinhua* (*English Language Version*) (February 25, 2000).

[13] "WTO entry Pros, Cars as PRC Industries," *Liaowang* (February 28, 2000).

[14] U.S. Department of Commerce, *Global Steel Trade* (July 2000) p. 153.

of China's leading producers, including Baoshan and Capital Iron and Steel, were beneficiaries of this aid.[15]

—In April 2001 China's State Economic and Trade Commission (SETC) approved loans at subsidized interest rates worth US $4.6 billion to over 80 steel projects designed to expand capacity for hot-rolled flat products and plate by 13.7 million tons, cold rolled flat products by 6.8 million tons, and galvanized sheet by 2.5 million tons.[16]

—Additional large scale subsidies are provided to Chinese steelmakers by regional and local governments.

—The Chinese government gives "export tax rebates" on a preferential basis to domestic steel producers, which have been credited with substantially improving China's export position.[17]

At present, under current Department of Commerce rules, given China's non-market economy status, U.S. countervailing duty law (CVD) does not apply to Chinese exports. If and when all or parts of the Chinese economy graduate to market economy status, U.S. CVD rules should be applicable immediately to imports from China.

—The U.S. should retain flexibility to use alternative benchmarks to measure countervailable benefits arising out of subsidies, so that, for example, even if a particular sector is graduated to "market" status, other sectors providing subsidized inputs reflecting state controls would not be so considered.

—The U.S. should seek to ensure—if necessary through legislation—that if massive Chinese subsidies to the steel industry continue, those subsidies will be subject to U.S. CVD rules even if individual steel enterprises are privatized, unless and until the subsidies are fully repaid.

Given China's historical and current reliance on export subsidies, it is important that the current WTO ban on export subsidies be made fully applicable to China after accession. In addition, U.S. CVD law should be fully applicable to Chinese export subsidies, whether or not a remedy is available under WTO Dispute Resolution procedures.

Enforcing U.S. Rights

The Commission has expressed interest in the extent to which China will be able to live up to the bilateral trade obligations which it is assuming with regard to the U.S. as it joins the WTO. To date, the record is mixed. China has met many of its commitments under the 1992 MOU with the U.S., and we have a right to expect that it will make a good faith effort to comply with its new WTO obligations. However, with respect to steel, it should be recalled that in the 1992 MOU China committed not to implement an import substitution policy and to phase out its quantitative import restrictions on steel by the end of 1993. These commitments were in conflict with China's industrial development objectives, and industrial policy prevailed. Based on this experience, it is important that the U.S. government closely monitor China's adherence to its WTO commitments, particularly in sectors like steel which are the subjects of intensive government promotional efforts.

If China breaches its WTO commitments, the United States has recourse to WTO Dispute Resolution procedures, and should utilize procedures in appropriate cases. At the same time, we must bear in mind that to date these procedures have not proven fully effective in enforcing U.S. rights under the GATT, and the WTO has not yet demonstrated that it can handle cases in which complex factual issues are in dispute, as is likely with respect to China. For example, China has denied that it maintains quantitative restraints on steel imports, despite extensive evidence to the contrary, and a future U.S.-China dispute over this or similar issues would involve issues of fact which WTO dispute resolution procedures and the WTO Secretariat are ill-equipped to handle. Accordingly, the U.S. must remain ready to act unilaterally, where necessary, in defense of its rights, consistent with its obligations under the WTO. As a practical matter this will entail the application of antidumping and countervailing duty measures, as well as remedies available under other statutes.

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[15] "PRC Government to Continue to Implement Debt-to-Equity Swaps for Steel Firms," China Daily (Business Weekly Supplement, Hong Kong Edition) (March 26, 2000); "SOE's Sign Huge Debt-Equity Swap Agreements," Xinhua (November 10, 1999); "AMC's Sign 3.6 Million Yuan Agreement With Steel Giant," Xinhua (January 5, 2000).

[16] World Steel Dynamics, Chinese Steel Unique, Unbridled, Unstoppable, Core Report VVV (June 2001).

[17] "Government to Raise Tax Rebate Rates for Export Goods," Xinhua (July 19, 1999); WJO Deal Poses Competitive Threats to Chinese Mills, Metal Bulletin (November 16, 1999).

The Nexus With U.S. Security Interests

Steel has been a "strategic" industry for centuries, meaning an industry essential to national defense and the ability to wage war. The advent of nuclear weapons, the development of "smart" weapons systems, and the increasing use of specialized nonferrous and exotic metals in aircraft and submarines have perhaps made steel somewhat less central to defense capability than it was earlier in this century, but the fact remains that many of the platforms from which modern weapons systems operate are still predominantly made of steel. The Navy's ships and the armored vehicles, artillery pieces, trucks, and munitions used by the Army and Marine Corps are made of steel, as are countless other major and minor items of equipment used by all of the armed services.

The existence of a strong domestic steel industry has proven vitally important in all of the wars of this past century, and the same will be true in the unfortunate event that we became involved in another major war. While such a conflict today seems unthinkable, it should be recalled that our entry into a number of wars which are within living memory came as a surprise to most Americans, including World War II, the Korean conflict, and the Gulf War. Moreover, while we have allies who would undoubtedly be willing to supply us with steel during wartime, the need to transport a vital raw material across thousands of miles of ocean during a war is a major strategic disadvantage. The British discovered this in World War I, when they had to import large tonnages of steel vital to their war effort along sea lanes that were under attack by enemy submarines.

Whether or not we regard China as a "strategic competitor" with the United States, an important element in China's emergence as a major power is the rapid development of strategic industry like steel. China clearly regards the existence of a strong indigenous steel industry as essential to its broader national aspirations, including its military capacity. By the same reasoning we should implement trade and other policy measures necessary to prevent the further erosion of our own steel industry, which has played a major role in defending the nation during the past century and may be called upon to do so again.

Maintaining a Coherent U.S. Policy—The Case of Ex-Im Bank

President Bush recently launched an initiative to respond to the crisis confronting the U.S. steel industry. The President has asked the U.S. International Trade Commission to undertake an investigation pursuant to section 201 of the Trade Act of 1974 which can provide the basis for comprehensive import relief for the U.S. industry. The President is also preparing to engage our trading partners in negotiations to reduce surplus steelmaking capacity worldwide. These initial steps are very positive. While discussions are still under way about what additional policy measures may be needed to enable the U.S. industry to recover fully, one thing should be clear already—no arm of the U.S. government should take action which undermines the objective of the President's program. I am referring specifically to proposals by the U.S. Ex-Im Bank to provide loans to finance expansion of steelmaking capacity abroad at the same time that the President is trying to reduce capacity.

USX has always supported the efforts of Ex-Im Bank to promote U.S. exports, and our subsidiary, USX Engineers and Consultants, recently participated in an Ex-Im Bank program to assist a mill located in Romania to become more environmentally efficient. However, it is irrational for Ex-Im Bank to finance the construction of additional steelmaking capacity abroad for products which are already in global oversupply. Last year Ex-Im Bank approved a loan to the Benxi Iron and Steel Company in China which would help finance the expansion of Benxi's capacity for hot-rolled flat products by 1.5 million tons.

—This loan was approved at a time when worldwide there was already over 75 million tons of effective hot-rolled capacity that was not being utilized at all—or more than double the amount needed to supply the entire U.S. market for a year.[18]

—In China in 2000 there was already nearly 10 million tons of unutilized hot-rolled capacity, and the capacity surplus is forecast to swell to 14 million tons by 2004.[19]

—Benxi's own hot-rolled capacity utilization rate was a disastrous 44% in 2004, and even without the planned expansion this utilization rate is not forecast to increase significantly in the foreseeable future.[20]

[18] Metal Bulletin Research, April 2001.

[19] Metal Bulletin Research, April 2001.

[20] Metal Bulletin Research, April 2001. Benxi hot-rolled utilization rate forecast for 2004 is 48%. Ibid.

—China's capacity glut in hot-rolled flat products is so severe that the Chinese government has established a controversial output-restraint cartel in this sector.
—The U.S. government is currently conducting an antidumping investigation with respect to hot-rolled flat products from China. The Department of Commerce has made a preliminary finding of dumping with respect to China at margins as high as 67.44 percent and the U.S. International Trade Commission has made a preliminary finding that dumped Chinese hot-rolled flat steel products have materially injured U.S. steel producers.

This episode underscores the need for some additional guiding principles for Ex-Im Bank financing. First, Ex-Im Bank should not finance investments that would increase capacity for a commodity product which is already in massive global oversupply. Investments in such sectors should be limited to environmental safety, and capacity reduction. Second, no loans should be extended to countries where companies have been found to be dumping in the U.S. market, or while an antidumping investigation is pending. Finally, as part of its effort to reduce global excess capacity in steel, the U.S. government should engage other governments in a dialogue to ensure that no country extends export financing for capacity expansion in steel which would aggravate the existing surplus.

Conclusion

The expansion of the Chinese steel industry is occurring in the face of an already existing global steelmaking glut. The United States must closely monitor China's compliance with the bilateral agreement between China and the United States and with China's WTO commitments particularly in regard to the steel industry. The steel industry continues to be a strategic industry in terms of national security. China clearly views the development of a strong steel industry as integral to its emergence as a major industrial and military power. We cannot allow the desire to promote a bilateral trade relationship with China to be placed above our national security interests and the maintenance of a domestic manufacturing base. Finally, the Ex-Im Bank must take steps to assure that its actions are consistent with and in support of other programs of the United States to reduce global steel overcapacity.

Co-Chairman BECKER. Thank you, Mr. Usher.

Mr. Gerard?

STATEMENT OF LEO W. GERARD, INTERNATIONAL PRESIDENT, UNITED STEELWORKERS OF AMERICA

Mr. GERARD. My name is Leo Gerard. I am the International President of the Steelworkers Union. I am amply filling the suit of my predecessor, but yet trying to fill his shoes.

[Laughter.]

I will attempt to follow the same kind of procedure with those lights that he used to brag about to me of how he followed them. He will know what I mean.

[Laughter.]

Let me just say that it is a bit difficult to add new testimony after listening to Tom and his testimony, in particular his closing remarks about the Ex-Im Bank and global overcapacity, because certainly on this and a lot of other important issues to the steel industry, the position that he has iterated and that I would reiterate are substantially identical.

I want to make just a few reinforcing points about global overcapacity and the funding of new capacity in China by the Export-Import Bank or by other means, whether it is through the IMF or other funding agencies that are a pass-through of American taxpayer dollars. It is irrational to have in excess of 20 steel companies in America either in bankruptcy, struggling to get out of bankruptcy with a half-a-dozen others on their way to bankruptcy, to have American taxpayer dollars through various funding agencies, whether it is the Export-Import Bank or others, funding that global overcapacity and to fund it in a non-market economy and in an economy that, I think, is easily recognized as one of the world's leading human right violators.

I will attempt through my time to say a few words about some of the issues around human rights and the environment that I think need to be considered.

Again, reiterating Tom's point that China recently became the largest manufacturer of steel in the world, not just carbon steel but stainless steel, and its plans to increase capacity in the next five to six years, our understanding is primarily not through generating of its own internal capital or its own internal cash, but, in fact, primarily through various levels of government subsidy and various international grants and loans.

I have strong reservations about the ability of America to enforce any trade agreement with China. If we probably apologize enough times for having a steel industry, they might let us get some steel into their country, or if we apologize enough times, they might let us do something else when they violate trade laws.

I want to talk a little bit about workers' rights in China that are virtually nonexistent. I don't know, Mr. Chairman or Commissioners, if you have had a leading Chinese dissident appear before your Commission, but I suggest you should, if you haven't, Harry Wu.

Chairman D'AMATO. Mr. Wu did testify before this Commission on May 9th on issues related to workers and workers' rights.

Mr. GERARD. Harry Wu is a steelworker. Harry Wu was a steelworker while he was in prison, making steel. The set of values that I grew up with and the set of values our union has, on that issue alone, that should be enough for this country not to have a trading relationship, based on that kind of economic structure.

In China, there are no trade unions. In fact, the Chinese will say to us that they have 130 million people that are in the official All-China Federation of Trade Unions. The All-China Federation of Trade Unions is nothing but an extension of the Chinese Communist Party, and you get appointed to the union. Sometimes, I don't know that that's all bad, being appointed to certain positions in the union, but I don't think you ought to be appointed to the union.

The right to strike, which is a fundamental right, and I think in any democracy it's the fundamental right of workers worldwide, it is a right that has been recognized internationally, was removed in China in 1982. There is no vehicle for workers to improve their standard of living. There is no vehicle for workers to dissent. There is no vehicle for workers to have an open opportunity to share in the wealth that they may create. So I don't know how we can expect ourselves to compete, and I don't know that we should expect ourselves to compete with that kind of a system.

I think Tom did an excellent job of pointing out that, particularly the steel industry, but we could certainly talk about a lot of other industries, which you'll do today, are, in fact, not privately held, and, in fact, are run by various arms of the Chinese government, whether it's the military, whether it's the prison system. Even the private, apparently privatized companies are extensions of government corporations, so that the steel mills of that country are operating in a much less open way than we are in this country.

I think we need to talk about the environment and environmental standards. In China, there are 244 small steel plants, I would venture to say, that with virtually negligible, if any, environmental controls or environmental regulation. Twenty-five percent of China's coke, which is self-generated, is produced with 6,000 children, whose wages are $20 a month. And anyone that understands the integrated steel making industry knows that coke is an important input into making steel. So not only is the industry environmentally unsound and government subsidized, its inputs, the majority of China's coke is produced in beehive ovens that were virtually outlawed in this country almost 50 years ago and should have been. There are no clean air and clean water standards, and this industry in America has stepped up to the plate and is one of the more environmentally sound industries, one of the more environmentally sound steel industries in the world.

Productivity, productivity in China is an average of 21.8 man hours per ton. In America—it depends whose numbers you accept—we are somewhere in the 3.8 to 4.1 man hours per ton. Yet, when you have your inputs produced by child labor, slave labor, when you produce the steel in prison camps, when you have government subsidized industries and that steel makes its way into this market, it undermines this market and undermines this industry on standards and regulations that this country will not stand for.

Everything that is going on in China in its industries are diametrically opposed to the values that this country holds so dear. I find it, to be personally honest with you, I find it abhorrent that we would be so naive as to think that by pretending that we will grow our trade deficit with China, that somehow we will lead them to democracy.

What we are doing is entrenching that their system works. What we are entrenching with them is they can continue to operate the way they do and we will prostitute ourselves for some theoretical access to their market, when in the reality, in the last three, four, five years, the deficit, the trade deficit with China on steel and all manufacturing products is growing. We don't get any steel into their market. Yet, the manufacturing deficit with China is greater than the deficit with Mexico, and everything in China is counter to the values of this country.

So I maybe have digressed a bit just from steel, but I think you can't have steel in isolation of the realities of that country and the realities of the way they run that country.

Let me just say in closing, again reiterating some of Mr. Usher's comments, since 19—I mean, I guess we could go back to 1980, but let me just go back to '97. Since 1997, the American steel industry has been in a continuous state of attempting to recover from various national economic downturns. We got whacked in '97 with the Asian downturn, which was followed by the Latin American downturn, which was followed by virtually the Russian-Eastern Bloc collapse, to an international economic downturn where we have 350 million tons of excess capacity in steel with only two so-called open markets in the world, the United States and Canada. I happen to have lived in both countries and I thought maybe I could really screw the other side and move to Russia or something.

[Laughter.]

But you look at what would happen with China being subsidized to grow its steel industry, having the kind of environmental and labor standards that I articulated, having U.S. taxpayers fund through various vehicles the expansion of that industry, and when it is the largest steel industry in the world, what will it do in its next economic downturn and where will that steel go? Thank you very much.

[The statement follows:]

PREPARED STATEMENT OF LEO W. GERARD

Thank you very much, Mr. Chairman. My name is Leo Gerard. I am the International President of the United Steelworkers of America and I appreciate the opportunity to testify on behalf of our members regarding the economic and security implications of the bilateral economic relationship between the United States and China.

The United Steelworkers represents approximately 690,000 members in the United States and Canada, including most of the workers employed in the steel industry in the United States. The steel industry has historically played a key role in maintaining U.S. national defense and security.

During the last three years, the steel industry has suffered from increased levels of imports that have reduced domestic shipments, devastated employment, and caused prices to fall to their lowest levels in over 20 years.

Although the Bush Administration has initiated an investigation under Section 201 of the nation's trade laws into the damage that imports have done to the steel industry, as of today, 20 steel companies have filed for bankruptcy protection and several others remain on the brink of doing so.

The purpose of my testimony this morning is to discuss the growth of steel imports from China, the abuses of workers rights that are taking place in China and the threat that additional steel imports could pose to American steel workers and industry.

The Steel Industry in China

China produces more steel today than any other nation in the world. China produced 126 million metric tonnes of crude steel in 2000, compared to 100 million metric tonnes by the United States.

By almost all accounts, the growth and transformation of China's steel industry has been nothing short of phenomenal, as is shown in the attached graph. China's steel production has increased three-fold since 1980 when it produced just 37 million metric tonnes.

China lacks the competitive advantages of other major steel producers. Its industry is fragmented. It produces an overly narrow range of products and much is of poor product quality. Its labor productivity is low. And its iron ore reserves are low-grade and costly to concentrate.

So how has China, despite these disadvantages, achieved the remarkable growth in its steel industry? China's steel industry enjoys three major advantages: (1) it has low labor costs as the result of its violations of workers' rights; (2) it has access to low cost capital through state-ownership; and (3) much of the industry operates under lax environmental standards.

Workers Rights in China

The steel industry in China employs approximately 2.3 million workers, who earn an average of approximately U.S.$1.25 per hour worked.

Unfortunately, steelworkers in China are unable to exercise an independent voice in their workplace, unable to collectively bargain and may be imprisoned for forming labor unions or participating in social protests.

While China reports that there were 130 million members of trade unions in China in 1999, none belonged to independent unions. China's 1992 Trade Union Law prevents the establishment of unions that are independent of the public authorities and ruling party. Only one union is allowed at any level: the All-China Federation of Trade Unions (ACFTU). Officials of the ACFTU are appointed by the Chinese Communist Party and remain obligated to the central party.

The right to strike was removed from China's constitution in 1982. Despite this, the number of labor disputes has risen each year since 1992, according to a report by the Independent Confederation of Free Trade Unions (ICFTU) to the International Labor Organization. Strikers and organizers can be detained or sent to forced labor camps for up to three years without a trial.

There were 240,000 people in forced labor camps in 1999, according to Chinese government statistics. The ICFTU estimates that as many as 60,000 Chinese were being held for disturbances of public order in 1999. This was in addition to the 1,900 individuals being held at the end of 1999 that had actually been convicted of counterrevolutionary crimes.

The ICFTU has documented widespread examples where workers in China have been confined to employer housing, locked-in from the outside, their personal identification confiscated upon arrival at the enterprise. Commercial manufacturing facilities are frequently surrounded by barbed wire and protected by armed guards on watchtowers.

State Ownership and Subsidies

China's largest steel companies are state-owned. For these and other firms, the central government manages and controls all decisions on expansion and replacement of larger units of equipment.

During the last two years, China's government has funded the construction of three new thin-slab casting and hot rolling mills with 4 million metric tonnes of annual capacity. The plants use world-class technology—the same as used by Nucor here in the United States—and will produce hot rolled strip using only 2.5 manhours per tonne.

According to the International Trade Administration's report to the President on Global Steel Trade, China is expected to spend U.S. $6 billion to upgrade its steel industry over the next several years in an effort to improve its competitiveness for China's entry into the WTO. Much of this aid will go to China's largest steelmakers, over half in the form of low-interest loans.

Environmental Standards in China

Although China has reduced the production of steel in less efficient, more heavily polluting open hearth furnaces, approximately 20 million metric tonnes of its raw steel production still comes from 244 small steel plants. These small steelmakers likely have little or no pollution control technology.

China has increased its production of blast furnace and foundry coke through greater use of environmentally harmful beehive ovens. Furthermore the American Coke and Coal Chemicals Institute has estimated that about 25 percent or 6,000 of the workers producing and distributing foundry coke for export in China may be children, who are paid wages of $20 per month.

Productivity and Labor Costs

Although China's steel industry has grown dramatically over the last two decades, it has not been due to efficient production.

According to World Steel Dynamics, the U.S.-based steel consulting firm, an average steel mill in China required 21.8 hours to produce and ship a metric tonne of steel in 1999, compared to 4.6 hours in Canada, 4.1 hours in the United States and 4.0 hours in Japan. This is shown in the second attached graph.

But because steelworkers in China is paid just U.S.$1.25 per hour, despite the poor productivity of most Chinese steel producers, employment costs average just US$55 per tonne in China, compared to $157 in the United States and $162 per tonne in Japan.

But even at just U.S.$1.25 per hour, steelworkers in China earn 5 times that of the average manufacturing worker in China.

China Steel Trade

Despite the size of its steel industry, China is a net importer of steel. In 1999, China imported 16.9 million tonnes of finished and semi-finished steel and exported 6.0 million tonnes of finished and semi-finished steel.

According to China's State Bureau of Metallurgical Industry, China's steel production and demand are far from balanced. China overproduces wire rod, hot rolled bar, plate and welded tubes. Yet, China must import higher grade products, such as hot rolled sheet, cold rolled sheet, oil-country tubular goods, stainless steel, and tool steel.

As shown in the third and fourth graphs attached to my testimony, China exported 6 million metric tonnes of finished and semi-finished steel in 2000, nearly 130% more than in 1990. Approximately 20% or 1.4 million metric tonnes of China's exports went to the United States.

Despite a domestic shortage of hot rolled steel, China exported 350,000 metric tonnes to the United States in 2000—or 26% of China's exports to the U.S. The other major products exported from China to the U.S. include semi-finished steel, standard pipe, reinforcing bar, cut-to-length plate, and oil-country tubular goods.

The average steel import price from China is usually substantially below the average import price for the same product from other nations. For example, the 350,000 metric tonnes of hot rolled steel imported from China had an average price of $285 per tonne. This was about $20 per tonne less than the average import price and $35 less than the average market price.

Not surprisingly, the European Union, Canada and United States all filed steel dumping cases against Chinese steelmakers between 1996 and 2000.

Trade cases are currently pending in the United States against China's steelmakers involving blast furnace coke, hot rolled steel, steel concrete reinforcing bar and foundry coke. The U.S. and China entered into a suspension agreement in October 1997, limiting exports to the U.S. of certain cut-to-length carbon steel plate until November 1, 2002.

So despite the modest levels of U.S. steel imports from China, there is ample evidence for concern regarding the steel trade between the U.S. and China.

Concerns Regarding Continued Growth of Imports from China

While the United States imported 1.4 million metric tonnes of steel products from China in 2000, there is overwhelming evidence to suggest that steel imports from China will continue to increase, without any accompanying increase in U.S. steel exports to China.

China is a formidable player in the world steel market. It is the world's largest steel producer and the largest producer of iron ore. China's steel producers have low labor costs perpetuated by the government backed suppression of worker's rights, have access to low-cost government capital, are not subject to the same rigorous environmental standards as many of their international competitors.

The trend of rising steel imports from China is likely to be reinforced by the efforts of central planners to reduce overproduction of certain steel products or to maintain production and employment.

China's emergence as a growing presence in world steel trade has the potential to create serious distortions in the international marketplace and threaten productive domestic capacity in the United States.

This is of enormous concern to steelworkers in the United States. To the extent the United States has elected to pursue a policy with China of greater openness and economic exchange, efforts to assist China with economic development should be conditioned upon compliance with international labor standards.

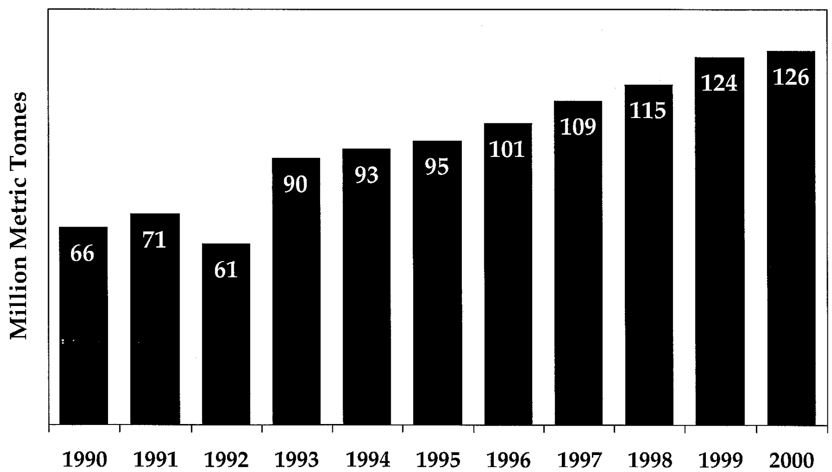
While it would be wrong to attempt to deny China access to the tools of economic development, such as a modern and efficient steel industry, the United States should not allow multi-national corporations or state-owned enterprises to compete in the international marketplace through the denial of worker rights and the use of forced labor.

I echo the comments of AFL–CIO Secretary-Treasurer Richard Trumka, who, in his testimony before this Commission in June, urged you to recommend the use of the leverage of our trade relationship and the influence of our investors to support the rights of Chinese workers and citizens, and to challenge the Chinese government to participate in a serious dialogue about reform.

Working people have rights to organize to improve wages, working conditions and workplace health and safety—be they in East Chicago, Illinois; Hamilton, Ontario; or Shanghai, China.

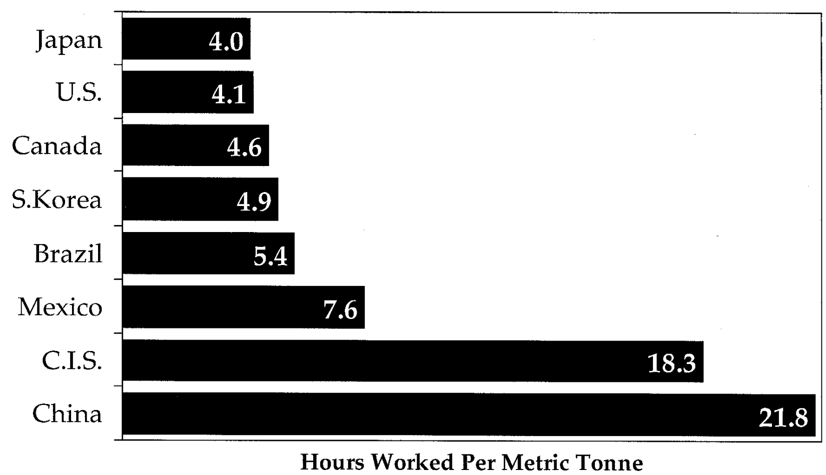
Thank you for this opportunity to discuss these important issues.

China Crude Steel Production



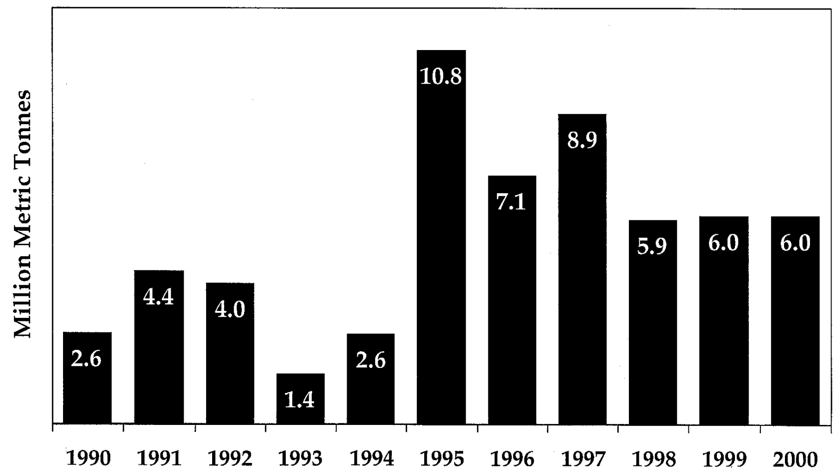
Source: International Iron and Steel Institute.

Comparative Labor Productivity



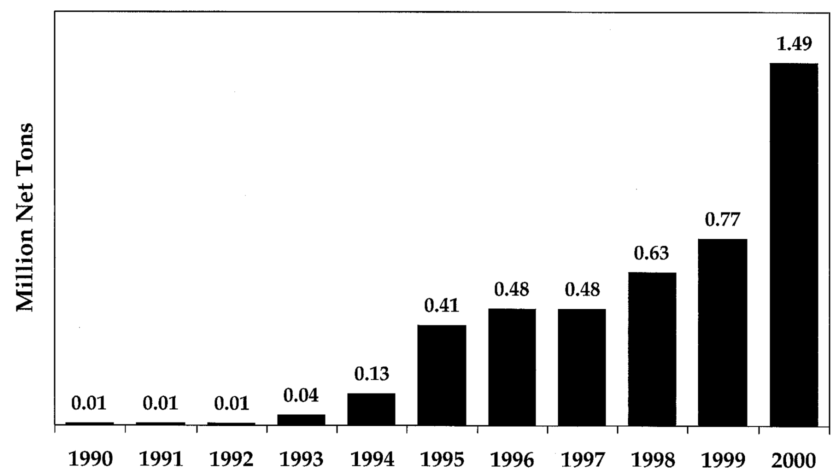
Note: Labor productivity for world cost curve reference plant comparisons as of April 2000.
Source: World Steel Dynamics, Steel Strategist #26, July 2000, Exhibit K7, page 104.

China Steel Exports



Source: International Iron and Steel Institute.

U.S. Imports of Steel Mill Products From China



Source: American Iron and Steel Institute.

Selected China Steel Statistics

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	Change 1990-99
Production of Crude Steel	66,349	71,000	60,935	89,539	92,613	95,360	101,237	108,911	114,588	123,709	86%
Production of Crude Steel Ingots	49,034	49,284	53,341	55,280	53,124	48,835	45,208	41,079	34,471	37,200	-24%
	74%	69%	88%	62%	57%	51%	45%	38%	30%	30%	
Production of Continuously Cast Steel	14,807	18,835	24,282	30,305	36,542	44,325	53,929	66,059	78,832	85,200	475%
	22%	27%	40%	34%	39%	46%	53%	61%	69%	69%	
Production of Liquid Steel for Castings	2,508	2,881	3,312	3,953	2,947	2,200	2,099	1,773	1,285	1,300	-48%
	4%	4%	5%	4%	3%	2%	2%	2%	1%	1%	
Production of Crude Steel in Oxygen Blown Converters	28,228	35,978	38,453	41,239	44,098	46,877	52,266	63,479	70,310	82,000	190%
	43%	51%	63%	46%	48%	49%	52%	58%	61%	66%	
Production of Crude Steel in Electric Furnaces	14,015	15,004	17,626	20,753	19,538	18,110	18,932	19,121	18,143	19,600	40%
	21%	21%	29%	23%	21%	19%	19%	18%	16%	16%	
Production of Crude Steel in Open Hearth Furnaces	13,157	13,092	13,992	14,446	13,849	13,084	12,610	9,696	5,437	2,100	-84%
	20%	18%	23%	16%	15%	14%	12%	9%	5%	2%	
Production of Hot Rolled Steel Products	51,532	56,382	66,943	77,075	84,275	89,798	85,513	94,903	105,084	119,574	132%
Production of Hot Rolled Long Products	31,687	34,648	42,548	49,204	54,246	55,755	55,177	57,018	66,286	65,406	106%
Production of Hot Rolled Flat Products	14,725	16,030	19,180	22,469	23,474	27,003	29,255	31,068	39,594	42,983	192%
Production of Railway Track Material	1,340	1,371	1,411	2,013	2,262	1,604	1,455	1,502	1,567	1,471	10%
Production of Heavy Sections	3,605	3,646	4,494	5,962	4,494	4,056	5,105	5,548	5,710	6,296	75%
Production of Light Sections	12,185	13,705	17,553	19,618	23,391	24,712	24,277	25,306	27,491	31,417	158%
Production of Concrete Reinforcing Bar					13,354	14,592	14,566	16,673			
Production of Hot Rolled Bar (Other Than Rebar)					7,021	6,997	5,886	5,004			
Production of Wire Rod	9,989	11,000	12,570	14,074	15,711	16,872	18,339	19,278	22,300	25,949	160%
Production of Electrical Sheet and Strip	673	606	688	762	812	745	766	844	825	888	32%
Production of Tin Mill Products				79							
Production of Tubes and Tube Fittings	4,320	4,929	5,837	5,788	7,362	8,228	7,640	9,343	7,973	7,966	84%
Production of Seamless Tubes	2,112	2,414	2,652	2,836	3,040	3,270	3,340	3,605	3,467	3,451	63%
Production of Welded Tubes	2,208	2,515	3,185	2,952	4,322	4,958	4,300	5,738	4,506	4,515	104%
Exports of Semi-Finished and Finished Steel	2,611	4,378	4,037	1,412	2,566	10,745	7,131	8,907	5,863	5,975	129%
Imports of Semi-Finished and Finished Steel	4,154	3,719	8,089	36,869	25,813	14,806	16,537	13,619	13,106	16,910	307%
Net Imports	1,543	(659)	4,052	35,457	23,247	4,061	9,406	4,712	7,243	10,935	609%
	2%	-1%	5%	27%	19%	4%	8%	4%	6%	8%	
Apparent Consumption of Crude Steel	68,279	70,181	85,939	133,056	120,882	100,242	112,422	114,449	122,992	136,395	100%
Apparent Consumption Per Capita (Kg Crude Steel)	59	60	73	111	100	82	91	92	98	108	82%
Apparent Consumption of Finished Steel	53,125	56,415	69,854	106,215	105,360	97,842	105,150	108,473	116,227	106,830	101%
Apparent Consumption Per Capita (Kg Crude Steel)	46.0	48.2	59.0	88.8	87.2	80.2	85.3	87.2	92.6	84.3	83%
Production of Iron Ore	179,344	190,558	209,762	226,352	250,696	261,919	252,283	268,623	222,236	209,340	17%
Imports of Iron Ore	14,191	19,035	25,172	33,020	37,343	41,150	43,874	55,106	51,771	55,274	290%
Imports of Scrap	115	134	1,240	3,130	2,203	1,393	1,292	1,829	2,021	3,340	2804%

Note: Figures in Thousand Metric Tonnes.
Source: *Steel Statistical Yearbook 2000*, International Iron and Steel Institute.

Imports of Steel Mill Products from China

by Product

	DECEMBER 2000, YEAR TO DATE				
	CARBON	ALLOY	STAINLESS	TOTAL	%
STEEL MILL PRODUCTS					
SHEETS HOT ROLLED	392,653	1,744		394,397	26%
BLOOMS, BILLETS AND SLABS	170,311	97	6	170,414	11%
STANDARD PIPE	166,273	24		166,296	11%
BARS - REINFORCING	163,125			163,125	11%
PLATES CUT LENGTHS	148,182	1,279		149,462	10%
OIL COUNTRY GOODS	92,558	14,961		107,519	7%
PLATES IN COILS	91,326	1,001		92,327	6%
STRUCTURAL SHAPES HEAVY	83,485	20		83,506	6%
SHEETS COLD ROLLED	45,897	155	3,253	49,305	3%
LINE PIPE	30,790	28		30,818	2%
WIRE DRAWN	25,546	579	2,840	28,966	2%
SHEETS & STRIP GALV ELECTROLYTIC	12,451			12,451	1%
WIRE RODS	8,156		2,160	10,317	1%
MECHANICAL TUBING	6,377	159		6,535	0%
BARS - LIGHT SHAPES	5,584	41		5,625	0%
SHEETS & STRIP GALV HOT DIPPED	4,829			4,829	0%
TOOL STEEL		3,829		3,829	0%
STAINLESS PIPE & TUBING			2,328	2,328	0%
PIPE & TUBING NONCLASSIFIED	1,904	100		2,005	0%
BARS-COLD FINISHED	1,301	126	69	1,495	0%
STRUCTURAL PIPE & TUBING	1,104			1,104	0%
BARS - HOT ROLLED	449	595	52	1,096	0%
STRIP - HOT ROLLED	774			774	0%
TIN PLATE	326			326	0%
PRESSURE TUBING	160			160	0%
RAILROAD ACCESSORIES	132			132	0%
STRIP - COLD ROLLED	11	2	26	39	0%
INGOTS AND STEEL FOR CASTINGS		20		20	0%
SHEETS & STRIP - ELECTRICAL		11		11	0%
TOTAL STEEL MILL PRODUCTS				**1,489,211**	**100%**

Note: Data in Net Tons.
Source: American Iron and Steel Institute.

United Steelworkers of America

PANEL I DISCUSSION AND QUESTIONS AND ANSWERS

Co-Chairman BECKER. Thank you, Mr. Usher. The Chairman will start the questions.

Chairman D'AMATO. Thank you very much, both of you, for very frank and clear testimony, right on the money in terms of the inquiries that this Commission will address.

I take it that the feeling from both of you, from both the business and the labor side, is that there is not a high level of confidence that WTO procedures will be effective in protecting the U.S. steel industry from unfair practices and that we should continue to use all the bilateral leverage and laws that are on the books here to ensure fair treatment.

Neither of you mentioned the one tool that we have in the GATT, Article XXI, which is the national security exception. Obviously, correct me if I'm wrong, the Chinese in their subsidizes could consider their steel industry to be a national security asset, important to their national security, as do other nations. I assume we do, too, consider it a national security asset. So it seems to me an easy reach logically to find that Article XXI of the GATT, in the event of unfair trade practices, would impact on our national security and would then lead to an additional tool or an additional rationale to invoke U.S. bilateral leverage in this case. Would you both agree with that?

Mr. USHER. I would agree. I think it is important to put into context that this is an industry, and people who aren't close to it don't appreciate it, but this is an industry that is in trouble, and it's not just companies that are in trouble. This is an entire industry in trouble.

And in any free market economy like we have, you can make the argument that there are inefficient producers. They should go away. That's the way the market works, and we would fully ascribe to that. But when every single company cannot earn their cost of capital over the last five years, there is something wrong with what's going on.

I would characterize this industry, and George in his office had a great poster showing the contribution of steel during the Second World War, and a lot of people, I think, have the mistaken view that the next war will be waged with missiles and high tech, et cetera. You know, much of the steel that went into the effort went into tanks and other pieces of armament, but it is the entire infrastructure of the country. Steel is such a pervasive material that if you are going to have a country of strength, you need a steel industry.

You know, it is one thing to lose a color TV industry to the rest of the world. It's another thing when you don't have a steel industry and you need that for a whole host of different things, whether it's to build buildings or roads or infrastructure or sewer systems or water systems or natural gas transmission lines or electricity systems or whatever. Steel is an essential thing, and we are in the process of eroding that in this country, while China, on the other hand, continues to expand and is treating it as a military asset.

Mr. GERARD. I picked up, again from Tom, but before I do that, let me just say that, speaking for the Steelworkers Union, we don't have faith that we can expect the WTO or GATT to protect the steel industry, either. The most recent decisions by the WTO are spitting in the face of the American Congress and the American steel industry when they've overruled Congressional decision making rules about how we should be able to protect our own industry.

There is a 232 hearing going on, being conducted by the Commerce Secretary's office with regards to iron ore and semi-finished steel. Because it's verging on the cusp of collapse, and if you don't have the ability to make steel in this country and you view it like you do t-shirts, running shoes, and TV sets, then you won't have an ability to have an industrial base to the country. You can't make a computer without steel. You can't build roads and bridges. You can't move materials.

It's not just—I was yesterday in Newport News shipyards in Virginia, the largest, most sophisticated aircraft carriers in the world. Are we going to build those with Chinese steel? Are we going to build those with Russian steel? Are we going to build those with steel from Kazakhstan? We're on the verge of losing the steel industry in this country.

To put it in a human perspective, there are 700,000 retirees and dependents who get their retiree health care from an industry that's collapsing. If China expands their steel industry the way we anticipate their doing and there is a downturn in China, the American steel industry, combined with a downturn in Russia, could be wiped out in weeks unless we have the legislative means to protect the industry and its workers. I have no doubt about that.

I would think it would be incumbent upon this country to identify the steel industry as a strategic industry for national defense and for national security. I view those as two separate terminologies. National security, in my view, is the ability to have an industrial economy. It's the ability to build a computer, to build a road. National defense is a little bit more, in my head, like Newport News and tanks and guns. But for both those reasons, we need a strong industry.

Chairman D'AMATO. Thank you very much.

Co-Chairman BECKER. Commissioner Mulloy?

Commissioner MULLOY. Mr. Usher, on page five of your prepared testimony, you talk about safeguards and you talk about that we got a provision in our agreement that we would be able to use the safeguard provision for 12 years following China's accession to the WTO. But then, interestingly, you point out Congress must enact legislation fully implementing this provision. Did we not take care of that in the legislation that was passed to do PNTR or do we have to come back and pass separate legislation to fully implement the safeguard provision that we negotiated?

Mr. USHER. I think it's my understanding, Commissioner, that they need to do additional work there, but I'd have to get back and amend that.

Commissioner MULLOY. Here's what I would urge, is that if you, looking at the package that was negotiated, and if there are things that were not taken care of in the PNTR bill that you think are necessary to fully implement the bilateral and then the subsequent final package with China and the WTO, it would be very important for us to know that so that we could consider that in our recommendations to the Congress next March, or before. We have been invited to give recommendations if we think they're really important when we——

Mr. USHER. We'll follow up on that.

Commissioner MULLOY. Good. Thank you.

Mr. USHER. Good suggestion.

Co-Chairman BECKER. Commissioner Robinson?

Commissioner ROBINSON. Yes. I'd like to ask both of you a little bit more about the financing element. I was, of course, intrigued by both of your comments concerning the U.S. Export-Import Bank as well as the role that Mr. Gerard discussed in terms of what are known in town as international financial institutions, I think primarily the World Bank and arms of the World Bank like the International Finance Corporation, which I understand is a rather heavily subsidized vehicle used for beleaguered developing countries, but which China has had access to.

According to our briefing materials for this hearing, for example, Krupp-Thyssen [ph.] partnered with Shanghai Pudong Iron and Steel Group [ph.] to do a $1.4 billion expansion of a stainless steel plant that was reportedly financed by, in part, the International Financial Corporation. Now, obviously, the U.S., as you know, has something in the neighborhood of an 18 to 20 percent share of World Bank capital and, in effect, voting leverage. These are decisions that the U.S. needs to concur in. It would be very interesting to go back and see what our vote was or whether we had a position on the matter.

And, of course, Export-Import Bank is self-evident. That's our show. But the Overseas Private Investment Corporation, I don't know whether it's gotten involved in assisting overseas steel capacity, for example.

But this is an important element, and by the way, I am sympathetic to the argument that steel is a vital part of the defense industrial base of the United States from a national security perspective.

Having said that, what progress do you feel—I'd like to hear from each of you—that you've made to date in terms of sensitizing this administration or the previous administration concerning this Ex-Im Bank matter of stepping up to finance an industry overseas in vast oversupply at the expense of our own industry? And likewise, any progress to date on international financial institutions, and depending on the answer there, what would your recommendations be if you're not satisfied that concrete steps are being taken in a sensible way to defend the industry from the predations of overseas subsidized suppliers.

Mr. GERARD. I want to take some institutional credit and to allocate some credit to my friend and colleague Commissioner Becker, as well as Tom Usher and the steel industry for having sensitized the Export-Import Bank on the issue of subsidizing, or additionally subsidizing, if that's the right word, the expansion of the Chinese steel industry.

Through the steel industry's work and Co-Chairman Becker's work, just recently, the Senate Finance Committee and the folks responsible for overseeing the Export-Import Bank cut the allocation by a small amount, but to send a clear signal, and they expressed their reasons for doing that, which was particularly directed at the silly subsidization of the steel industry's expansion.

Having said that, I don't think that there has been sufficient oversight and sufficient concern, sufficient value allocation to the other, as you referred to, international financial institutions who are continuously funding global overcapacity in a number of sectors, but in most recent terms, more aggressively than ever in China.

I think that there ought to be rules and the rules ought to be clearly tied, first and foremost, to the set of values that exist. Are there workers' rights? Are there environmental rights? Are there those things, and is there a global overcapacity in that sector? What will be the direct benefit? And then how do we guarantee against that expansion being targeted back at America? And if we identify the steel industry, as I well think it should be, as an important strategic industry for defense and national security, then there ought to be steps to make sure that that subsidization can't be redirected back to this country.

Clearly, I think that recommendations about the oversight of these global financial institutions and their role in helping to exacerbate the pending catastrophe has to be a cornerstone of any recommendations that would come.

Mr. USHER. I would only add that we are working very aggressively on the latest banking bill to try and get restrictions to prohibit the type of thing that the Export-Import Bank did recently, and at every opportunity, we try to sensitize people in the administration and on the Hill to what's going on. In many cases, we find it's a case of the right hand not knowing what the left hand is doing, and so it's a constant challenge to try and keep bringing this to people's attention, because it just makes no sense to continue to subsidize an industry that has as much world over capacity as steel.

Mr. GERARD. Let me add one point that I forgot. I assume that the Commission has looked into it or heard about it. It was the attempt by a number of Wall Street financial institutions to sort of redirect American capital to China in the attempt to market shares in Petro China and the role that the labor movement did in exposing that.

I don't know how you market shares in an industry that doesn't have a market economy and isn't governed by the rule of law. So I would be extremely worried about other Wall Street institutions attempting to take a government industry in China, theoretically private, and using that to raise capital for the expansion of that industry back in China.

I think the Petro China deal got exposed for what it was. It was a sham and the process collapsed. But I am extremely convinced that Wall Street is back figuring out how to do another sham because they will probably lose the Social Security one, too, so they are going to have to find some other way to generate some fees.

Co-Chairman BECKER. Thank you. Let's move on to Commissioner Lewis.

Commissioner LEWIS. Mr. Usher, I'd like to ask you first, you mentioned in your statement that the Shougang steel mill has more employees than the entire U.S. steel industry. Could you give me some numbers there, please.

Mr. USHER. This is an industry that back in the mid-'80s probably had about five times as many people as are working today. At U.S. Steel, for example, we currently have 18,000 people. In the mid-'80s, this number would have been closer to 100,000 people.

This notion that the U.S. worker is not a productive worker is totally without merit. We, I would say, and I have visited steel mills around the world. There is no steel industry in the world that is as productive as the workers are today, and this has come at great expense and many workers have been retired. Many retired early. It has put a tremendous burden on the system, but the companies are taking care of their obligations in terms of pensions and retiree health care to these people.

But we have become a very, very efficient industry, and as I think Leo said in his testimony, today at U.S. Steel, for example, we are under three man hours per ton of steel produced, where in China it would be 20 man hours per ton of steel produced.

Commissioner LEWIS. How many total employees in the U.S. steel industry today?

Mr. USHER. In the total industry, I don't know, maybe Leo has that number——

Mr. GERARD. About 250.

Commissioner LEWIS. Two-hundred-and-fifty thousand?

Mr. GERARD. It depends how you define the industry. We would define it as making steel.

Commissioner LEWIS. Yes, of course.

Mr. GERARD. About 250.

Commissioner LEWIS. And how many employees at the Shougang steel mill?

Mr. USHER. Was that in the testimony?

Commissioner LEWIS. On page four, you said one Chinese mill employs more workers than the entire U.S. steel industry.

Mr. USHER. I think it's in the neighborhood of that 250. The Chinese industry has over three million workers producing, I think my number is 126 million metric tons.

Commissioner LEWIS. A hundred-and-twenty-six million metric tons?

Mr. USHER. A hundred-and-twenty-six million metric tons. The——

Commissioner LEWIS. Three million employees?

Mr. USHER. Three million employees. That one mill, Bill tells me, has close to 300,000 workers, or that one company.

Commissioner LEWIS. Thank you, Mr. Usher. I just wanted to get those numbers out.

Mr. USHER. Yes.

Commissioner LEWIS. Actually, your company or representatives are members of the Business Roundtable?

Mr. USHER. Yes, we are on the Business Roundtable, yes.

Commissioner LEWIS. Right. What happens when you discuss among other corporate leaders the problems facing the steel industry? What is their response to you when you talk to them about the things you talked to us today?

Mr. USHER. I would say, in general, it depends on who it is.

Commissioner LEWIS. Go ahead. Give me the range.

Mr. USHER. I mean, some people are very interested in being able to sell things to China and they really don't care about the steel industry.

Commissioner LEWIS. Well, the fact is that we're only selling China $15 billion worth of goods and they're selling us $100 billion worth of goods.

Mr. USHER. Yeah, but if you're one of that 15, they tend to view that in a very parochial way. So I have quite heated arguments, I would have to say, with some of my fellow BRT members.

Commissioner LEWIS. And what happens when you discuss the national security implications? What's that discussion like?

Mr. USHER. Again, it depends. There's no, I would say, uniformity. Some people are sensitive to it and agree. Others don't see it as a major problem. So it's like any group. There'd be a divergence of opinion.

Commissioner LEWIS. Do they think we can build with Chinese steel and Russian steel and U.S. aircraft carriers?

Mr. USHER. There are people, whether at BRT or elsewhere, who think it is going to be a grand happy world forever. There are others who think belligerence will continue in the future. History has taught me that I'm in the camp of the latter.

Commissioner LEWIS. If U.S. Steel were permitted to invest in a steel mill in China and take advantage of the low wages there, would your company do that?

Mr. USHER. No. I'd be much more interested in having the laws that protect the market in the United States and investing in the United States. I mean, just to put in perspective, the U.S. market today consumes about 125 million tons. Domestically, we can produce 100 million tons. So the other 25 million tons has to be imported, and that's a crime, in my opinion.

The thing that keeps people from investing in the United States is this irrationality of the way trade is conducted in steel. Most of the rest of the world, including China, especially, has barriers to steel coming into their economies. Hence, whenever there is any kind of downturn in the world, Russia, Asian crisis, whatever, it all comes here.

So for a person that is in a market where there is a deficit of steel, I would love to go out and build new steel mills, employ new steelworkers in the United States, but I can't really do that because I can't tell you in 2004 or 2006 what's going to happen. Something in the world could just, as it happened over the last three years, destroy this industry. That's what the problem is. So I wouldn't be as interested in building in China as I would be in building in the United States.

Commissioner LEWIS. Thank you. Mr. Gerard, I'd like to ask you a question. I've long felt that the right to unionize has several ramifications. Number one, you can't have unions in a country that's not a democracy, so it's like a canary in a mine shaft. It's a test of whether a country is democratic.

The second aspect of this is that Korea has pretty strong labor unions and the Korean steel industry has people who belong to unions there. Because they belong to unions, they're able to get wages to the point where they are living wages and they can buy American goods. The Chinese workers in the steel mills or the Mexican workers in the steel mills are not unionized and their wages are not increasing and they can't buy American goods.

So it seems to me that labor rights in trade agreements not only refers to the ability to have them earn more money compared to us, but it gives them the ability to buy American goods because they're earning wages that are really living wages. I'd like your comments on that.

Mr. GERARD. I agree with you. I think that, if I can do this sort of sequentially, that trade union rights are the canary in the mine shaft. I have told this story probably 100 times, but this is another opportunity to tell it.

Commissioner LEWIS. I mean, Solidarity was the union that broke the——

Mr. GERARD. The story that I want to tell you is around that time. In the *New Yorker*, there was a full-page cartoon. I don't know if any of you ever saw it. It was a split-screen cartoon and in half of the screen, it had General Jaruzelski in Poland standing on his balcony. He was then the president, the communist president of Poland, and the workers down below were marching and they had signs that said, "Free Democratic Trade Unions," and on that screen, he was looking down and he said, "Damn fascists."

[Laughter.]

In Chile, they had General Pinochet standing on his balcony with all of his medals looking down and the workers were marching with their signs and they said, "Free Democratic Trade Unions," and he said, "Damn communists."

[Laughter.]

The reality is that you can't have a democracy if you don't have a free independent trade union movement. If you don't have a free independent trade union movement, there is no ability for the workers to bargain collectively. Collective bargaining is the best tool for the redistribution of the wealth that workers create. It's even better than the tax system. And through that system of collective bargaining, you can, in fact, over time, raise the standard of living of workers.

I have some strong concerns about the way the economy in Korea is managed and there is the whole issue of subsidization and all of that, so I don't want to give that ground, but I will say that in the period of time where Korean workers have been able to have free and independent trade unions, their standard of living and their dignity in their workplace and their ability to have what we would call a middle-class lifestyle is now on its way. They're not there, but they're a lot closer than they were.

I would view that as a cornerstone of any relationship with any trading partner, whether it's Mexico, China, Vietnam, or Jordan, whoever it is that we have a relationship with trade. Capitalism is not value neutral. You can attach values to it by setting the rules, and when you set rules that are going to punish workers, then you state what your values are. So when America is not prepared to set rules with China that articulate American values, or with Mexico, you are sending a very strong message.

I actually believe that the trading agreements, and this is probably for a different discussion in a different forum, that these trading agreements aren't meant to raise the living standards of the workers in the countries in which we're doing them. They're meant to create centers of exploitation. Mexican workers' wages have fallen 25 percent since NAFTA. Our trade deficit, which was, what, a couple of billion dollars, has skyrocketed through the roof in the last five years with China. Chinese workers' living standards have fallen. More workers are going to prison. They've got to staff their prisons, because that's where they do their manufacturing. There's more exploitation, not less, because that's how they do it.

Commissioner LEWIS. Then finally, I'd like to ask Mr. Usher a question. May I?

Co-Chairman BECKER. Quickly.

Commissioner LEWIS. Okay. People from other countries visit our industries, and I'm sure you have visitors from China coming. Do you have access to their mills? Do they let you visit them the way they visit us?

Mr. USHER. I would say, in a very limited sense. I would say coming over here is much more open. Over there, we are able to see what they want us to see. So in a very selective way.

Commissioner LEWIS. Thank you.

Co-Chairman BECKER. Commissioner Dreyer?

Commissioner DREYER. As the time for accession by China to WTO draws near, we all become more aware of the inadequacies of the WTO remedies for dispute resolution, and I believe you both mentioned that. Can either of you suggest any improvement in those provisions, or do you also see as a major problem the unwillingness of successive U.S. administrations to use the remedies that they have available, although, for example, as Japan has just tried to use sanctions has shown, it can backfire badly, as well.

Mr. USHER. I would say there is a tremendous clamor, for example, around the world to get rid of the current antidumping laws that we have in this country. Certainly, people who are interested in unrestricted trade often say that this is a hindrance. I would say that it is just the opposite.

As we rely more and more on the WTO for trade resolutions, we need to keep in place our trade laws so that, in fact, if the trade resolutions drag on or really are inconsistent with what the objectives of the WTO are, that we have good trade laws in place that we can fall back on. This idea of turning over our national sovereignty, which is what we're doing with the WTO, without adequate laws on our books, I think would be a mistake.

Commissioner DREYER. Excuse me. It seems to me, however, that laws are only as good as the willingness of the people behind them to enforce them.

Mr. USHER. Yeah, and, I mean, that is another problem. The administrations come and go. Some are more committed to things than others and that's a challenge, but that's what we have in a democracy and it's something I think we need to continue to work on.

Mr. GERARD. I would pick up, and just let me come back to the WTO issue. I don't have faith in the WTO process and I think the WTO from the point of view of workers, from the point of view of national sovereignty, from the point of view of enhancing and protecting and promoting democracy is a totally flawed process. It has nothing to do with trade. It has nothing to do with democracy. It has nothing to do with protecting workers. What it has to do with is protecting investment rights. These are all investment agreements. They're not trade agreements and we ought to quit fooling ourselves about that, in my view.

The reality of—again, I keep coming back and saying that investments in capital aren't value neutral. They have the values you attach to them. I think that we ought to be pushing for not just the enforcement of our existing trade laws, but we need to strengthen those trade laws.

I think it's immoral, I think it's wrong, I think it flies in the face of the values that built this country and other democracies for us to actively promote an integrated trading relationship with a country like China.

Commissioner DREYER. So if I understand you correctly, you're saying that the WTO process is fundamentally flawed——

Mr. GERARD. Yes.

Commissioner DREYER. —and what we should rely on is strengthening our domestic regulations with regard to dumping, et cetera.

Mr. GERARD. Yes, and let me also—part of that is that I think it's wrong for us as a nation to elect officials to govern us and then turn the governance over to a society that meets in secret and we don't know what the rules are and who gives testimony and under what conditions they made their decision.

Mr. USHER. One issue on the WTO is in this transparency. As Leo says, it's difficult to find out what's going on.

Co-Chairman BECKER. I want to inject something just very quickly here, since we're on that subject. Japan has challenged the hot rolled case, which was decided in the industry's favor during the Asian crisis, I think about 1998. How do you see that unfolding, the WTO decision in support of China and challenging the——

Mr. USHER. In support of Japan.

Co-Chairman BECKER. —I mean, excuse me, Japan, and challenging the legality of our trade laws. How do you see this proceeding from this point?

Mr. USHER. I guess I don't know for sure. I would hope that the administration would continue to stick with the position they have of following our trade laws, but the Japanese, for example, have been very, very aggressive in going after this dumping law. They think it is designed to hurt them, and, in effect, it is, because today, I could load steel that I produce at Gary works, put it on a 747 in a first class seat, and take it over and sell it in Japan and make money on it. They have a closed market. We can't get in there for the high-quality steel applications, and it's not just us. No steel company in American can.

So the Japanese have a system of a closed market, closed a thousand different ways, and yet they want to come over here and sell steel, incremental steel, at pricing that allows them to keep their mills at full employment. I mean, how this thing will be resolved at the WTO between our laws and that practice, I think is a serious issue, and it is our hope that we have some backbone on this thing and don't roll over.

Mr. GERARD. Let me put it in additional perspective and try to bring it back to what could beat China. Japan has 66 million tons of domestic overcapacity. That didn't happen by accident. They had a deliberate policy to build more steel mills to have more steel to use it to export and to bring back dollars to do whatever it is they want to do back in Japan. It won't be long that China will be doing the same thing because this is the only open market, totally open market in Canada—Canada is too small—in the world. So if you are going to try to dump for dollars, this is the place to do it when you've got such a strong currency, as well.

On the issue of WTO, our learned and well-informed former General Counsel Carl Frankel sent me an e-mail last night. He's analyzed this most recent Japan WTO case and he said it has the potential to destroy the industry and he thinks that it could be deadly. Remember that every nation that has a domestic overcapacity in steel, which is every nation that produces steel but two, is targeting our trade laws. If these decisions by the WTO eliminate the guts that it takes to stand up for American industry and American workers, it will be the death not just of the steel industry and others.

Currently, under the U.S. trade laws, it's much more helpful if the administration would support cases that we've brought with the industry on antidumping or subsidy or even 201, but it's not mandatory that they do it. One of the reasons the Bush administration stepped forward is the Steelworkers Union was going to do it the week after they stepped forward. If no one else was going to do it, we were going to initiate the 201. Now, if they wipe out our trade laws, we can't do that. We can't even stand up to defend ourselves. That's how perverted the system now is becoming.

Co-Chairman BECKER. Thank you. Commissioner Reinsch?

Commissioner REINSCH. Thanks. I'm sorry I was late and missed part of your testimony, but I had a chance to review it. I want to pick up where Roger left off on some of this Ex-Im stuff, if I could, very briefly.

Mr. Gerard mentioned the Visclosky amendment, the one that reduced the Ex-Im's appropriation by $18 million in retaliation, I guess, for the Benxi loan guarantee. Mr. Gerard indicated he was for that. I assume, Mr. Usher, you were for it, too?

Mr. USHER. Yes.

Commissioner REINSCH. Help me out here, then. It seems to me the effect of that amendment, which is prospective, is simply to deny other American exporters the opportunity to export in non-steel areas. Why is that a good thing?

Mr. GERARD. I don't understand your question.

Commissioner REINSCH. The effect of reducing the Ex-Im Bank's funding is to preclude other companies, other American companies, from taking advantage of it.

Mr. GERARD. I don't——

Commissioner REINSCH. There's less money to go around, $18 million less, which means there's going to be some American exporters, probably not in your sector, who are not going to be able to get loan guarantees because of that amendment. Why is that good?

Mr. GERARD. I think it's probably good because I could take you through probably 20 industrial products, from automobiles, auto parts, electronics, televisions, that are in global oversupply, and American Export-Import Bank and other international financial institutions are the guilty culprits in subsidizing and funding that global oversupply. We're currently talking about steel, but we could do that in a number of other products that are funding their expansion in non-market economies or in economies that exploit their workers, like Mexico, and that global oversupply is then targeted back to this market. I don't know that it does anything good for American workers and I am convinced it does nothing good for American consumers.

Commissioner REINSCH. So you'd favor getting rid of the Ex-Im Bank?

Mr. GERARD. No, I'd favor putting some values on the capital that it uses.

Commissioner REINSCH. Okay, but how does the Visclosky amendment do that?

Mr. GERARD. I think that the Visclosky amendment sends a very clear signal that when you're making these decisions, you ought to make sure that you're very cognizant of the damage you could be causing in America, and in the Export-Import Bank, $18 million is peanuts. It's only a shot over the bow.

Commissioner REINSCH. Well, if you multiply the effect of it on the ability of the bank to make loan guarantees, the estimates I've seen suggest you're effectively canceling somewhere between $100 and $200 million worth of loan guarantees.

Mr. GERARD. I personally would have been much happier if the number had been much higher.

Commissioner REINSCH. Well, just as an aside, it seems to me one of the things you're doing is costing yourself some friends elsewhere in other industries——

Mr. GERARD. In what industry?

Commissioner REINSCH. —because what you're doing is punishing other American industries because you don't like a decision that the Ex-Im Bank made.

Mr. GERARD. I would respectfully disagree with you.

Commissioner REINSCH. Well, let's turn——

Mr. GERARD. I think that we're sending a value signal for what America stands for and we should not stand for that kind of subsidization/exploitation of Chinese workers or Mexican workers or any other workers where the bank feels it ought to go and dump this capital.

Commissioner REINSCH. Well, you're sending that signal to the bank, which is fine. I think you're sending a very different signal to your industrial colleagues in the United States.

Mr. GERARD. I disagree.

Commissioner REINSCH. But let's turn to the other question you raised, which Mr. Usher mentioned, which is the Bayh amendment in the Senate. I'm intrigued by the Bayh amendment for two reasons. One, it's not an amendment, as I understand it, unless it's been changed, designed to deal with the overcapacity problem that Mr. Gerard just alluded to. It's an amendment designed to deal with unfair trade practices and to punish foreign producers who engage in unfair trade practices, which is a perfectly legitimate policy objective. I'm not complaining. But it's not an overcapacity issue.

I guess my question is two-fold, and maybe Mr. Usher wants to respond to this. One is why did you choose to go down that route rather than the overcapacity route, and two, on the amendment in particular, as I understand it, unless it's been changed, it would prohibit bank funding not only for cases of outstanding 201 findings or dumping duty orders or CBD orders, but also prevent financing to people that are under investigation in these cases, which seems to me to be hanging them before the verdict. Can you give us your thinking on both of those?

Mr. USHER. Yeah. I guess I would say on this overcapacity thing, as Leo said, everybody has overcapacity, and currently, there are about 25 million tons of imports that need to come into this country, and a number of imports come into this country and they don't violate our laws and the system sort of needs that amount of imports.

The problem is, those countries that have both the overcapacity, as most countries do, but also trade and bring it in here basically and destroy the market. This market needs a certain amount of imports. We don't have the domestic capacity to handle that, so we need imports, but we can't have those people who are violating the laws being the importers. So it is really more geared towards that.

The second point I think you made, it's not just companies or countries that have actually violated those laws, in which there are charges against them. I guess our view would be that these things should be able to be resolved relatively quickly and this shouldn't be a lengthy time process. But if there is a country that has had a history of doing this, and again there are charges that they are dumping, rather than be precipitous and approve some type of a loan to them, let's just wait and see what the results are.

Commissioner REINSCH. Well, I know the industry, because I worked with you for a long time, has a long history of trying to get these cases resolved more quickly, with good reason, because they're not, and the industry has a long history of complaining about how long it takes. I certainly agree they should be resolved quickly. But these things tend to take between nine and 14 months, as I recall, which means you're——

Mr. USHER. Far longer than it should.

Commissioner REINSCH. No argument, but the consequence of that is you're knocking people—essentially, you're executing them before the conviction here, and I personally think it ought to be the other way around.

But leaving that aside, let me ask quickly about exports. Historically, the U.S. industry has not been a huge exporter of steel. Why not?

Mr. USHER. Well, we have. In fact, in the early '90s, we exported quite a bit of steel to China. Steel is a product that has, you know, just to put some numbers in perspective, say a value of $400 a ton and it costs $50 a ton to move it around the world. It is a product that is probably, if it can be produced efficiently, best produced close to where the market is. This is a business that has not had the kind of margins that can pay for the cost of production and then also add a $50 bill on top of it to move it to some other part in the world.

So from a domestic standpoint, we have been in a deficit position. Imports are coming into this country. To disadvantage us to try to move it to some other country and pay an extra $50 hasn't made sense for the most part.

There are also countries in which there are attractive markets that we would want to get into for certain niche products that are very high profitability products, but we really are restricted because of closed markets within those countries.

Mr. GERARD. Let me just, on the issue of exporting, Tom and I may disagree about this, but for reasons that are beyond debate today, the industry shut down almost 60 percent of its capacity during the '80s and wiped out close to 300,000 jobs, part of what I think was in a rush, way too quickly, to move up the productivity curve. And what that did, it left a vacuum for countries to set up permanent residence on the export end in this country, and it's like inviting the disease in.

I think that we've never been able to recover from that as a steel industry and the imports have continuously climbed up the curve to the point where, if you go back to the mid-'80s, President Reagan endorsed the VRAs when imports were in the range of 18 to 19 percent. Imports in the last surge were up in the 38 percent, and we're going to end up being pleased when they drop back down to 24, 25, 26, 27 percent.

That chunk of your market being chewed up makes it very difficult for you to sustain long-term stability, which makes it very difficult for you to grow your capacity, which makes it very difficult for you to have steel that you could export, which means that you've got to then find, as Tom pointed out, these niche markets where you can maybe export some sort of thin slice of what you produce, but never enough to be an exporter.

Co-Chairman BECKER. If I could break the line here, if you don't mind, we have two Commissioners that have indicated they have questions that have not yet spoken. I'd like to give them an opportunity, looking at the clock up there. If I could go, let's see, Commissioner Ledeen.

Vice Chairman LEDEEN. This ends at 9:30?

Co-Chairman BECKER. Yes.

Vice Chairman LEDEEN. Jim, why don't you go first, and then if there's any time left over——

Commissioner LILLEY. I've just got a very short question I'd like to get your observation on.

Co-Chairman BECKER. Commissioner Lilley?

Commissioner LILLEY. Shougong Iron and Steel outside of Beijing has, I think, roughly 150,000 workers in it. It's about ten or 20 miles west of Beijing.

Mr. GERARD. I can't hear you.

Commissioner LILLEY. Shougong Iron and Steel is in Beijing. It's about ten or 20 miles west of the center of town. It's about 150,000 workers and it's gone through great convulsions because it's been accused of massive corruption. It was tied to the former mayor of Beijing, who is now in jail. Its management was attacked for very inefficient practices, and you tie that into other reports we have of worker violent demonstrations in Manchuria in these old mills that the Japanese built probably prior to World War II, very backward. A lot of discontent in the labor market, both at the management level and worker level.

My question is, are we turning the Chinese steel industry—I realize they're exporting to us and they can do these things, but is this an industry really that has some very fundamental problems, and as China goes into its so-called growth, are we going to see this industry maybe begin to rip apart, go downhill? It's showing a lot of signs of being in real trouble. A question: Is this true?

Mr. GERARD. I don't know what you mean by going downhill. The stuff that we're reading is that part of the challenge that they're trying to deal with is the modernization and, I guess, the level of dissent based on the level of exploitation that's going on with that. People are trying to express that displeasure and ending up in jail and, I guess, other places.

I think that there is going to be an accelerated modernization of the industry as it moves up the production curve to add ten, 15, 20—I was just reading this morning that there's three projects on that will add four million tons that will be of the efficiency of the U.S. steel industry. I don't know if that will be tons to replace a mill that produces two million tons with 22,000 workers. I don't know. We can produce two million tons in some mills with 350 workers. Or I don't know if they'll keep those mills open and produce those new four million tons with 1,000 workers. I don't have access to that kind of knowledge of China.

Mr. USHER. I think some of the Chinese industry, especially some of the new stuff that's being built, is up to world class standards and probably could be a very competitive force in the world going forward. A lot of the problem is a lot of these older mills that you made reference to that are continued to be run, and in a free market economy, there would be no way they could stay afloat.

I'm often reminded of a story that was in the *USA Today* about, I guess, about three years ago, and it was a refrigerator plant in China in which they had become distressed with the quality levels. So some people from the government went out and they got all the workers out in front of the plant and they called out the plant manager and the manager of quality control and shot them. Short-term, this is a great motivator. Long-term, it makes you wonder about how it will stay together.

Is this thing going to disintegrate? I don't know. Is the whole country going to disintegrate?

Co-Chairman BECKER. Where did that happen, the shootings?

Mr. USHER. I forget. I read this in the *USA Today*. I'd have to go back and research it, but it was a story that just sort of emphasized to me how things are different in China.

Co-Chairman BECKER. About how long ago, Tom?

Mr. USHER. Like I say, I think it was about three years ago. I'm going to have to do some research on that, but it was in a story in the *USA Today* about this refrigerator plant.

Mr. GERARD. I could well envision, as you think about this and you think about the social consequences and the Chinese sort of political economic structure, I could well envision the Chinese making one of two decisions, building all of this new capacity with modern state-of-the-art technology and then deciding whether that will be for export or for domestic consumption and keeping all of that old capacity that has 22,000 workers making two million tons and deciding whether that will be for export or for consumption domestically, and why would they not build domestic overcapacity if everyone else is attacking the U.S. trade laws and everyone else is knocking down the very slim, narrow protections we have already? And then why wouldn't they target that domestic overcapacity to America?

I don't for one minute believe, regardless of what any politician says, that the Chinese government intends to be the long-term friends and allies of America. I have a much different view of that.

Commissioner LILLEY. Well, we're going to talk about that tomorrow.

Co-Chairman BECKER. Commissioner Ledeen?

Vice Chairman LEDEEN. Could we just review the bidding on a couple points, because I'm not clear. Just quickly, do we have the legislation that we need from your point of view, and if not, what do we need that we don't have, whether within the GATT or WTO or domestic context?

Mr. USHER. I would say we do not. We're continuing to try and work on it, but we need continued strengthening of the anti-dumping and countervailing duty legislation. We need sort of rules of engagement to keep what happened in steel over the last three years from reoccurring. And we need much more timely resolution of these types of things than we have had.

Mr. GERARD. I would again reiterate Tom's point about we need to strengthen America's domestic trade laws. We certainly need to speed them up. I think that one of the problems with the law is that you've got to prove you've been almost fatally wounded. You've got to prove that you've been damaged to the point where it hurts to get some kind of remedy.

The other thing is, I will reiterate my comments about the WTO and these other international trade agreements. I think all of them in the long term for America's sovereignty, for America's ability to have a strong industrial base, for advocating and promoting and defending America's historical values, that these laws are terribly flawed. Let me just give you one example.

Vice Chairman LEDEEN. With all due sympathy, we've got——

Mr. GERARD. As long as you're sympathetic.

Vice Chairman LEDEEN. We've got two minutes left, and I'm very sympathetic, but I have another couple of questions. I'd like to ask the two of you if you'll be good enough to give us in writing specific suggestions for legislation.

Mr. GERARD. Sure.

Mr. USHER. Yes.

Vice Chairman LEDEEN. Because this is part of our mandate and we can address this and we'd like to address it. I'm sure all of us would like to address it.

Mr. USHER. Yes, we'll give a joint——

Mr. GERARD. We'll try to do a joint presentation.

Vice Chairman LEDEEN. Well, I mean, that looks very suspicious, but——

Mr. USHER. Okay. We'll give independent, then.

Vice Chairman LEDEEN. But if you insist, that's fine.

Mr. GERARD. We'll take it both ways.

Vice Chairman LEDEEN. I'd like to just——

Mr. GERARD. We'll give you ours and we'll let Tom agree with us. [Laughter.]

Vice Chairman LEDEEN. I'd like to make one comment on the canary in the mine shaft, which was obviously an inescapable metaphor for this session. Trade unions in and of themselves are not an indicator of anything, speaking as a historian of fascism. Communist regimes, fascist regimes had trade unions. It's free trade unions.

Mr. GERARD. Those were the terms I used, free democratic.

Vice Chairman LEDEEN. Yes. The issue is democracy. It's not that the existence of trade unions indicate either one thing or another. It's that a free society permits free trade unions and an unfree society produces phony trade unions, as they have all throughout the century.

The last question is on productivity. Do you have any sense—Mr. Usher, you just said that your understanding is that modern Chinese steel producers are going to be competitive with the rest of the world. By that do you mean that their productivity will be as good as ours, or——

Mr. USHER. I doubt—productivity measured in labor input per ton will still be higher than ours, but they will have world class equipment and they will be able to be very productive and very competitive, I would say.

Vice Chairman LEDEEN. Okay. When we were studying the Soviet Union, one of the interesting things about it was that if you tracked Western turnkey factories into the Soviet Union, you had a 40 percent drop in productivity. It didn't matter what the field was, whether it was Italian cars or German chemicals or French textiles and so forth.

I don't believe that we have any sensation, that we have any understanding of whether a similar thing happens when Western companies, when Western technologies go into China. It would be invaluable for policy makers in the United States to be able to get a grip on this. I mean, how does China function? How good are they at managing large-scale enterprises?

Steel is a great window through which to look at this question. If you have information about it or if you could point us in a direction where we could put a researcher to work on it, we'd be very grateful for this.

Mr. USHER. Okay, we'll look. But as I said in the past, they certainly don't have the transparency that we would have and we're limited in what we can see when we travel there, but we'll look and see if we can give you something that would assist you.

Vice Chairman LEDEEN. Thanks.

Mr. GERARD. Just for the record, Commissioner, I want to make sure that you didn't in any way misinterpret any of my words. I'm very careful to always use the word "free democratic trade unions." I understand the difference.

Commissioner LEWIS. And that is exactly what I meant, Commissioner Ledeen. That is not the canary in the mine shaft.

Vice Chairman LEDEEN. I know.

Co-Chairman BECKER. We're going to have a couple of very quick questions here to wrap up. Commissioner D'Amato?

Chairman D'AMATO. I don't really have a question. First of all, I want to thank you for your testimony. I think it's been very illuminating and invaluable testimony, and I appreciate your taking time out to come visit with us.

I want to follow up just one point that the Vice Chairman made and asked you to provide us, that's legislation. Also in that summary, could you assess why it is that the current American legal structure is inadequate, with all these cases that we've had. It seems the more cases we have, the worse the industry—the more success we have, the more failure we see in the way of bankruptcies, and there's something fundamentally wrong with the laws, the way they're implemented—either what they are on the books or the way they're implemented or a combination that is not successful. Why is this the case? I mean, the time frames are one thing, but I think there may be other factors involved. We ought to know why our current legal structure is imperfect and then what your recommendations are to how to make it perfect, how to make it really effective.

Mr. USHER. We will be glad to submit that.

Chairman D'AMATO. Thank you very much.

Co-Chairman BECKER. Just one very short question. I haven't had a list of questions, but I'm curious, the hot button question of today, should the President be given fast track authority?

Mr. GERARD. Absolutely not.

[Laughter.]

Chairman D'AMATO. A two-word answer.

Mr. GERARD. And I speak for Tom on that, too.

Co-Chairman BECKER. Okay.

[Laughter.]

Mr. USHER. Leo speaks for himself on that.

Co-Chairman BECKER. I predicted the answer and your response, also. I want to express my appreciation——

Commissioner LEWIS. George, what is Mr. Usher's response?

Co-Chairman BECKER. Pardon?

Commissioner LEWIS. I didn't hear Mr. Usher's response.

Mr. USHER. I just rebutted what Leo said, that he speaks for me.

Commissioner LEWIS. So you think he should be given fast track authority?

Mr. USHER. Yeah. I think this is a point we would disagree, but I would say yes.

Commissioner LEWIS. With or without labor rights or union rights?

Mr. USHER. I mean, I think these are important considerations, but I think it does hamper us. We have been supportive of many of the trade initiatives of the past. We are not anti-trade people. We just sort of feel that there have to be rules of any type of game, including in trade, and we want those rules enforced.

Mr. GERARD. We are for rules in trade, we just don't want them done too fast.

Co-Chairman BECKER. I just wanted to make sure everybody understood that they're not together on everything.

[Laughter.]

I want to thank both of you for your testimony. It's been very good and I think you would agree with that, based on the questions that came forward.

Mr. USHER. Thank you.

Mr. GERARD. Thank you.

Co-Chairman BECKER. Thank you very much.

Chairman D'AMATO. We'll go ahead and get started. We've got a pretty full morning ahead of us before we break for lunch. We've got an interesting and important panel here.

Representing USTR is the General Counsel, Peter Davidson. We welcome him. We have also the Acting Commissioner of the United States Customs Service, Mr. Charles Winwood, and his Assistant Commissioner, Donald Shruhan. Then we have a commentator who has just returned from a long service in Shanghai with an American law firm, who has just written a very interesting book published—the ink is still wet on the book, I believe, isn't it, Gordon?

Mr. CHANG. It is.

Chairman D'AMATO. I think what we'd like to do is follow the same process that we have in the past. If the witnesses will try and summarize their comments in about ten minutes, we'll have all of you give your testimony and then we'll open it up to questions from the panel and the panelists. Then we will try to stick to the seven-minute rule in asking your questions in the first round so everyone gets an opportunity to question the witnesses.

With China's WTO accession expected in the near term, the U.S. focus will be on whether accession will adequately open up the Chinese market to U.S. goods and services and also what the impact of China's entry into the WTO will have on its own political and economic system, the big questions that we're all wrestling with.

Participants on this panel will discuss the status and specifics of China's WTO accession agreement, in addition, China's record of compliance, not only projected with that agreement but with previous agreements that we have signed with them in the customs area and other areas, and the implications for WTO accession on both the United States and China.

We'll start off with Peter Davidson, who is the current General Counsel for the USTR. We welcome you to the Commission. Thank you for coming.

PANEL II: ADMINISTRATION PERSPECTIVES/BILATERAL TRADE AND WTO ISSUES: ADEQUACY OF ENFORCMENT LAWS ON IMPORTED GOODS

STATEMENT OF PETER DAVIDSON, GENERAL COUNSEL, UNITED STATES TRADE REPRESENTATIVE

Mr. DAVIDSON. Thank you very much, Mr. Chairman. I appreciate the opportunity to be here, distinguished Commissioners, as well. I know some of you from past lives and I appreciate the opportunity to be with such a distinguished panel.

I have to give a little caveat at the outset. As I mentioned to Commissioner D'Amato, I am pinch-hitting for Ambassador-designate Jon Huntsman, who will hopefully be confirmed by the Senate shortly and is by far more expert than I am on these issues, but I'll give it my best shot today.

I brought with me Terry McCartin, who is our Director of Monitoring and Enforcement in the China office at USTR and will speak a little bit in my testimony and afterward about efforts we have made to beef up our staffing in this area, as well, and I'll try to keep my remarks within the ten-minute time period.

Chairman D'AMATO. If you go over a little bit, we do have two hours, so you can go over a little bit, if you need to.

Mr. DAVIDSON. Okay. Thank you. I'd like to discuss today the administration's perspective on the U.S. trade relationship with the People's Republic of China and particularly its imminent accession to the WTO.

First of all, market access. China's accession to the WTO will be a major and direct step forward in ensuring significantly greater market access for U.S. businesses and farmers to China's large and expanding market. The groundwork for this achievement was laid by the United States in November of 1999 when the United States concluded a bilateral agreement with China on the terms of its accession to the WTO, capping, as you know, nearly 14 years of intense and often difficult negotiations.

The U.S.-China bilateral agreement provided us with a set of comprehensive, verifiable, one-way trade concessions that substantially opened China's market across the spectrum to U.S. goods, services, agriculture. By now, this Commission is familiar with the terms of our bilateral agreement and there's no need to go through them in detail today.

The major market access concessions are as follows. China will reduce its average tariff levels on goods of interest to the United States from 24 to seven percent. China will phase out all tariffs on information technology projects by the year 2005. China will broadly open up its services sector, such as insurance, banking, securities, telecommunications, express mail, legal accounting, and computer-related services. And finally, China will permit U.S. companies to operate wholesale, resale, and franchise distribution networks.

The 1999 U.S.-China bilateral agreement, critical though it was, did not mark the end of China's accession process. Still to be completed was the negotiation of the multilateral documents essential to the accession package, China's protocol of accession, and the report of the Working Party on China. These two documents describe how WTO rules will apply to China and how China intends to implement the commitments it is undertaking in the areas of goods, services, and intellectual property rights. It is principally the finalization of these documents that has occupied us since 1999.

As it now stands, we have been able to achieve international consensus on Working Party Report provisions on numerous additional issues critical to ensuring market access with China, including technical barriers to trade, administration of tariff-rate quotas, intellectual property rights, and agricultural and industrial subsidies. All of these market access concessions supplement more broad-based reforms to which China has also committed in an effort to address practices that have not only made it difficult for U.S. companies to do business in China, but have also hindered the development of China's own economy.

For example, China has agreed to commitments to greater transparency in the operation of its trade regime. Laws, regulations, and other measures will be published before they're enforced and interested parties will have an opportunity to comment on these provisions before they are implemented. Administrative actions relating to trade matters will be subject to judicial review, and China has agreed that the practices of all levels of government will comply with WTO commitments.

I will speak a bit about protection against Chinese imports. Let me turn to the area of trade remedies and specifically provisions in China's WTO accession package that strengthen the ability of the United States to safeguard itself against unfairly traded imports from China once China accedes.

Here, as a part of our 1999 bilateral agreement, we were able to negotiate three separate mechanisms. Last month in Geneva, all aspects of these mechanisms were multilateralized and have now been made a part of China's accession package. Perhaps the most important of these mechanisms involves the antidumping laws.

These are the laws that we use most frequently in the United States, as you know, against low-price injurious imports.

Historically in antidumping cases involving Chinese products, we have used a special methodology known as the non-market economy, or NME, methodology to make the key measurement when calculating the amount of dumping that is taking place. Although this methodology has long been a part of U.S. law, it is not expressly incorporated in WTO rules. We achieved a significant concession when we were able to gain China's agreement that we and other WTO members will be able to continue to use this methodology for the next 15 years after China's accession to the WTO.

Another significant concession that we obtained is the creation of a special safeguard mechanism protecting U.S. industry and workers against import surges from China. This mechanism, known as the product specific safeguard, will be available to the U.S. and other WTO members for 12 years after China's accession. It is distinctive because it goes beyond the normal safeguard measures authorized by WTO rules in two important ways.

First, it employs a more lenient injury standard, known as a market disruption, rather than the normal serious injury standard. Secondly, it is China-specific, meaning it allows us to apply safeguard measures that are targeted solely at Chinese products rather than at imports from all countries.

The third mechanism is a safeguard that applies to textile products. This mechanism will be available to the United States and other WTO members for approximately seven years after China's accession, or until the year 2008. Like the new product specific safeguard, this textile safeguard employs a market disruption injury standard and is China-specific.

Before I move on, let me make one more point that underscores the level of protection that we have put in place for U.S. industry and workers. The terms of China accession to the WTO are directed at the opening of China's market to U.S. industry, not the opening of the U.S. market. China already has wide access to the U.S. market and has had it for years, so accession will not increase the penetration of Chinese products in the U.S. market. Nevertheless, we have still negotiated the mechanisms described above in order to ensure protection against any injury that U.S. industry and workers might suffer following China's accession to the WTO and the Administration is committed to invoking and applying those mechanisms whenever necessary.

I want to step back for just a moment and talk a little bit about the bigger picture, since I've gone through some of the details of our arrangements. First of all, the agreement on China's accession, as I've mentioned, will reduce China's trade barriers across a range of services and goods, eliminate or significantly reduce restrictions on freedom to import and distribute goods within China, and rectify industrial policies intended to draw jobs and technology to China.

Second, China's commitments are effective immediately upon accession. China will be required to take concrete steps to open its market from day one in virtually every sector. The phase-in of further concessions will be limited to five years in almost all cases, and in many cases to three years.

Third, the agreement is enforceable. China's commitments are specific, with timetables and dates for staged and full implementation. We will enforce them through our trade laws, WTO dispute settlement processes as necessary, and other mechanisms, including an annual multilateral review of China's implementation and compliance for eight years, with an additional review in the tenth year. We intend to set up a network to help us identify and act upon problems as early as possible, drawing on the assets of our embassy and consulates in China, the Departments of Commerce and Agriculture, American Chambers of Commerce in China and the region, and at USTR, we have added additional personnel who will focus on monitoring and implementation efforts.

Fourth, as I have already touched upon, the agreement helps ensure through a variety of mechanisms that trade with China does not injure U.S. workers and industry.

Fifth, the increased transparency and accountability that WTO membership and implementation of WTO rules compel can only have a positive effect in other areas. The essence of the WTO is it is a rules-based system that requires its members to play by the rules and operate with openness and transparency, both when making their laws and regulations and when enforcing them. WTO provisions and philosophy also stress the central role of markets and private enterprise. The reforms China is undertaking to enter the WTO and comply with its new WTO commitments will provide the basis for further liberalization in China, including an increased commitment to the rule of law.

Let me turn now to what remains to be done before China can formally accede to the WTO. At this point, China has completed the negotiation of all of its bilateral agreements, with the principal exception of Mexico, which is currently engaged in intensive bilateral negotiations with China. Along with our other trading partners, we are in the process of verifying and rectifying each of the commitments China has made in its various bilateral agreements to ensure that the most liberalizing one is reflected in the final accession documents.

On the multilateral side, last month, we were able to produce a completed protocol of accession and a working party report with only one or two unresolved issues. In mid-September, what we hope will be the final working party session will convene to approve the final text of these documents. If we are successful, this package will then be sent to the capitals for review. The full accession package will then be reviewed by Ambassador Zoellick and concerned agencies of the U.S. Government.

After that review, the President will decide whether he can certify to Congress, as required in the PNTR legislation, that the final package is at least equivalent to the bilateral agreement negotiated in 1999. We believe that the final package will meet that standard.

If the President is able to provide such a certification and other countries provide their approvals, WTO members at a meeting of the General Council, possibly at a WTO ministerial meeting in mid-November, would then approve the terms of China's accession to the WTO. China will then need to complete its domestic approval processes and formally accept WTO membership. China will become a WTO member 30 days after filing its formal acceptance with the WTO.

One final point is we fully expect the WTO to also approve Taiwan's accession in the same time frame as China's accession. As a major player in international trade in a new and thriving democracy, Taiwan deserves membership and a larger role in the international community. We have discussed our expectations on Taiwan's accession thoroughly with all concerned parties and we are confident that there is a consensus on this point.

Let me conclude by saying that China's accession to the WTO will be a benefit to China, but it's not a favor to China. Indeed, it contains the most rigorous and broad-ranging commitments ever required of a new member of the GATT or WTO. Major beneficiaries will be American businesses and farmers and workers. Accession will significantly open the world's most populous country, and arguably the fastest-growing economy in the world, to our exporters and service suppliers without changing China's access to our market.

I look forward to your questions and that concludes my comments, Mr. Chairman.

[The statement follows:]

PREPARED STATEMENT OF PETER DAVIDSON

I am pleased to appear before the U.S.-China Security Review Commission today to discuss the Administration's perspectives on the United States' trade relationship with the People's Republic of China and, particularly, its imminent accession to the WTO.

Market Access

China's accession to WTO will be a major and direct step forward in ensuring significantly greater market access for U.S. businesses and farmers to China's large and expanding market. The groundwork for this achievement was laid by the United States in November of 1999, when the United States concluded a bilateral agreement with China on the terms of China's accession to the WTO, capping nearly fourteen years of intense, often difficult negotiations.

The U.S.-China bilateral agreement provided us with a set of comprehensive, verifiable, one-way trade concessions that substantially open China's market across the spectrum to U.S. goods, services and agriculture. By now, this Commission is familiar with the terms of our bilateral agreement, and there is no need to review them all in detail today. The major market access concessions under the agreement are as follows:

—China will reduce average tariff levels on goods of interest to the United States from 24% to 7%;

—China will phase-out all tariffs on Information Technology Products by 2005;

—China will broadly open up its services sectors, such as insurance, banking, securities, telecommunications, express mail, legal, accounting and computer-related services; and

—China will permit U.S. companies to operate wholesale, retail, and franchised distribution networks.

The 1999 U.S.-China bilateral agreement, critical though it was, did not mark the end of China's WTO accession process. Still to be completed was the negotiation of the multilateral documents essential to the accession package—China's Protocol of Accession and the Report of the Working Party on China. These two documents describe how WTO rules will apply to China and how China intends to implement the commitments it is undertaking in the areas of goods, services and intellectual property rights. It is principally the finalization of these documents that has occupied us since 1999.

As it now stands, we have been able to achieve international consensus on Working Party Report provisions on numerous additional issues crucial to ensuring market access with China—including, *inter alia*, technical barriers to trade (or standards), administration of tariff-rate quotas, intellectual property rights and agricultural and industrial subsidies.

All of these market access concessions supplement more broad-based reforms to which China has also committed, in an effort to address practices that have not only made it difficult for U.S. companies to do business in China but have also hindered the development of China's own economy. For example, China has agreed to commitments to greater transparency in the operation of its trade regime. Laws, regulations and other measures will be published before they are enforced and interested parties will have an opportunity to comment on these provisions before they are implemented. Administrative actions relating to trade matters will be subject to judicial review, and China has agreed that the practices of all levels of government will comply with WTO requirements.

Protection Against Chinese Imports

Now, let me turn to the area of trade remedies and, specifically, the provisions in China's WTO accession package that strengthen the ability of the United States to safeguard itself against unfairly traded imports from China once China becomes a Member of the WTO. Here, as part of our 1999 bilateral agreement with China, we were able to negotiate three separate mechanisms. Last month in Geneva, all aspects of these mechanisms were multilateralized and have now been made part of China's accession package.

Perhaps the most important of these mechanisms involves the antidumping laws. These are the laws that we use the most frequently to protect U.S. industry and workers against low-priced, injurious imports from China. Historically, in antidumping cases involving Chinese products, we have used a special methodology—known as the "non-market economy," or NME, methodology—to make the key measurement when calculating the amount of dumping that is taking place. Although this methodology has long been a part of U.S. law, it is not expressly incorporated in the WTO rules. We achieved a significant concession when we were able to gain China's agreement that we (and other WTO Members) could continue to use this methodology for 15 years after China's accession to the WTO.

Another significant concession that we obtained is the creation of a special safeguard mechanism protecting U.S. industry and workers against import surges from China. This mechanism, known as the "product-specific" safeguard, will be available to the United States (and other WTO Members) for 12 years after China's accession. It is distinctive because it goes beyond the normal safeguard mechanism authorized by WTO rules in two important ways. First, it employs a relatively lenient injury standard known as "market disruption" (rather than the normal standard of "serious injury"). Second, it is China-specific, meaning that it allows us to apply safeguard measures that are targeted solely at Chinese products (rather than at imports from all countries).

The third mechanism is a safeguard that applies to textile products. This mechanism will be available to the United States and other WTO Members for approximately 7 years after China's accession, or until the end of 2008. Like the new product-specific safeguard, this textile safeguard employs a market disruption injury standard, and it is China-specific.

Before I move on, let me make one more point that underscores the level of protection that we have put in place for U.S. industry and workers. The terms of China's accession to the WTO are directed at the opening of China's market to U.S. industry, not the opening of the U.S. market. China already has wide access to the U.S. market, and it has had it for years. So, accession will not increase the penetration of Chinese products in the U.S. market. Nevertheless, we have still negotiated the mechanisms described above in order to ensure protection against any injury that U.S. industry and workers might suffer following China's accession to the WTO, and the Administration is committed to invoking and applying those mechanisms whenever necessary.

The Bigger Picture

I now want to step back for a minute and let you see the bigger picture:

—First, the agreement on China's accession, as I have mentioned, will reduce China's trade barriers across a broad range of goods and services, eliminate or significantly reduce restrictions on freedom to import and distribute goods within China, and rectify industrial policies intended to draw jobs and technology to China.

—Second, China's commitments are effective immediately upon accession. China will be required to take concrete steps to open its market from day one in virtually every sector. The phase-in of further concessions will be limited to five years in almost all cases, and in many cases to three years.

—Third, the agreement is enforceable. China's commitments are specific, with timetables and dates for staged and full implementation. We will enforce them through our trade laws, WTO dispute settlement processes, as necessary, and other mechanisms including an annual multilateral review of China's implementation and compliance for eight years, with an additional review in the tenth year. We intend to set up a network to help us identify and act upon problems as early as possible, drawing on the assets of our Embassy and Consulates in China, the Departments of Commerce and Agriculture, and the American Chambers of Commerce in China and the region. At USTR, we have also added personnel who will focus on monitoring and implementation efforts.

—Fourth, as I have already discussed, the agreement helps ensure, through a variety of mechanisms, that trade with China does not injure U.S. industry and workers.

—Fifth, the increased transparency and accountability that WTO Membership and implementation of WTO rules compel can only have a positive effect in other areas. The essence of the WTO is that it is a rules-based system that requires its members in turn to play by the rules and to operate with openness and transparency, both when making their laws and regulations and when enforcing them. WTO provisions and philosophy also stress the central role of markets and private enterprise. The reforms China is undertaking to enter the WTO and comply with its new WTO commitments will provide the basis for further liberalization in China, including an increased commitment to the rule of law.

Remaining Steps

Now, let me turn to what remains to be done before China can formally accede to the WTO.

At this point, China has completed the negotiation of all of its bilateral agreements, with the principal exception of Mexico, which is currently engaged in intensive bilateral negotiations with China. Along with our other trading partners, we are in the process of verifying and rectifying each of the commitments China has made in its various bilateral agreements to ensure the most liberalizing one is reflected in the final accession documents.

On the multilateral side, last month we were able to produce a completed Protocol of Accession and a Working Party Report with only one or two unresolved issues.

In mid-September, what we hope will be the final Working Party session will convene to approve final texts of these documents. If we are successful, this package will then be sent to capitals for review.

The full accession package will be reviewed by Ambassador Zoellick and other concerned agencies of the U.S. Government. After that review, the President will decide whether he can certify to the Congress, as required in the PNTR legislation, that the final package is at least equivalent to the bilateral agreement negotiated in 1999. We believe that the final package will meet that standard. If the President is able to provide such a certification and other countries provide their approvals, WTO members, at a meeting of the General Council, possibly at the WTO Ministerial meeting in Doha in mid-November, would then approve the terms of China's accession to the WTO.

China will then need to complete its domestic approval process and formally accept WTO membership. China will become a WTO member thirty days after filing its formal acceptance with the WTO.

One final point is that we fully expect the WTO to approve Taiwan's accession in the same time frame as China's accession. As a major player in international trade and a new and thriving democracy, Taiwan deserves membership and a larger role in the international community. We have discussed our expectations on Taiwan's accession thoroughly with all concerned parties, and we are confident that there is a consensus on this point.

Conclusion

Let me conclude by saying that China's accession to WTO will be a benefit to China, of course. But, it is not a favor to China. Indeed, it contains the most rigorous and broad-ranging commitments ever required of a new member to the GATT or WTO. Major beneficiaries will be American businesses and farmers and their workers. Accession will significantly open the world's most populous country, and arguably the fastest-growing economy in the world, to our exporters and service suppliers, without changing China's access to our own market.

I look forward to your questions.

Chairman D'AMATO. Thank you very much, Mr. Davidson.

We would like to move right on to the Customs Service, Acting Commissioner Charles Winwood. We appreciate your coming. Thank you very much for testifying before the Commission.

STATEMENT OF CHARLES W. WINWOOD, ACTING COMMISSIONER, U.S. CUSTOMS SERVICE, DEPARTMENT OF THE TREASURY

ACCOMPANIED BY:

DONALD SHRUHAN, DEPUTY ASSISTANT COMMISSIONER, INTERNATIONAL AFFAIRS, U.S. CUSTOMS SERVICE, DEPARTMENT OF THE TREASURY

LESLEY ANNE KESSLER, OFFICE OF THE CHIEF COUNSEL, U.S. CUSTOMS SERVICE, DEPARTMENT OF THE TREASURY

Mr. WINWOOD. Thank you, Mr. Chairman and members of the Commission. Thank you for providing an invitation to provide a statement this morning. I regret to tell you, as we already worked out previously before my appearance here this morning, that I'll have to leave immediately after my statement for another commitment, but Mr. Don Shruhan, sitting to my left, will stay, along with a member of our staff sitting directly behind him, Lesley Anne Kessler, to respond to any questions that might arise at the conclusion of your panel this morning.

As part of its worldwide network of representative offices, U.S. Customs maintains an active presence in Beijing, China. As in all our foreign posts, Customs personnel in China serve as part of America's diplomatic team. Our staff coordinates its work closely with the State Department and other U.S. officials in country. We serve at the invitation of the Chinese government and work in cooperation with China's trade and law enforcement personnel.

Our representatives in China cover a range of enforcement issues that include but are not limited to prison and forced child labor investigations, export controls, intellectual property rights, dumping, textiles, commercial fraud, and other trans-shipment cases. Staff in Beijing are assisted in their work by employees based in our Office of Investigations here in Washington, D.C. We have two Customs special agents and one intelligence research specialist that support our global forced labor program, to include China, from headquarters.

Now, turning to some matters of specific interest to this Commission, as you are aware, the U.S. Customs Service is the lead law enforcement agency for investigations involving an importation of goods made with forced prison labor into the United States. Our primary authority derives from Section 1307 of Title XIX of the United States Code, which prohibits the importation of goods made wholly or in part with convict, forced, or indentured labor under penal sanctions. In addition, we enforce Section 1761 of Title XVIII, United States Code, the primary criminal statute prohibiting the importation of goods made with convict labor.

The investigations of allegations of prison labor is a high priority for the Customs Service, but at the same time, these case are often difficult to substantiate and diplomatically sensitive. This is true not only for China, but for many countries in which Customs investigates charges of this nature.

We continue to work with the Chinese government to gain access to prison sites where the manufacture of goods with convict labor has been alleged. We have a memorandum of understanding and a statement of cooperation in place that governs this process. Under that agreement, Customs must file site visit requests with China's Ministry of Justice. At the current time, we have a number of these requests pending.

As long as the situation remains as it is, Customs has adequate resources in place in China to manage our workload there. However, should the number and/or geographic span of cases increase, we would likely be in a position to seek additional funding to meet our mission needs. This has been the case, for example, in areas of child labor investigations.

Customs has received resources from Congress to post additional special agents at selected foreign posts around the world as our activities in this field have expanded. To date, we have substantiated three allegations of forced prison labor in China.

Now, the first involved E.W. Bliss Company of Hastings, Michigan, which in 1992 plead guilty to charges of knowingly importing machine presses made with prison labor. The company forfeited the merchandise and paid a substantial fine.

In 1994, the Court of International Trade ruled in favor of the United States Government in a suit brought by China Diesel Imports. That company, which was importing diesel engines produced by the Yunnan Machinery Company of China, was protesting the exclusion of its products by U.S. Customs, which had found evidence of prison labor in their manufacture in violation of Section 1307.

And this past year, Customs investigated Office Mate International Corporation of Edison, New Jersey, and a sister company, Allied International Manufacturing Corporation, or AIMCO, located in Beijing, China. The individual who owned both companies was convicted of transporting into the United States over 100 million paper binder clips that had been assembled with prison labor in China.

The AIMCO case highlighted another vital aspect of our prison labor investigations, one that is equally or more important to our success than resource issues. It is our need for reliable investigative leads, including those provided from outside sources. In this particular case, Customs was approached by a private businessman, the owner of a U.S. manufacturer of binder clips, about the use of prison labor by a competitor. He provided video footage shot in China to support his claim. That footage enabled Customs to launch its investigation, which was conducted mainly by our Newark, New Jersey, office. Without this initial lead, the case might never have been opened.

For this very reason, Customs maintains a strong relationship on forced prison and child labor issues with a broad array of international partners, from private companies operating overseas to nongovernmental organizations. We are ready to act, but we cannot do it alone. We need solid, credible information to open and advance our investigations.

Again, the Customs Service is committed to enforcing the laws that prohibit the importation of prison labor goods into the United States. In China and elsewhere, we will continue to pursue these investigations vigorously, along with a host of other enforcement priorities managed by our enforcement teams.

I wanted to thank you once again for the opportunity to appear today, and as I said, I regret that I have to leave, but Mr. Shruhan, at the appropriate time, along with Lesley, will be able to answer any questions that might arise in this Commission panel this morning. Thank you very much.

[The statement follows:]

PREPARED STATEMENT OF CHARLES W. WINWOOD

Commissioner Becker, Chairman D'Amato, members of the Commission, thank you for your invitation to provide a statement on the work of the U.S. Customs Service in China.

As part of its worldwide network of representative offices, U.S. Customs maintains an active presence in Beijing, China. As in all our foreign posts, Customs personnel in China serve as part of America's diplomatic team. Our staff coordinates its work closely with the State Department and other U.S. officials in country. We serve at the invitation of the Chinese government, and work in cooperation with China's trade and law enforcement personnel.

Our representatives in China cover a range of enforcement issues that include, but are not limited to: prison and forced child labor investigations; export controls; intellectual property rights; dumping; textiles; commercial fraud; and other transshipment cases.

Staff in Beijing are assisted in their work by employees based in our Office of Investigations here in Washington. Two Customs special agents and one intelligence research specialist support our global forced labor program, to include China, from Headquarters.

Turning to matters of specific interest to this Commission, as you are aware, the U.S. Customs Service is the lead law enforcement agency for investigations involving the importation of goods made with forced prison labor into the United States. Our primary authority derives from Section 1307 of Title 19, United States Code, which prohibits the importation of goods made wholly or in part with convict, forced, or indentured labor under penal sanctions. In addition, we enforce Section 1761 of Title 18, United States Code, the primary criminal statute prohibiting the importation of goods made with convict labor.

The investigation of allegations of prison labor is a high priority for the Customs Service. At the same time, these cases are often difficult to substantiate, and diplomatically sensitive. This is true not only for China, but for many countries in which Customs investigates charges of this nature.

We continue to work with the Chinese government to gain access to prison sites where the manufacture of goods with convict labor has been alleged. We have a Memorandum of Understanding and Statement of Cooperation in place that governs this process. Under that agreement, Customs must file site visit requests with China's Ministry of Justice. At the current time, we have a number of these requests pending.

As long as this situation remains, Customs has adequate resources in place in China to manage our workload there. However, should the number and/or geographic span of cases increase, we would likely be in a position to seek additional funding to meet our mission needs.

This has been the case, for example, in the area of child labor investigations. Customs has received resources from the Congress to post additional special agents at select foreign posts around the world as our activities in this field have expanded.

To date, we have substantiated three allegations of forced prison labor in China. The first involved the E.W. Bliss Company of Hastings, Michigan, which in 1992 pled guilty to charges of knowingly importing machine presses made with prison labor. The company forfeited the merchandise and paid a $75,000 fine.

In November 1994, the Court of International Trade ruled in favor of the U.S. government in a suit brought by China Diesel Imports. That company, which imported diesel engines produced by the Yunnan Machinery Company of China, was protesting the exclusion of its products by U.S. Customs, which had found evidence of prison labor in their manufacture, in violation of section 1307.

This past year, Customs investigated Officemate International Corporation of Edison, New Jersey, and a sister company, Allied International Manufacturing Corporation, or "AIMCO," located in Nanjing, China. The individual who owned both companies and several senior managers were convicted of transporting over a hundred million paper binder clips assembled with prison labor in China into the United States.

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For this very reason, Customs maintains a strong relationship on forced prison and child labor issues with a broad array of international partners, from private companies operating overseas to non-governmental organizations. We are ready to act but we cannot do it alone. We need solid, credible information to open and advance our investigations.

Again, the Customs Service is committed to enforcing the laws that prohibit the importation of prison labor goods into the United States. In China, and elsewhere, we will continue to pursue these investigations vigorously, along with the host of other enforcement priorities managed by our foreign teams.

I want to thank the Commission once again for this opportunity to appear today. I regret that I must depart immediately, but Don Shruhan and Lesley Anne Kessler of my staff will remain to answer any questions you might have.

Chairman D'AMATO. Thank you very much, Mr. Commissioner. We appreciate your coming and that strong statement. We will be glad to question Mr. Shruhan on that, and we look forward to a long relationship with you and will give you any assistance we can in developing the tools that you need to do the enforcement that is so necessary under these agreements.

Mr. WINWOOD. I would appreciate it. Thank you.

Chairman D'AMATO. Thank you. I'd like to move on now to Mr. Gordon Chang, who is a long-term partner with a major American firm in Shanghai. He has done some writing in the past on the Chinese economic situation and has just released a new book based on his experiences in China. We'll let you tell us about that, Mr. Chang. Thank you.

STATEMENT OF GORDON G. CHANG, AUTHOR AND ATTORNEY

Mr. CHANG. Thank you, Mr. Chairman. As you point out, the ink on my book is barely dry. It was released by Random House just three days ago.

I've lived and worked in mainland China and Hong Kong for most of the last two decades. My practice primarily involved corporate finance transactions, both debt and equity, but I also participated in litigation in the Chinese courts and other dispute resolution forums in China, and the book is based upon my experiences in China over the past 20 years.

I've been asked to summarize *The Coming Collapse* and I can do that in one sentence. The Communist Party of China will fall from power within the next five years, perhaps a decade, but probably the next five years.

For many people, this is a startling conclusion, because China presents the image of success. But I've come to this conclusion for a number of reasons, and the most important one is China's upcoming accession to the WTO, because China is not ready.

As the General Counsel Davidson mentioned, accession to the WTO will be significant. There will be many changes. Of course, the ones we will most see relate to the drop in tariffs. But also, China will eliminate many of the internal barriers to trade. It will ascribe to general WTO rules of fairness and non-discrimination. And perhaps most important, China will become a part of the dispute resolution mechanism which is based and administered outside China.

In the WTO era, the state-owned enterprises, which are the pride of Chinese socialism, will just not be prepared for the enhanced competition that accession will bring. Beijing has essentially deferred structural reform of the SOEs. There has been some window dressing. The SOEs look more profitable, but they are not more competitive. Some analysts say that in the years following accession, only a few of the approximately 1,100 Chinese companies that are listed on Chinese stock exchanges will survive. I don't know if the shake-out will be that horrendous, but certainly, there will be a change.

With state-owned banks, the story is similar. They have gone through two major recapitalizations, one in 1998 and the other in 1999 and 2000. Yet even after the recapitalizations, they still are insolvent and they're not prepared for accession.

Many people look at WTO accession and say, well, it really won't be that serious because of three reasons. First of all, China will cheat. Second of all, foreign investment will swell. Third of all, gross domestic product, GDP, will increase.

Will China cheat? Senior Chinese leaders tell us all the time that they won't, and I, for one, take them for their word. But just because I don't think that the Chinese leaders will cheat, that's not the end of the story, because there is a group in China, and it's a very large group, that will cheat. Every province, every city, every municipality will do everything it can to protect local industry in the WTO era, and much has been made of this.

I tend to think, though, multinationals, which have fought so hard for China's accession to the WTO, are not going to take this lying down, and I think the one thing that's important about WTO is that you don't have to listen to the bureaucrats anymore in the WTO era, and because of that, I think that eventually multinationals will prevail, if not in China, then certainly in WTO dispute resolution mechanisms, however flawed they may be.

So, in essence, I think that China will cheat, but I don't think it will be as major an issue as most people expect.

In terms of foreign investment, there will be some increase in foreign investment after accession, but I don't think the boom will be as big as people predict and won't last as long as they expect, because in China today, there's overcapacity in every industry segment except for telecommunications. Overcapacity in China is mirrored by overcapacity in the world today.

If you're a manager of the China operations of a multinational, one thing that you will want to do, of course, is have more foreign investment to take advantage of the emerging national marketplace. But if you're an executive in London, Paris, or New York, the compelling solution for you will be to use idle capacity outside China and export to China. That's the compelling solution and that's what WTO permits.

When the waves of imports flood China, I think that gross domestic product will not increase. I think it will decrease. It may decrease by one percentage point or two percentage points, and that may not sound like a lot, but China is already on the precipice and I think that just a small decrease can have a disproportionate impact on the stability of the government.

Today, the number of unemployed and underemployed workers in China is greater than the combined population of France, the United Kingdom, and Germany, and certainly WTO accession will aggravate the issue of unemployment.

To keep the economy going, the Chinese government is now engaged in a program of massive fiscal stimulus. It's been doing this for the last three years and it's been running budget deficits. Today, China looks financially solvent. For instance, if you look at the measure of debt to GDP, it's only 22.9 percent, and that's within the 60 percent safety mark that's recognized around the world.

But that 22.9 percent figure really does not adequately give you a good picture of what's happening in China because that figure does not include many of the central government's hidden obligations. So take, for instance, pension obligations, unfunded pension obligations. That's somewhere in the vicinity of $850 billion U.S., or by itself, 79.4 percent of GDP. Another set of hidden obligations are loans to the state-owned enterprises from the state-owned banks. Those loans are about $860 billion at the end of 2000. If you look at just those portion of the loans that are non-recoverable, that the state-owned enterprises will not pay back, that is about $490 billion.

You start putting these figures together, the $490 billion for the loans, the $850 billion for the pension obligations, and you come up with a ratio of about 147 percent, more than twice the internationally recognized safety mark.

So we look at all of this and we have to ask, what will WTO accession bring, and I think at the end of the day, in the next five years, when China is trying to spend its way out of problems, it's always going to be faced with the problems of worker unrest, so this next five-year period is critical.

It's also the five years when there's going to be a very important political transition in China. So when the government is at their weakest, the challenges will be at its greatest.

Many people have asked me why I wrote the book *The Coming Collapse*. Well, I think the discussion of the demise of the Communist Party in China is really long overdue. I, for one, and many others, were caught by surprise by the fall of communism in Europe, and this time I think that we should be better prepared. Thank you very much.

[The statement follows:]

PREPARED STATEMENT OF GORDON G. CHANG

Mr. Chairman and Members of the Commission, thank you for the opportunity to present my views.

I am the author of *The Coming Collapse of China*, which will be published by Random House next week. I have lived and worked in China and Hong Kong for most of the last two decades. I was a partner in the international law firm of Baker & McKenzie and counsel to New York law firm Paul, Weiss, Rifkind, Wharton & Garrison. During this period I specialized in major corporate finance transactions involving China's state-owned enterprises. In these transactions Chinese enterprises issued equity securities in China, the United States, and Hong Kong. My practice also included other types of transactions by which foreign parties acquired interests in businesses on the Chinese Mainland. Moreover, I have extensively participated in litigation in China's court system and in other dispute resolution forums in China. *Coming Collapse* is based in part on the knowledge and experience gained during my period of law practice and my travels throughout China.

These days China presents the image of success. Chinese leaders tell us that they're doing a great job, and they give us statistics that back them up. Foreign (non-Chinese) experts assure us that the People's Republic has a bright future.

We can all look at the potential of China and become giddy. We extrapolate, multiply, and then let our imaginations run wild. The consensus is that the Communist Party has found the right formula for sustained development. "China's stars have never seemed in better alignment," said one American economist in the middle of 2000. "China's time is now." Now that China has been awarded the 2008 Summer Olympics and is about to enter the World Trade Organization, who can be pessimistic about the most populous nation on earth?

Before we let our optimism overwhelm us, let's look at the facts. The facts point to one conclusion: China is a weak giant, not a strong one. I have been asked to summarize *The Coming Collapse of China*. That I can do in a few words: the Communist Party of China will fall from power within a decade.

Nothing in this world lasts forever, so predicting the fall of the Party and the republic it leads is not a major feat. After all, the People's Republic maintains an unsustainable economic and political system, so talking about its demise is long overdue. *Coming Collapse*, if it has any startling message at all, is this: the fall of the Party is near.

Why will we see great changes soon? China is not prepared for accession to the WTO. Its state-owned enterprises and banks are not ready for increased competition. The economy, in reality, is stalling, not growing fast enough. The result is worker and peasant unrest. The central government's finances are in bad shape, and one day the People's Republic could run out of money. But before that happens, the rulers of China will run out of something even more precious: time.

Accession to the WTO

In the past, the central government's deft handling of multinationals and private entrepreneurs resulted in the fastest economic growth in the world, perhaps the fastest the world has ever seen. Change was impressive, and the country is a far better place today than when Deng Xiaoping grabbed power from the hapless Hua Guofeng at the end of 1978. We shouldn't take anything away from Deng, but one point should nonetheless be mentioned. In his era, China was, as a practical matter, accountable to no one. It set the rules and administered the game. Therefore, it was able to achieve the desired results.

In the WTO era, the story will be different. Tariffs will drop and internal barriers to trade will fall, but those changes will not be the most important ones. From the day of accession China will be subject to the strict regime of WTO rules and its international mechanisms for resolving disputes. The changes in China will be dramatic. When China accedes to the global trading body, the country will no longer be the sole master of its own economy.

China, however, is not prepared for accession. In Beijing today structural reform of state-owned enterprises has been essentially deferred because there is a lack of comprehension of the seriousness of the situation. A little while ago Premier Zhu Rongji proclaimed victory in his three-year campaign to make SOEs profitable. A close analysis of the numbers indicates, however, that most of the claimed profits are the result of a fortuitous rise in the world price of oil and the availability of central government subsidies (such as the relief of interest expense). Moreover, we will never know to what extent fabrication has enhanced these statistics.

Yet we don't really need to sort the good numbers from the bad. The real issue is not the profitability of the SOEs. After all, under China's accounting rules, almost anything can be made to look profitable. In the WTO era we can forget about profitability because it will be competitiveness that counts. And despite their improved profit picture, most SOEs will not be able to compete. That's because China's state-owned enterprises have made relatively few preparations for WTO: they largely assume that Beijing's ministries will continue to protect them. The assumption is wrong, however. WTO is unforgiving, and accession will limit the ability of the central government to defer problems to the indefinite future. Therefore, some analysts believe that only a handful of China's listed companies will survive the first few years after accession. Maybe it won't be that bad, but one thing's for sure. The shakeout will be horrendous.

The story is much the same for the state-owned banks, which include among them some of the weakest financial institutions in the world. Insolvent and backward, these banks are kept afloat by the central government, which cannot afford to let them fail. The most recent recapitalization of the “Big Four” banks still left them straining under mountains of bad debts and nonperforming loans, so their rehabilitation is still beyond the horizon. Reform in this area has so far failed, and China’s commercial banking institutions are still not ready for the enhanced competition of the WTO era.

In short, many of China’s enterprises, and maybe even some of the banks, will fall by the wayside in the first few years after accession. So the consequences for the economy will be critical. Not everyone thinks that the impact of accession will be so severe, however. There are three main arguments why WTO won’t be so bad at first: China will cheat, foreign investment will swell, and GDP will rise.

Will China cheat on its commitments? Senior Chinese leaders tell us, every few days, that they will honor all the promises that they have made. Take them for their word: they won’t go back on what they said. Their honesty, however, doesn’t mean that compliance should be taken for granted because there is a group in China that will cheat. Every province, city, and town will protect local industry. They will employ traditional tactics as they seek to preserve the present. Powerful today, they will fail tomorrow. Multinationals will fight because, if there is one reason why WTO is significant, it is this: WTO means foreign investors don’t have to listen to the bureaucrats anymore. WTO rules will be enforced after all is said and done. Local officials will fight, but foreigners will eventually prevail.

Those who say foreign investment will mushroom are ignoring the realities of China and the world at large. China is suffering deflation because, except for telecommunications, there is too much capacity. Overcapacity in China is matched by overcapacity in the world today. China managers will want to build bigger facilities in country to take advantage of the emerging national market. But executives in New York, London, or Paris will want to export to China from existing factories. WTO means that tariffs will drop and local rules against distribution will lapse so that exporting to the Mainland will not only be a feasible solution but also the compelling one. Need proof? Volkswagen, with a roughly 50 percent share of the domestic car market in China, says that it will not be able to compete with imported cars after accession due to the scheduled reduction in tariffs. The world’s most efficient car plants are just two days away from China by ship. Even General Motors, which is committed to making parts and assembling vehicles on the Mainland, plans to import car parts and even whole cars into China in the future.

Bottom line is that there will be some increase in foreign investment, but the boom will be smaller than predicted and shorter than expected. So those analysts who foresee an explosion in foreign investment have misperceived the future.

When the waves of imports flood China, it’s unlikely that Gross Domestic Product will continue its current pace (whatever that actually is now). Accession will knock one or two percentage points off GDP growth. That means GDP, at least in the first few years after accession, will trend downward. Maybe not by much, but enough to be felt. China is perhaps at the point where the loss of a percentage point of growth would have a disproportionate impact on the urban proletariat and the peasantry.

Technocrats in Beijing, while tinkering with reform, have been able to maintain social stability in the big cities. Yet we must remember that in the smaller urban areas workers are restless. They used to demonstrate in the tens and hundreds. Now they protest in the thousands and tens of thousands. The trend is clear. If growth slips further, the central leadership will have to struggle to maintain order. Today, the number of all the unemployed and underemployed probably exceeds the combined population of France, Germany, and the United Kingdom. No one really knows what the actual figure is, but we’re talking about a social problem of large proportions. Despite what state media sometimes implies, there is no general safety net in the country for the unemployed.

Now let’s talk about the 900 million peasants. We don’t think about them very much because they’re hidden from the view of most visitors, but in the coming years they will be a force to be reckoned with. Like many of their urban cousins, peasants, or “farmers” to use the term favored by official newspapers, are discontented. They also demonstrate, and their acts of disobedience have taken on a desperate tone: barehanded peasants fight the armed security forces of the state. What does that tell us?

We hear central government leaders talk about social order and think that they’re obsessive, but they have good reason to be concerned about the stability of the modern Chinese state. Today, the state is keeping the economy going by massive fiscal stimulus, which means running increasing budget deficits. If there’s a river, technocrats will dam it. If there’s a pension, they’ll increase it. And when they find a patch of land, they build a highway. They do all those things to keep their economy going.

Now the situation looks manageable. The ratio of public debt to GDP in 2000 was 22.9 percent. That figure is well under the internationally-recognized safety mark of 60 percent. Public debt is not the end of the story, however. To figure out the true capability of the central government to borrow, one must add in pension obligations and indirect loans to the state, for instance. In a recent report Merrill Lynch suggests that the figure is 120 percent, but it's more than that for sure.

I think it's just shy of 150 percent. China's pension obligations are US$850 billion (or 79.4 percent of GDP). This is not the official estimate, which is unrealistically low. This figure comes from the respected Chinese Academy of Social Sciences (and is not the highest one that can be found). Finally, include nonrecoverable loans extended by banks and other financial institutions (other than the policy banks). These loans probably amount to approximately US$490 billion. I have assumed that half the loans in the banking system are nonperforming and that 20 percent of the nonperforming loans are recoverable (assumptions that are not the most pessimistic that exist). Add pension obligations and rotten loans to the amount of public debt, and one can begin to see the dimensions of the problem.

The debt to GDP ratio would, of course, be higher if we had reliable GDP statistics and if we had a better idea of all the obligations of the central government. We can quibble over the numbers, yet all of us will eventually arrive at the same stark conclusion: Beijing is running out of money and it is running out of time. It has just a few years, perhaps only five, to put things right.

Those are the five years when the negative effects of WTO accession will impact China. The country will be a beneficiary of joining the global trading organization, but the benefits come later after structural reform has had an opportunity to take effect. In the beginning, however, there will be the layoffs and business failures that accompany change. That's inevitable—China is curing decades of economic mismanagement. Analysts who assume that the road leads straight up from here simply ignore common sense. The next few years will be rocky.

We see all the change in China and assume that progress, in one way or another, must continue. We should not take further development for granted. The concern is not that China is doing the wrong things. Today one will find evidence of solutions that, with time and political will, could work. If China had decades, everything might come out right. But whether China is on the right road is not the critical question.

When the People's Republic falls, historians will say that there wasn't enough time. China's cautious—sometimes glacial—approach to reform is not suited to the severe problems it faces or, for that matter, a world where the pace of change is accelerating.

While the world speeds up, China crawls to the "tipping point," to borrow the phrase popularized by Malcolm Gladwell. Gladwell likens social change to epidemics, which begin with the smallest of events. "Things can happen all at once, and little changes can make a huge difference," he writes. So change does not occur gradually; it takes place in one critical moment. China, on the eve of membership in the WTO, will tip when something, and probably just an inconsequential event, goes wrong. In some small village or large town, events will get out of control. Mao Zedong said all it takes is a single spark to start a prairie fire. Now it is just a matter of time.

Politics Still Rule

The People's Republic could survive the upcoming transition if WTO accession were just a question of economics. After all, drastic situations usually breed drastic solutions. Yet one cannot discuss China's economy in isolation. To understand economic development in the People's Republic, we need to look at politics. There is one essential truth about the People's Republic: ideology still reigns in China, despite all the progress we have seen and whatever we may want to think. We should all remember Mao Zedong's infamous instruction to "put politics in command." Today's leader, Jiang Zemin appears more modern as does the party he leads. Yet his words remind us that the old system remains in place. "Talk politics," Jiang often says, evoking memories of the first days of the People's Republic.

In short, Jiang Zemin is returning China to an earlier time. We can dismiss his words, but we do so at our peril. The proof lies in what he is doing. The supposedly up-to-date Communist Party still engages in ideological exercises, most notably the Three Stresses (sometimes translated as "Three Emphases") campaign, which focused on studying Marxism, promoting righteousness, and being politically correct. The campaign had all the old elements of Maoist China, such as study sessions and group and individual self-criticisms. The Three Stresses campaign was soon followed by the more modern Three Represents campaign. Again, Party and government units were instructed to hold study sessions while important problems were left unattended.

Jiang's answer to China's pressing problems is to strengthen the Party. This is not mere talk: the Party is currently spreading its cells to all but the smallest organizations, including private businesses. All the Party building campaigns are reminders that the leadership of China will not let go of the past.

The Communist Party still believes that its destiny is to rule China for all time. As we see modern things in China, such as growing capital markets, we must remember that the Maoist system itself is not modern and has not been reformed. Beijing's leaders will continue to permit change, but they will do their best to prevent change that threatens their system. China's officials are, as they so often remind us, building socialism, not capitalism. They can permit temporary retreats from their ultimate goal, but the last thing they will do is abandon their ideology. When we grasp this fundamental truth, we can better understand what they do. And why their regime will not survive.

PANEL II DISCUSSION AND QUESTIONS AND ANSWERS

Chairman D'AMATO. Thank you very much, Mr. Chang.

Questions, Commissioner Wessel?

Commissioner WESSEL. I thank all the panelists for being here. I don't know how to respond, Mr. Chang, to your book and its thesis because I don't know whether we should be commending USTR and previous administrations for finding the tool to bring about the demise of the communist leadership, if that will yield worker rights, human rights, and democracy in China. So maybe this is a brilliant long-term plan over the last 13, 14 years to bring China in the WTO.

What do you see coming in the place, if the demise is within the next five to ten years? What do you think the result will be?

Mr. CHANG. Commissioner, my crystal ball is not quite that clear about what happens afterwards. As I mentioned in the book, I don't know if what happens afterwards is better or worse than what we have today, but the one thing I know is that the Chinese people will have hope.

Commissioner WESSEL. With the economy in turmoil, and if, in fact, as you pointed out, the question of what accession might mean to inefficient industries in China, what would be the seeds of economic growth that might come out of that, do you have any idea?

Mr. CHANG. Well, if you look today, there's a very vibrant private sector. It's not exactly clear how big it is. Maybe the best estimate is 45 percent of non-agricultural GDP is derived from the non-state sector. Certainly, any quick tour of a major city or even a small hamlet will show you that there are many families that are involved in small mom-and-pop businesses. So, clearly, there are the seeds of a vibrant private economy, and long-term, I think that's the only solution for the Chinese people and that's what, in fact, will happen. That will be the basis of the economy.

Commissioner WESSEL. Thank you. Mr. Davidson, unfortunately, several of our auto companies chose not to participate in our hearings today, so we don't have the benefit of their testimony, but during GM's negotiations on their contract to build facilities in China, allegedly they agreed that not only would they transfer $1 billion worth of technology to the Chinese, but they would also within ten years source all of their domestic production in China from indigenous plants in China, basically creating a massive parts production complex.

I know that the accession agreement deals with performance requirements. GM is not the only company with this issue. Boeing with offsets, a number of other companies have agreed on performance requirements. Are those existing contracts and agreements null and void when the accession agreement comes into play, or is it only prospective?

So GM's commitment to sole source out of China, and they've already, as I understand, started to import parts from China. Will they be given leeway on that? Will they not have to abide by that contract term once the accession agreement comes into play?

Mr. DAVIDSON. Well, I'm not familiar with nor aware of the GM contract, so I don't comment one way or the other on what it does.

Commissioner WESSEL. Then generally, if an existing contract is in place abides by the existing performance requirements, would a company not have to abide by that in the future if the accession agreement comes into place?

Mr. DAVIDSON. I don't know. Mr. McCartin, do you have a view on that?

Mr. MCCARTIN. We'll have to get back to him on that.

Mr. DAVIDSON. We'll get back to you, Commissioner.

Commissioner WESSEL. I appreciate that. From Customs, let me understand, and I know this also involves other agencies of the U.S. Government, in the last decade or so, we've seen a massive increase in the number of invasive species, and I think we've seen in the last year or so tremendous press interest in the Asian longhorn beetle, which I think has been attributed to imports coming from China.

What knowledge do you have of and enforcement tools do you have to understand what we're doing about invasive species, which have now attacked not only our hardwood products but many of our plant life, et cetera? That is a principal concern of some of our agricultural interests in the country.

Mr. SHRUHAN. First of all, I think the Department of Agriculture handles the invasive species that are coming in. We work with them at the ports of entry, and again, we will work with them trying to stop any invasive species that will be coming in. But I'd have to get back to you on exactly what we're doing because I'm not familiar with it.

Commissioner WESSEL. If you could, because as we've looked at the question of the Asian longhorn beetle, we tried to identify specifically where that was coming from so we could have preventive measures to treat the pallets, because these come in the wooden pallets that the goods come into the U.S. in, and found out that we had inadequate Customs information. For example, my understanding was as we looked at tracing some of the infestation in New York that Customs data only referred to the products coming into the Port of New York, even though, as I understand, it could be Elizabeth or two or three other ports.

Mr. SHRUHAN. Right.

Commissioner WESSEL. From what I am told, the Customs Service is engaged in a procedure now to reduce the scope of import data in light of their desire to computerize, which I think is certainly something that I and others support, but if you reduce the scope of the information that we have as to where the goods are coming from, not only which country, which areas in that country, but also the ports of entry here, our enforcement activities, I think, would be hindered, as well. Can you respond on that?

Mr. SHRUHAN. What we'll do is we'll have to get back with you, because I'm not sure how we're handling that right now, but we'll get back with you on that issue.

Commissioner WESSEL. Okay. Mr. Davidson, as I think Commissioner D'Amato referred to at the beginning, one of the operative provisions of the law under which this Commission operates asks us to include among our recommendations whether Article XXI should be triggered by Congress, used by Congress to address our security interests. Can you respond on the administration's view as to the possibility of doing that, the impact of that, and whether the administration would advocate the use of that?

Mr. DAVIDSON. Commissioner Wessel, I appreciate the question. I'm hesitant to respond on behalf of the Department of Defense, the State Department, others without first—first of all, at USTR, we're not the lead agency in those types of security issues, and so I'd be happy to help try to coordinate a response to you that would be a more definitive response than I would be able to give you today, so I'd be happy to work with you on that, but it may be counterproductive for me to offer something up at this point.

Commissioner WESSEL. If you could get back to us on that. I assume that USTR, though, would be the lead agency as this would be a WTO action, whether to trigger that or not.

Mr. DAVIDSON. Okay. I'd be happy to get back to you on that.

Commissioner WESSEL. And finally, seeing that the light is on, my understanding is that there is, with regard to the U.S.-Jordan Free Trade Agreement that was signed recently, that there was a side letter that the administration made public regarding how it intends to enforce that.

This Commission is required under the statute to present to the Congress both a classified and an unclassified report articulating the concerns and interests that Congress should be looking at. Can you provide to us any documentations, any side letters, memorandums of understanding regarding China's accession to the WTO, whether they are classified or unclassified, so that we can review those over the coming months to be able to ably provide information to the Congress.

Mr. DAVIDSON. Absolutely, Commissioner. We will work closely with you to make sure that you have the information you need to make the most informed judgment you can, and we'll make sure that that happens throughout the process of review.

Commissioner WESSEL. Thank you.

Co-Chairman BECKER. Thank you, Commissioner. Thank you for your willingness to provide that coordination in response to us.

Commissioner Dreyer?

Commissioner DREYER. Mr. Chang, I enjoyed your book tremendously.

Mr. CHANG. Thank you.

Commissioner DREYER. I happened to read it right after I read the book *Hegemon* by Steven Mosher and it's very interesting how different a picture the two of you draw. His book is also well written. Is this just a case of different people feeling a different part of the elephant, the blind man with the elephant, or can you elaborate on what makes your vision of China so different from his, which, for the rest of you, who have not read Hegemon, is of a growing powerhouse that will eventually overwhelm Asia and be the rival of the United States?

Mr. CHANG. Commissioner, it's a big elephant or a big dragon, and maybe we are looking at different parts of it. It is very difficult, because people see China, and China has an image which it works actively to show to the rest of the world. I lived in Shanghai for about the last four and a half years and just saw something different, and the reason why I wrote the book on a very fundamental level was I was reading what foreign experts were writing about the People's Republic and that just didn't correspond with what I saw around me in Shanghai day to day. And so I got agitated enough and said, well, I want to set the record straight, and then it became a passion which then became a book.

So in that sense, I think that many people can see in China very different things, but certainly the regime tries to present an image of itself to the world which I think is quite different than the reality.

Commissioner DREYER. And you mentioned vibrant civil culture that's on the verge of emerging. People have made the argument that, in fact, what China has is a very different kind of capitalism than is in the West and that rather than having the entrepreneurs pushing the government to make certain decisions, it's the other way around, that Chinese capital is very heavily dependent on official patronage and on zhongnanhai and so forth.

Would this, in your view, disappear if the Communist Party collapsed, or would—I realize this is a predictive question, or would the institutions that were set in place by the Communist Party, in other words, the bureaucrats directing the capitalists, would those institutions and practices be likely to survive?

Mr. CHANG. Either could happen. My guess is that they wouldn't survive. There are many different Chinas for us to see. Many of the private entrepreneurs, especially the more successful ones, are very dependent on the party for patronage and for all sorts of things that you mentioned in order to continue their businesses. And so, in a sense, they really are not a force for change, or at least they're not as much a force for change as we would otherwise think.

On the lower level of the economic order, you have, as I mentioned, the mom-and-pop businesses and those operate in a very sort of brash capitalistic type of society. But in general, the leadership tells us, and we have to take them for their word, that they are building socialism, not capitalism.

They're Marxists and they believe that there is a precise order to history and that many of the Marxists, including Jiang Zemin, the president himself, have said, well, look, you know, we skipped over a phase of history, which was capitalism, because Marx said in the traditional way you go from an agrarian society to capitalism and then to a perfect state of communism. What Mao Zedong tried to do was to get over capitalism in four years and it didn't work, and so what they're saying is, well, to get back to the perfect communist state, we have to go back to capitalism, which is sort of like adolescence, you know, one of those awkward phases, but you have to go through it nonetheless.

So I wouldn't call the economy capitalist the macro-level, but certainly at many levels, it is a very capitalist economy, but only at the bottom.

Commissioner DREYER. Thank you. For Mr. Davidson, the problem of WTO accession looms—we've had witness after witness say that you cannot expect China to comply, and for some of the reasons mentioned by Mr. Chang. Maybe the leaders want to, but the lower levels have every incentive to cheat.

In your deliberations on the WTO provisions, have you as a group discussed this matter? It seems to me on other issues, such as proliferation, this is this tendency for successive administrations to believe what the central government is saying. We don't know anything about how those missiles disappeared and how they ended up in Iran, or no need to impose sanctions because Pakistan didn't pay a lot of money for those ring magnets, that sort of thing.

Have you discussed what will happen if you catch the Chinese government doing something like this and you get this, well, we didn't know it was happening, you know, I didn't know the gun was loaded and therefore I'm innocent, and what would be done?

Mr. DAVIDSON. Yes. As I mentioned before, I'm not competent to speak to the security questions, and so I'll leave that aside for the moment. But in trade matters, we expect the Chinese to comply and we have every expectation that at every level, they will comply, and that we will hold them to that.

Now, is this just a matter of trust or do we actually have some mechanisms in place to enforce that——

Commissioner DREYER. Exactly.

Mr. DAVIDSON. —and I think that's what your question is, and the answer is the latter. We are designing mechanisms to put into place to ensure compliance, and at the first level, to be able to detect noncompliance and then do something about it.

How are we going to do this? Well, we continue to work with the Chinese since 1999 in terms of complying with the 1999 agreement, and what we are doing is reviewing laws and regulations as quickly as we can. Now, there are going to be hundreds of laws and regulations at the local and national levels that need to be revised, changed, repealed altogether, and that's a massive undertaking and we're doing that expeditiously.

But for the phase-in periods, there's going to be a number of review mechanisms put in place. Every year, we are going to have an annual multilateral review mechanism which is going to be serving as the main enforcement for that. As I mentioned in my testimony, we are also going to rely on the Agriculture Department, Department of Commerce, American businesses, Chambers of Commerce in China to be able to relay instances of noncompliance to us as quickly as possible.

And then, very quickly, we have added a number of resources within USTR specifically. Within my office, the General Counsel's Office, I have just completed the hiring of six attorneys, positions that were available when I took my office in February, and have hired a number of people to specialize in this area. Mr. McCartin could detail for you later—I see my time is expired—but can detail later some of the other personnel steps that are being taken.

So a number of multilateral mechanisms are going to be put in place for the annual eight-year reviews and the tenth-year review as well as these kind of, I'd say, more informal mechanisms that we will rely on to give us information about noncompliance.

And then in terms of enforcement, we have our own U.S. domestic laws, as I mentioned. We have WTO enforcement mechanisms. And we have a number of other bilateral relationship or multilateral relationship mechanisms outside the trade sphere, as well. So those are all means of both finding out whether there is compliance and then, ultimately, ensuring it.

Chairman D'AMATO. Thank you very much.

I want to call on Commissioner Bryen, but I want to follow your comment up with one statement. I want to read to you a statement and see if you agree with it.

The U.S. has foregone its usual practice in reviewing in detail all the drafts of laws that would have to be passed to implement China's trade commitments, a practice presently applied toward Russia in its attempts to enter the WTO. Instead, the U.S. is, according to this statement, favoring a strategy that relies on explicit commitments in the Working Party Report and sets up an intensive review mechanism after China joins the trade body. This strategy is a reflection of both the pressures to find the most practical way forward on China's accession agreement and also China's unwillingness to share information on how it will change its laws in order to comply with WTO commitments. For example, China has not shared draft revisions of laws on antidumping or regulations in the telecommunications sector.

So I guess the question is, here, we're talking about the emphasis on the rule of law. As General Counsel, is it concerning to you that we may be moving too quickly in terms of reviewing laws in place and that the Chinese may be encouraged to drag their feet in putting into place laws to implement this agreement?

Mr. DAVIDSON. Commissioner, let me start by saying I think the positive reinforcements that will happen from the rule of law provisions, the transparency provisions that the Chinese have agreed to generally are going to have beneficial effects throughout the Chinese society, both for foreign companies that are trading and, I think, domestic Chinese businesses, as well.

In answer to your specific question, the reforms that need to be undertaken in China are enormous—hundreds of laws, regulations, national, local regulations, and many of these responding to the phased-in commitments that are going to be happening over the next several years. A pre-review of all of those and an expectation that they would provide us all of the local and national regulations and laws, the final ones that would be in place, was not feasible up front.

However, significant progress has been made. We are making significant progress, and I mentioned to Commissioner Dreyer both the monitoring compliance and enforcement efforts that we're going to be taking to make sure that those commitments are made on time and that we are reviewing those well in advance of the deadlines for compliance so that there is both the strong expectation and commitment from the Chinese that they be put in place.

So we are going to, again, continue to make our yearly reports on each of these as we kind of move through the phase-in period. Yearly reports to Congress and the monitoring efforts will hopefully turn up any problems well in advance of deadlines so that we can respond accordingly.

Chairman D'AMATO. Thank you very much.

Mr. Chang, do you have any comment on that issue of the rule of law and the putting into place of adequate laws to enforce these agreements? Do you have a feel for that?

Mr. CHANG. I don't think that one agreement to join the WTO is going to negate a culture and history of 5,000 years. There is no rule of law in China. The party talks about "rule by law," where they have a law for everything, for every dissident, for every union member, for every individual, and these days, actually, the United States Government, of course, is trying its best to promote the concept of the rule of law in China and those efforts are commendable.

But the senior party leadership in its most recent crackdown is now talking about the "rule of virtue" as opposed to the rule of law, and it's also talking about the benefits of collectivism over individualism. So we're moving in the wrong direction in general.

In terms of WTO and specifically what central government officials will do, I think they will drag their feet to the extent that they can. As I said, I think that they will honor their commitments to the letter, though maybe not in the spirit, and I think that we will have difficulty, especially at the provincial and municipal levels.

Chairman D'AMATO. Thank you. Commissioner Bryen has a question on customs, which is an agreement which is in place, a rule of law in place between the two countries.

I want to make it known to the Commission, those Commissioners who don't know, that we have with us in the audience a woman, Alicia Zhao, who met privately with the Commission earlier last month and is a permanent resident of the United States but a Chinese citizen who, unfortunately, returned to China to visit her family a year and a half ago and found herself thrown into a detention center in a forced labor situation. Apparently, detention centers of this kind under Chinese law are not supposed to have forced labor and do not fall under the agreement, apparently, that we have signed with them. But Ms. Zhao has submitted to the Commission, at our request, a statement of her experience, which is available in the back and she's certainly available to talk to people about that experience.

[The statement follows:]

PREPARED STATEMENT OF ALICIA ZHAO

Dear Commissioners: My name is Alicia Zhao. I am a marketing professional and a resident from California. I am here today to share with you my experience of being illegally detained in China and being forced to make plastic hair brushes, which were known for export.

Right before Christmas in 1999, I was on a vacation trip in Hong Kong and then crossed the border to Shen Zhen, China. Just because I was affiliated with a local Falun Gong practitioner, whose family hosted me, I was arrested the next morning around 5:00 a.m. by 6 policemen. They took away my passport and airplane tickets, and started to take turns interrogating me. At 11:00 p.m., I was told that I would be sent to the Futian Detention Center for 15 days of "administrative detention" as I had "violated the public order." I asked to call a lawyer, as I didn't go to any public places, not to mention violating the public order. My request was of course denied.

I was deprived of all my belongings including shoes and eyeglasses, and was thrown into a cell crowded with 40 prostitutes and drug addicts. I was bare feet, had to sleep on the cement floor, and share a filthy thin blanket with 2 other prostitutes. Each day, we were provided with only 2 simple meals—the leftovers from the detention center staffs would be charged at a premier as they were considered better food. The meals were delivered through a 8 inch by 11 inch rectangular hole on the wall. It is the very same hole that garbage was pushed out from the cell.

On these little food, we were forced to work at least 14 hours a day. Each one of us had to make 70 plastic hair brushed each day, even on the weekends and during Christmas holidays. The plastic needle studs easily picked our fingers to blood as we pushed them into the holes of the hairbrush base. If one couldn't meet the quota, one would be deprived of sleep or punished. I witnessed a prostitute being dragged out of the cell via hair by a guard and was beaten severely. I also witnessed inmates being penalized to stay up the whole night making hairbrushes as they missed the quota. The inmates in the other cells made shoes for export. We had to count the shoestrings for them and bundle them accordingly.

One inmate who studied the Chinese law after she was imprisoned told me that according to China's own law, people who had not been sentenced, such as those in detention centers, were not supposed to do labor. However, the reality is the detention center set the "unofficial" law for itself. Once you are in their hands, you are at their disposal. None of the inmates dared to reveal the actual forced labor situation to outside visitors at the detention center, as the guards threatened to prolong their jail terms and to beat them if they did so.

As a matter of fact, the Futian Detention center had built a model cell with all white porcelain bricks for the interior walls specifically for the show tours. Inmates were told exactly what to say to answer the questions from outside visitors. All the shoes, hairbrushes they were making would be hidden from the visitors. New blankets, new cups and toothbrushes would be sent to the cell to replace the old ones. However, as soon as the visitors left, all the new blankets, cups, etc. were taken away, and things returned to the original state.

Many Falun Gong practitioners imprisoned at detention centers and "re-education labor camps" were forced to do hard labor and were tortured. We call on the U.S.-China Commission to do investigation on those cases and to help rescue the Falun Gong practitioners persecuted in China.

Thank you.

Chairman D'AMATO. Commissioner Bryen?

Commissioner BRYEN. Thank you, Mr. Chairman. I want to talk to Mr. Shruhan about the forced labor issue. I read and listened to Mr. Winwood's statement, and frankly, I found it very disturbing. Let's go back through it.

From 1992 to the year 2000, the Customs Department has substantiated three allegations of forced labor. From 1994 to the year 2000—that's how I read this—they didn't do anything. Were there no investigations during that period?

Mr. SHRUHAN. No, there have been several investigations. To date, I think, we have had approximately 84 criminal investigations of prison labor, and currently, right now, I believe there are 18 open investigations in our office in Beijing, China.

Commissioner BRYEN. But so far as you have been able to determine, of these 84 cases, take away 18 that are still under review, only three have been found to be involving forced labor?

Mr. SHRUHAN. Well, no. We've issued detention orders, I believe, for 20—we have currently 20 detention orders right now for if any goods come into the country from these prison camps, then we would stop those goods. We would have them detained. So we have reasonable suspicion to stop those goods from coming into the United States. So we do have those 20 detention orders ongoing right now.

Commissioner BRYEN. Now, the detention order is in place during the period you conduct the investigation, is that how it works?

Mr. SHRUHAN. They can be, if we have reasonable suspicion to show that the goods that that prison are manufacturing were made with forced or prison labor and that are being entered into the United States.

Commissioner BRYEN. I got the impression in listening to the testimony that—you used some language that seems to suggest you have to have solid evidence, credible evidence, reliable evidence, and then the only evidence you seemed to like was a videotape that someone made of one of these prison camps. Someone must have risked their life to do that.

Mr. SHRUHAN. Well, first of all, Mr. Winwood was right. We are looking for individuals, we're looking for any type of information that can substantiate or tell us where forced labor in goods that are being manufactured in China that have a nexus in the United States, because we will vigorously investigate it. Again, we have an agreement with the Chinese. We have a memorandum of understanding that we signed in 1992 and a statement of cooperation in 1994 that we will, again, work within that framework of providing them the information and asking either to visit the factory or to ask them to do an investigation and report back to us.

Commissioner BRYEN. Isn't someone who has seen or witnessed forced labor sufficient to stimulate an investigation by the Customs Service? Wouldn't that be enough?

Mr. SHRUHAN. We would like to interview them. We would talk to them and we look at each case on an individual basis. The lady that we just heard about right now, we would like to talk to her, yes, and then we would evaluate that case——

Commissioner BRYEN. She's right here.

Mr. SHRUHAN. Yes, and we will do that. We have a headquarters task force on forced child labor and prison labor, a task force in headquarters, and we would definitely like to talk to her.

Ms. KESSLER. If I could just jump in here for just one moment to respond to what you were saying, and again, I'm sorry, my name is Lesley Anne Kessler. I'm with the Chief Counsel's Office at Customs and that's what I'm here to assist on, any legal questions today.

I think what Mr. Winwood was referring to in his statement is that the law we're enforcing is Section 1307, which prohibits any goods made with forced or convict labor from entering the United States. We have to pursue these investigations with an eye towards challenge in court. Keeping that in mind, it's very important that our evidence is credible and that it's strong.

An example of this is the China Diesel case, which I'm sure you're aware of. That's one of the three cases, court cases, that you were mentioning. The Court of International Trade did look at all the evidence and really scrutinized our evidence to finally determine that we did have enough evidence to exclude the merchandise from the United States.

So when we pursue these investigations, I think Mr. Winwood was trying to say that what we want to have is strong and credible evidence. If there is information that forced or prison labor is occurring, obviously, the Customs Service would be very interested in knowing of that information and pursuing that information.

Chairman D'AMATO. Could you identify yourself? I'm sorry.

Ms. KESSLER. Lesley Anne Kessler. I'm an attorney with the Chief Counsel's Office.

Chairman D'AMATO. Thank you.

Commissioner BRYEN. Well, it's understandable that you'd want to be able to protect a decision that the Customs Department made in court, but on the other hand, it's hard for me to understand why there have been so few successful actions taken so far, given the fact that it's widely reported that there's a pattern of this kind of abuse in China. That's, I think, the fundamental point.

I have a question, and maybe you can answer this one. When a good is imported from China to the United States, is there an import certificate, typically? Does it require some kind of documentation?

Ms. KESSLER. You know, I'm not aware that there is. I can certainly check to make sure that that's——

Commissioner BRYEN. I hope there is, and do they have to—would it be reasonable, given what our laws are, to ask them to certify any good that's imported into the United States was not a product of prison labor?

Ms. KESSLER. Certainly, it would be reasonable to request certification. However——

Commissioner BRYEN. I'm trying to find a way to turn the process around a bit, put the burden on the Chinese rather than on American courts.

Ms. KESSLER. Right. The problem that we still run into, though, is that if we want to prohibit goods that are made with prison labor coming into the United States, we still have to verify that that certification is valid, and if they're just issuing certifications which are not, in fact, truthful, we're in the same situation that we were prior to having the certification.

Commissioner BRYEN. But if you have witnesses—that comes back to this issue of what are the standards here and what is reasonable, credible, and reliable evidence. If you have eyewitnesses who are ready to go to court with you, I mean, I think we need to challenge the Chinese and say, you have to come now and bring your witnesses to our courts. I'd like to turn the process around, in effect, and I think the law gives us the latitude to do that so that we can put the pressure.

Look, no one likes forced labor. It's a terrible thing. We've had evidence in this century, whether we talk about what happened in the Soviet Union, we talk about what happened under the Nazis, I mean, some terrible things happened to people, some of which is still being sorted out even as we speak. So the more pressure we can bring on China about this, the more it will become unfeasible for them to continue it, and we want it stopped. So that's why I'm asking these——

Ms. KESSLER. I certainly understand your point——

Commissioner BRYEN. —more vigorous about this.

Ms. KESSLER. Yes, evidence of that nature that you've described certainly would be extremely helpful in a litigation situation.

Commissioner BRYEN. I mean, what Customs ought to do, and maybe you agree, is to review the procedures and to think about requiring on import certificates a declaration that these goods are not made in any forced labor situation, pursuant to our law, and they have to certify. That's what I'm trying to get at. I think that would be helpful, because then we can use people who come forward in this country who have seen some of this, or even people who come forward elsewhere who have seen some of this that are willing to testify, we could put a lot of pressure on stopping this kind of situation.

Ms. KESSLER. It's a valid——

Commissioner BRYEN. I would like to push that idea and hope you will take it back with you.

Ms. KESSLER. I certainly will take your thoughts back with me.

Commissioner BRYEN. Thank you, Mr. Chairman.

Chairman D'AMATO. Thank you. Did you have a comment?

Mr. SHRUHAN. If I could just add, I would like to talk to the lady, but one of the things that happens, once we get the information, we can only look at forced labor that is imported in the U.S. That's the only thing, as a U.S. law enforcement agency, it has to have a nexus to the U.S. So if they are producing goods that are forced labor and are not going to the United States, U.S. Customs does not have jurisdiction.

Commissioner BRYEN. I understand that, but I'm sure we could persuade our colleagues in Europe to object to similar practices.

Mr. SHRUHAN. And we try. We have an outreach program where we do try to talk to as many people as possible, and if they have that information, we would love to get it.

Chairman D'AMATO. Mr. Becker, do you have a comment on this?

Co-Chairman BECKER. Yes. I don't want this to drift away and have a big gap before I have a chance to come back into this. We have at this table Customs and we have USTR. USTR is in the position right now of negotiating with China. Critics of PNTR and critics of China's accession into the WTO have documented and testified without end about the slave labor camps. We have had testimony not only before this Commission but before the Trade Deficit Commission and I know they've testified before Congress that there are over 1,000 slave labor camps in China, 99 of which are listed in Dunn and Bradstreet as manufacturing entities. This is not a secret. This isn't something that you have to discover.

I mean, we're sitting there at the table. I think we're on the same side. At USTR, have these questions been raised with your counterparts that you're negotiating with? Don't they have to verify? Don't we have to clean the deck, so to speak? Don't they have to say that these camps are nonexistent? Can we go into China and visit these slave labor camps?

Harry Wu has testified that he worked as a steelworker. The prior panel mentioned this, that he worked as a steelworker for 17 years in a slave labor camp—as a steelworker, repressed labor. I mean, textiles, people go in and risk their lives and go into factories in which women are forced to work in textile mills and factories. They traffic in women. I mean, this is not something that we have to discover and be surprised when they ship into the

United States and expect somebody to expose each one of them. We should be doing this now.

It sounds like I'm making a speech. I'm raising a question to USTR. Are you involved in this, and what are your comments on this?

Mr. DAVIDSON. Commissioner, I have been at USTR for a short period of time, but my understanding is that these issues have been discussed at length, and I think throughout the Congressional debate on PNTR and others, the concerns over these issues have been, I think, raised and have been well documented in the United States and elsewhere.

So the comment that I would make on this, and we'd be happy to get back to you with some information from those who have been in these negotiations over the last decade or so on various market opening opportunities in China and the arguments that we have made with the Chinese. I'd be happy to provide that information.

But I would make the general comment that it is the hope of those who, I think, had supported PNTR and of the Administration that these market opening opportunities will both be an effective way to open up the Chinese economy and to provide some opportunity for positive influences in this area, whereas we might not have those opportunities if we did not engage in the market opening exercises.

I have not been at the negotiating table over the last several years, but I'd be happy to get you in touch with those who have so they could provide you with the arguments that we've been making, because I'm certain that they have been happening.

Co-Chairman BECKER. Along that line, if these have been discussed by USTR and we've talked about specific places, should not that information go directly to Customs so that they could take action against those companies at that time?

Mr. DAVIDSON. It's a valid point. I'm not sure about specific instances that have been raised by USTR. Clearly, as a matter of concern, the issue has been raised. And again, I'd be happy to detail or go back and determine what kinds of interagency cooperation takes place in terms of processing information that comes in or that USTR or other agencies receive and what we do with the information. I'd be happy to get that interagency process back to you so that you can determine whether that's satisfactory or not.

Co-Chairman BECKER. And to the contrary on Customs, shouldn't you be pressing the USTR and these agencies that are involved in this kind of a discussion with China?

Mr. SHRUHAN. First of all, we are involved. We are meeting with a number of U.S. law enforcement and Federal agencies to try to—NGOs—trying to identify factories that are producing goods with forced labor that are being imported in the U.S. We have a procedure that we go through. As I said before, we have an MOU and a statement of cooperation with the Chinese.

The procedure is that once we have that information that you referred to, we then send it—our Customs attached office in Beijing will send a letter to the Ministry of Justice requesting either a visit to the factory to determine what is transpiring there so we can either refute or substantiate the allegation, or we ask the Chinese to do an investigation and report the facts back to us.

Chairman D'AMATO. Thank you, Commissioner. I think that it's the sense of this Commission that we would appreciate it, Commissioner Shruhan, if we could get from Customs in writing what additional tools and resources you think might be appropriate so that we can help assist you in getting to improve the enforcement provisions of your mandate in terms of these relationships, and including also whether or not the definitional terms in the various legal agreements and the memoranda that you have are sufficient to encompass all the facilities that might exist that produce goods for export from forced prison labor. It may not be called a prison. It might be called a detention center, but whatever.

Commissioner BRYEN. Mr. Chairman, maybe we could revisit this this fall and see if we can look at various solutions, because I'm concerned about the way this is being handled.

Co-Chairman BECKER. Mr. Chairman, if I might, the reference to the 99 slave labor camps that are listed in Dunn and Bradstreet as manufacturing entities, do you have that list?

Mr. SHRUHAN. I don't know if we have the one in Dunn and Bradstreet. We have the Lao Gai book, 1999–2000. Yes, we do have that and we are in the process of going through. If it has that they're producing goods that are being exported to the United States, we're looking at those factories and then see if they are, in fact, importing into the United States. If they are, then we'll start looking into it again on each one of them on a case-by-case basis to determine if we can do something about it, and then we would get with the Chinese and follow the system that I just described. So, yes, we are looking at that.

Chairman D'AMATO. Thank you very much.

Commissioner Lewis?

Commissioner LEWIS. I'd like to thank the three of you for coming here and helping educate us about what's going on. I have a question for each of you.

As far as the USTR, when we enter into a trade agreement, we have certain expectations of what will occur in terms of what it will do for consumers here, what it will do for businesses here, what it will do for workers here, what it will do for workers in the other countries where we're getting the goods from. Would it be a good idea to require an impact statement to be made before the trade agreement is finalized so that the people who are passing these laws and negotiating agreements know exactly what's expected and then we can gauge the experience of what occurs versus what was expected to see if we really realized what we thought would occur? That's a question for you, and I want to ask each of you a question and then you can respond.

As far as Mr. Shruhan goes, in reference to what Mr. Bryen was saying, shouldn't the emphasis be different? Mr. Winwood was saying we need leads to start the investigation. Now, some of the apparel factories overseas have joined organizations or American companies have joined organizations which allow inspections at any time. Shouldn't we require that in order for goods to come here, into this country, that the factories be inspected not when we have leads of slave labor, but that you have the authority to inspect the factory before the goods are certified to come in here?

And I'll give you an example. I used to be in the shipping business and I know that before steel could be used in the manufacture of ships, the American Bureau of Shipping, the Lloyds' Register of Shipping had to certify the steel was being made in accordance with their requirements before the steel could ever be used, not that somebody had to give them a lead that it wasn't being done.

Shouldn't you have the authority to inspect not when somebody gives you a lead, but in order for the goods to come in here, that you have to certify that it is not made with slave labor? Wouldn't that give you greater authority so you don't have to wait for the leads? That's the question for you.

And then for Mr. Chang, the question I have for you is, you indicated that the Communist Party will collapse within five or ten years, and the question is, what do you foresee taking its place, because just because there's no Communist Party doesn't mean that the nationalism that might result wouldn't also be antithetical to our interests, and do you think that the Chinese government today poses a questions to the United States? That's my threat for you.

Why don't we start with you——

Chairman D'AMATO. There will be seven minutes on these.

Mr. DAVIDSON. Thank you, Commissioner Lewis. I appreciate your thoughts. I think that when we do enter into trade agreements and we begin discussing whether a trade agreement would be beneficial to the United States or not, I think there's a thorough-going discussion of the impact on jobs, workers, farmers, other folks here in the United States, and that that's a very helpful process.

As you know, when we're under what was known as fast track laws in the past, there are requirements for an exchange of information between Congress and the executive branch, and, in fact, requires something that we should be doing anyways, which we probably would be doing anyways in the absence of those requirements, close consultations with Congress at every stage of the negotiations.

As you know, the administration is seeking trade promotion authority from Congress and is discussing with them the close consultations that will need to happen between Congress and the executive branch and we think it is absolutely essential that there be that kind of close relationship, talking about the impacts and the expectations of each of those agreements before we enter into the agreements. That's——

Commissioner LEWIS. But I don't mean for this to be held secret. Shouldn't it be publicized to what the expectations are, because my understanding is that NAFTA was sold on certain expectations which have not been realized.

Mr. DAVIDSON. Well, actually, I don't think that they're secret deliberations with Congress. I mean, I think they're meant to be fairly public, and, in fact, as you've seen over the last 15 or 20 years, these discussions are very public, both within the chambers of Congress and on the front pages of the newspapers. And so I think that there's a very active exchange and discussion, and that's a healthy thing, about what the expectations are, and then people can judge whether the——

Commissioner LEWIS. So you're saying impact statements essentially are being done today?

Mr. DAVIDSON. Well, I think that there is a—we're certainly willing to consider any variety of options and we'd be willing to talk about that. Exactly how it's implemented, whether it's a formal statement or how we go about doing it, I would be happy to look at that because I think it is important that people understand the benefits of trade and I think it's good for the trade agreements when they come back to say that, okay, here are our expectations of what it's going to do——

Commissioner LEWIS. And then to have assessments later as to whether they're realized.

Mr. DAVIDSON. And we can go back and see whether they've been realized or not, and I actually would not differ with you on the impact of the NAFTA agreement, although you didn't offer any specifics. But I think you could go back and look at a lot of the expectations——

Commissioner LEWIS. I'm sorry to have to cut you off, but I want to get Mr. Shruhan's answer. Thank you.

Mr. DAVIDSON. Okay.

Mr. SHRUHAN. First of all, also, I talked before about how we get the book and we find out they're imported to the U.S. Then we have to send a letter to use the procedures that we have.

The Chinese have not been adhering in providing us the information as required in the MOU or——

Commissioner LEWIS. No, I'm asking, shouldn't you have the authority before something's allowed to come in here, not when you get a lead, but in order to certify that factor as being okay to sell to America.

Mr. SHRUHAN. I think that's something that we could consider. However, if it proved to be false, we'd have to start an investigation. Then we'd be back——

Commissioner LEWIS. It's not a question of being false. I'm talking about not having leads. In order for a factory to sell goods to America, you have to——

Mr. SHRUHAN. Certify.

Commissioner LEWIS. Yes.

Mr. SHRUHAN. Right. And again, how are we going to verify that?

Commissioner LEWIS. You go visit them.

Mr. SHRUHAN. Well, again——

Commissioner LEWIS. Unannounced.

Chairman D'AMATO. You'll accompany them, Commissioner Lewis?

Mr. SHRUHAN. —we are in China at the invitation—you know, our three agents that are in China are at the invitation of the host government. We are required to use the framework of the MOU in the statement of cooperation. That's the way we have to operate. That's what we've agreed to, we have signed.

Commissioner LEWIS. So maybe the MOU should be changed.

Chairman D'AMATO. I'm going to have to cut you off here. Your time is expired.

Commissioner LEWIS. Okay.

Chairman D'AMATO. Commissioner Robinson?

Commissioner ROBINSON. Thank you. Chairman D'Amato preempted my question to Mr. Davidson, another sign of his sound judgment——

[Laughter.]

—but I must say, I was somewhat troubled by the same point and the USTR response. Namely, it sounded to me like it was an explanation vis-a-vis not going through what admittedly are a myriad of local and national adjustments to statutes of an implementing nature for WTO.

It sounded like the explanation was, "it's just too hard," when, in fact, it sounds to me, and I'd like your comment, to be a different matter, namely China's straightforward unwillingness to share information on how it will change its laws in order to be in compliance with WTO commitments. I mean, that strikes me as the more plausible. We do very hard things, even if there are thousands of them, every day in this country.

And it likewise sounds as though the U.S. response at the end of the day has been acceding to what we might term a standard Chinese admonition, you know, "trust us" at the top, leadership levels, and don't worry about those tedious details like the system of verifiable laws.

So that's my concern that echoes those of the Chairman and I just thought we might get your reaction to that.

Mr. DAVIDSON. I'd be happy to, Commissioner. I appreciate the opportunity to address that.

I think, as I mentioned before, and again, not meaning to say that that's so hard so let's not try to do it, but we are not going to trust Chinese compliance. We have, as I mentioned, several layers of both processes and mechanisms to make sure that compliance happens. We're going to be putting in place the monitoring resources that we need to put in place to make sure that we know whether they're proceeding in a timely manner to meet these requirements or not.

They know what is required of them at the end of the day, and the most important thing, I think, is to get their commitment to that end point and to say, this is what you need to live up to. It is very important how they get there, but I think the most important thing is getting the assurances that they ultimately will get there.

Now, we've been in a process of going through, as I mentioned, the hundreds of laws and regulations and things in kind of a prioritized basis of which are the most important to get down and I think that we've been making some substantial process. I was not in Shanghai with Ambassador Zoellick, but I understand that there are a number of discussions there that can be characterized as significant progress along these lines.

I think the most important point to be made here is that we have this tiered enforcement and systematic monitoring process in place to make sure that they're not saving everything up for the fifth year to say that, okay, we know we had to meet this, but, you know, gosh, there are 100 laws that we have to do yet and we just can't make it. We're not going to let that happen. We're going to be riding the process and make sure that these things are addressed in a timely basis.

I think another point to be made is that—well, I'll leave it at that for the moment because I can see you have a follow-up.

Commissioner ROBINSON. I do, and I'll thank you. Actually, I just wanted to move down the panel, if I could.

Mr. Shruhan, does Customs employ or have access to, and I presume it does, national sources and methods in its efforts to really identify and track the goods produced by forced labor that might be destined for this marketplace?

Mr. SHRUHAN. First of all, we use all the tools that—you know, we do have a large number of tools to look at goods that are coming in the United States. We utilize open source information. We utilize our domestic office as a source of information. We again have outreach, where we are talking with the trading community. We are talking with the people that are doing audits, when they go to factories. If they hear of prison labor, child labor goods, they report back to us and then we'll start looking into it. Our Treasury enforcement communication system and our system that we have for tracking goods into the country, we are able to work with that system to see if we can identify a number of anomalies, and we do work with other agencies, as well.

Commissioner ROBINSON. And I don't want to stray into a sensitive area here, but I'm thinking specifically about NSA-type capabilities. In other words, having served on the National Security Council myself, I'm obviously impressed with the capabilities of this country in some of the areas that we're concerned about here, but I'll leave that for another day.

Mr. Chang, I want to add my congratulations to you for, I think, enriching the debate on China at a crucial crossroads in our bilateral relationship, which I think your fine book has very much done. I've been looking at some of the same issues, as you may know, for example, the underfunded pension system, the hidden obligations, I think you called them, the scale of the non-performing bank debt. Really, this gets into, if we do the numbers, say, $1 trillion if you combined them, or you had $870 or something like that. But the fact is that this is big money and it obviously makes for an impressive, if you will, debt-to-GDP ratio.

Having said that, I'm just curious, do you buy the idea that China is going to need to ramp up very considerably its access to foreign capital markets, those obviously in Hong Kong, where it's listing a greater number of companies all the time, sometimes through the red ship vehicle and other vehicles that you're aware of and very familiar with, and not to mention they're obviously trying to develop the European market to a greater extent. More recently, they've used the U.S. and Japanese markets traditionally as their main sources.

Those numbers are not huge now. They are estimated to be for this country $30–$35 billion, something similar in Japan. Couldn't you see a quite sharp ramp-up in China accessing, say, Japan and U.S., in particular, capital markets in the coming years so that that number could easily go in, say, three to five years to $150 billion, for example, given the cavalcade of state-owned enterprises that are headed towards the markets?

Mr. CHANG. I agree with you, because over the course of, let's say, the first two or three years after accession, the government's needs are going to increase, not only because of domestic stimulus, but also because it's trying to solve some of the hidden obligation problems. They're already trying to pave the way with landmark bond issues to try to create a market so that in the future, when their needs do increase in the United States and elsewhere, that they will have a receptive market among the investment bankers and the investing public in the United States.

They're also trying to develop their domestic markets, because they can see that the foreign markets will not be big enough to absorb all their needs, especially considering when it becomes more known about the true state of China's financial system.

Commissioner ROBINSON. Thank you very much.

Chairman D'AMATO. Thank you. Commissioner Reinsch?

Commissioner REINSCH. Thank you. I just have two questions. For Mr. Chang, I was trying to think through the policy implications of your hypothesis, and I'm sort of bemused by it. Many of my colleagues and others in the academic community have talked at some length about the Chinese threat to the United States, whether it is military, economic, political, however you want to describe it.

It seems to me, from the perspective of the people who perceive such a threat in the United States, your thesis is good news, isn't it? I mean, what have we got to worry about if you are right?

Mr. CHANG. The period of instability before my prediction comes true could certainly be a very difficult one. To answer Commissioner Lewis's question——

Commissioner REINSCH. Good. Do that.

Mr. CHANG. China does pose a threat to the United States on a number of different levels. To take, let's say, the one that concerns me the most, every four or five years, some general in the People's Liberation Army threatens to erase Los Angeles or some other U.S. city. The most recent threat was made in March 2000 in a PLA publication.

Commissioner REINSCH. I think it's just L.A. I don't think they've focused on other ones yet, but we'll see.

Mr. CHANG. So some people may debate it, but I would call that a threat.

[Laughter.]

Commissioner REINSCH. There may be some people who disagree with you about that, but go ahead.

Mr. CHANG. The other threat is one which is more day-to-day, and that was highlighted by the reconnaissance plane incident of this April, and that is China claims the entire South China Sea for its own up to the continental shelves of the Philippines, Brunei, Malaysia, and Vietnam. It's important for the United States, either alone or working with its allies, to guarantee the sea lanes and the free right of passage for airplanes over the South China Sea. China at this point doesn't vigorously enforce its claims because it doesn't have the blue water navy and the air force to do so, but that's just a matter of time if the nation were strong. Fortunately, I don't think that it is, but certainly, in the interim, that is a threat, as well.

Commissioner REINSCH. Well, clearly, weakness contributes to instability, and weakness also contributes oftentimes to irrationality or efforts on the part of the PLA or whoever to do peculiar things in order to solidify domestic support or just to distract attention, among other things.

So I take your point. Should you be right, we have a period of confusion, and confusion is always dangerous. But on the other hand, if you're right, what you also end up with is a period of time in which China is going to be intensively preoccupied with its internal problems, it seems to me, which suggests some lack of interest in some of the other things you've just described.

Mr. CHANG. But China considers its internal problems to be the affairs of some other areas which don't consider them quite internal, say, for instance, Taiwan, and that is an area which could draw in the United States——

Commissioner REINSCH. Yes, but probably not Los Angeles. Thank you.

For the Customs people, I want to focus not on forced labor for the moment but on regular imports, if you will, if you can talk to me about that for a minute. Where do the Chinese stand in comparison to other nations with respect to Customs fraud, import fraud? Are they worse, better, the same as anybody else?

Mr. SHRUHAN. Well, we have a large number of investigations. Of course, we have textiles dumping, intellectual property rights, as well as, you know——

Commissioner REINSCH. Yes, but how do they stack up compared to the Koreans, the Japanese, the Germans, the Italians, whoever? Are they more or less——

Mr. SHRUHAN. We have a large number of allegations that there are violations coming from China, yes.

Commissioner REINSCH. I think you're saying they're worse. Is that what you're saying?

Mr. SHRUHAN. Well, I think we have a number of allegations in a number of areas. I can probably get back to you on exactly where they stand. I'm not sure.

Commissioner REINSCH. Okay. Do you find a lot of your allegations, over the last five years, say, being translated into either administrative penalties on your part or convictions?

Mr. SHRUHAN. We've had a number of cases that I would say would be both administrative and criminal, yes.

Commissioner REINSCH. That are successfully concluded, from your point of view? Okay. In those cases, do you find that, generally speaking, the problem is with the Chinese or with the importer, who may or may not be Chinese?

Mr. SHRUHAN. Well, first of all, you've got to look at every case individually, and I think what——

Commissioner REINSCH. I'm looking for trends. If there aren't any, say so.

Mr. SHRUHAN. I cannot give you an answer.

Commissioner REINSCH. Maybe you could help us, if you've got data on that or could develop some data on that, by supplying it later. I think it would be helpful.

Mr. SHRUHAN. I will try to get back with you on that exact answer.

Commissioner REINSCH. Good. I would appreciate it. I expect, if only because of the size of the trade deficit, that it's a larger problem than it is in some other cases simply because of the volume. But I think it would be helpful to us to have some sense of where that is and also any information you can share with us about things that are not finished or still under investigation. Beyond that, with respect to cases that have been concluded over some recent time period, you know, pick whatever you want, some analysis of who the bad guys are on this, whether they're the importers, whether they're the Chinese manufacturers, both, or whether it's the same person, that, I think, would be helpful, too.

Chairman D'AMATO. Thank you, Commissioner Reinsch.

Commissioner Lilley?

Commissioner LILLEY. I haven't read Gordon Chang's book yet, but I've read others that deal with the same subject, which actually belongs probably in our discussions tomorrow. There's a book called *Great Wall, Empty Fortress*. There's a book called *The Coming Conflict with China*. There's *Hegemon*. There's now his book. I think it shows us on the basis of the same or similar factual data you can come up with wildly different conclusions about what's going to happen to China.

I think, unfortunately, the Commission, what we do here depends upon how we interpret this, because if you listen to our United Steelworkers colleague of the last session, China is a monster that is going to devour us and destroy our steel industry, whereas we get a slightly different approach this time, and I think we've got to get much greater clarification on this because the wildly swinging variations in the interpretation of China, we can't put up with that sort of analysis.

Having said that, I would like to get to Customs and say there's one aspect of this that is not covered at all which comes up in a book written by Nick Eftimiades and also comes up in the Cox Report, is the enormous movement of American technology to China, and Customs is responsible for investigating that and curbing it.

What I've heard lately, and it's not anecdotal because I don't like anecdotal evidence on China because you can always find an anecdote to contradict any anecdote you have, is that there is a great draining of American technology to China that Customs can't even begin to handle with the personnel you have.

Nick talks about there are literally hundreds of cases of people taking technology out of here. There's one or two cases where you've nailed somebody and he's in jail in Pennsylvania for ten years, or there's the famous case of the NSA sting operation or the stealing of the F–14 blueprints that we catch them at.

But let me ask you, do you think that you've got a handle on this business of the technology flowing out, because the Cox Report has been attacked violently as having overstated this case, whereas some people feel, and Eftimiades's book says that we're just not able to deal with it. We don't have the resources. It's much too clever, obscure, obtuse for us to pick up. I mean, we're the obtuse ones, actually, according to lots of these comments. But do you feel as though Customs needs more people to cover this business of technology seepage from us to China?

Mr. SHRUHAN. Well, first of all, as you know, we do search mostly goods coming into the United States. We do not routinely search goods leaving the United States. So, yes, we are at a disadvantage there.

However, we do have a number of investigations. We have a very active export strategic investigations division where we do look at goods that are going out of the United States that require a license, whether it's a Department of Commerce or a Department of State license, DOD, et cetera.

An example would be the Defense Logistics Agency, DRMO, I believe is the—they were selling surplus military goods that are supposed to be rendered inert or they're supposed to be basically made into salvage or scrap, and we did see a trend for a while that that was being illegally exported out of the U.S., we think going to China.

So again, we are vigorously looking at that. Could we use more people? I defer to some others within Customs, but I think we're doing the best job we can with the resources we have.

Chairman D'AMATO. I think that means they need more people.

Commissioner LILLEY. Well, you get some very alarmist reports on this analysis of the amount of technology that's seeping through, all the way from a W–88 nuclear warhead to blueprints of night vision equipment, that sort of thing is going out, and you catch people. You conduct operations. You nail them in Canada, you nail them on the West Coast. But I'm told that this is just the tip of the iceberg.

Mr. SHRUHAN. Well, we have 25 Customs attache offices around the world and our export control program and our strategic program is one of our main priority investigative areas. And again, domestically, as well, our special agent in charge officers are really targeting this because we are concerned about licensable goods being illegally exported out of the U.S. and we do the best job we can. So I would say that almost every one of our foreign officers has export control cases that, again, could be trans-shipped to places that require a license. So we are looking at that very aggressively.

Commissioner REINSCH. Just for the record, I want to mention that the Department of Commerce shares enforcement responsibility in this area and the Bureau of Export Administration has 106 or so agent investigators also dedicated to this task.

Commissioner LILLEY. FBI is, too.

Commissioner ROBINSON. I'd be pleased privately to make a comparison between the various agencies' capabilities, but not right now.

Commissioner LILLEY. Yeah, well, I have watched that subject, too, from the point of view of an intelligence agency and I've seen what's gone on. Sometimes, it's not terribly reassuring because the scale of what we sense is being taken out of United States is pretty formidable.

Chairman D'AMATO. Thank you, Commissioner Lilley.

Commissioner Ledeen?

Vice Chairman LEDEEN. Mr. Shruhan, how many people do you have working in China?

Mr. SHRUHAN. We have three special agents working in China, in Beijing.

Vice Chairman LEDEEN. Three?

Commissioner DREYER. All three in Beijing?

Mr. SHRUHAN. Three in Beijing, yes.

Vice Chairman LEDEEN. All right. And then you have a few others in Hong Kong, is that right?

Mr. SHRUHAN. Yes. We have four in Hong Kong and three foreign service national investigators that work with us.

Vice Chairman LEDEEN. All right. And just to reiterate, I'm not asking anything that you haven't already answered, I just want to try to make it clear for the record. You have no independent investigative capacity whatsoever in China, is that right? That is, every single thing you investigate has to be preapproved by the Chinese government and then you are accompanied there by Chinese officials when you carry out your investigation, is that correct?

Mr. SHRUHAN. Yes. We have to work in coordination with the Chinese government.

Vice Chairman LEDEEN. All right, so that they could produce a Potemkin Village for you to drive through and so forth, so you have no idea whether the thing you're seeing is functioning the way it functioned at the time an allegation is made and so forth. You just rely on their good will for this information, in essence.

Mr. SHRUHAN. We'll rely on our—if we do the site, what we see there, yes.

Vice Chairman LEDEEN. All right. Thanks.

Chairman D'AMATO. May I just point out, Commissioner Ledeen, that the statement by our guest from the West Coast indicated that in the detention center she was kept in, that they had the capacity and did change the entire interior decor of the center when there was an investigation to make it appear to be something that it was not.

Commissioner ROBINSON. Can I just ask, is that situation unique? Do other countries let you go anywhere you want without any notice or accompaniment?

Mr. SHRUHAN. Each country is a little bit different. I used to be the Customs attache in Singapore and I covered 17 countries out of there. Each country was a little bit different, but normally, you had to coordinate your activities with the country. What they let you do beyond that was different in each country.

Chairman D'AMATO. Commissioner Mulloy?

Commissioner MULLOY. Thank you. I have a question for each of the witnesses, and if we can go pretty quickly.

Mr. Davidson, you talk on page three of your prepared testimony about the special safeguard mechanism that we have in the agreement with the Chinese on their WTO entry. Now, when Mr. Usher came in here earlier today from U.S. Steel Corporation, he talked about that safeguard and indicated it was very important for his industry, but he said Congress must enact legislation fully implementing this provision.

Do you know whether we have to enact, Congress has to enact additional legislation to make that provision as we've negotiated it fully effective?

Mr. DAVIDSON. I'm not sure of the answer to that because I think there are a number of aspects to this, and again, it gets into certain provisions, such as the methodology used to calculate and things like that, which are not statutory. But I'd be happy to work through either you, Commissioner, or Mr. Usher to make sure that we understand what his point is and we'll work through that process. But from my prepared testimony, that's not my understanding, but I'd be happy to work through that process.

Commissioner MULLOY. If you could contact him and his—and the Steelworkers, I think, made the same point. We've asked them to give us specific information, recommendations for us to consider making to the Congress, so——

Mr. DAVIDSON. I'm involved in another issue that he's interested in, as well, so we can, I'm sure, arrange for that kind of communication.

Commissioner MULLOY. Okay. That would be very, very helpful.

The second question is for Mr. Chang. I read your book over the weekend and on page 38, you make a very interesting discussion of the Chinese military budget. You say the official figures show a 12.7 percent increase in 2000 and a 17.7 percent increase in 2001, both numbers in excess of the economy's rate of growth for those years. The real increase in the military budget is not known outside Zhongnanhai, which I presume is their Pentagon or something like that?

Mr. CHANG. It's the leadership compound in the center of Beijing where all the leaders live and work.

Commissioner MULLOY. —because China hides most of its defense outlays. So what you're saying is, visibly, they're vastly increasing their military outlays, but you have no idea what the real increase might be.

Mr. CHANG. I could not give you a precise number, Commissioner. Most observers suspect that the increase is actually quite substantial, maybe even more than the numbers that have been announced, largely because it is known that the People's Liberation Army is trying to upgrade its capabilities across a broad range of its services. So, for instance, that number is suspected not to include procurement, and we know that there have been substantial purchases of planes and ships from Russia, for instance. So it's probably much higher than that. Chinese numbers are never very good, especially when they want to hide something, and most people suspect that they have a lot to hide.

Commissioner MULLOY. Okay. Mr. Chairman, I think that's an important point——

Chairman D'AMATO. How we get to those numbers will be a major question.

Commissioner MULLOY. I think that will be important for this Commission to try and get some idea what is really happening.

But a follow-up question on that. Do you think the overall trade and economic relationship with the United States contributes to China's ability to put more resources into its military budget?

Mr. CHANG. I think the answer to that question is yes. It also helps China do a number of other things. It helps Chinese citizens attain their own personal objectives. But certainly trade, and one-way trade, up to now has certainly strengthened the modern Chinese state, and the hope is that with accession to WTO, the trade becomes more balanced, and I see that happening. As you can see, the Chinese state won't survive balanced and fair trade.

Commissioner MULLOY. Fine. This is a question for Mr. Shruhan of the Customs Service. George Weiss, who was your former Commissioner and a former staffer on the Ways and Means Committee, testified before the Senate Foreign Relations Committee on May 21, 1997, five years ago, and in talking about the forced labor problem in China, he said, "We recognize the constraints of being unable to obtain the necessary proof without the consent of the alleged violator." In other words, if somebody makes an accusation and they don't let you go and really inspect it, you really can't come up with any conclusion. And then he said, "We simply do not have the tools within our present arsenal at Customs to gain the timely and in-depth verification that we need. Presently, we believe that we are only seeing part of the picture."

I think it's enormously important for us, and Commissioner Bryen talked about this, whether either within the existing statutory authority there's a way to kind of flip the burden of proof, or if that's not possible, if we could get the statutory language that you think would accomplish what you really need so that if we decide that's an important issue, that we know exactly what to recommend to the Congress on that point and explain why we would recommend it. So if you could get that type of information to the Commission, that would be very, very helpful.

Ms. KESSLER. Could I just make one point on that particular issue? I'm not sure that Customs agrees that the current statutory authority is inadequate. Where our problems lie are, as you said, in obtaining our evidence.

Commissioner MULLOY. Yes.

Ms. KESSLER. I'm not sure that any statutory fix would assist in that problem.

Commissioner MULLOY. It would depend on where the burden of proof, it would seem to me. If the statute is structured one way, it would put the burden of proof on one party. If it were structured another way, it could put the burden of proof on another party. I mean, I think that would be—and I would urge you to look at that in terms of what the public policy issue here is, and if you need additional authority, let us know, or tell us. In fact, I would specifically ask you to address that issue and come back and tell us, yes, we don't need additional authority because, or we do need additional authority and this is what it would be.

Ms. KESSLER. Certainly.

Commissioner MULLOY. Finally, Mr. Davidson, in your statement, and Ambassador Barshefsky said the same thing when she testified here in June, that our accession agreement with the Chinese into the WTO is a one-sided agreement, that we really got the goods on them because they already had access to our market and now we're going to get access to theirs, which we haven't had. What do you think they thought they were getting out of the negotiation? I mean, I don't think they're dumb, so I presume that they felt that they got something out of this WTO accession agreement that they wanted, and what do you think that might be?

Mr. DAVIDSON. Well, it's difficult for me to project what their intentions would be, but I would imagine that accession to the WTO provides significant benefits to them globally, both in terms of their trading, if that's your question, I mean, their ability to interact in the world economy, and I think also in terms of the position of China in the world generally, being a member of the WTO would probably have significant import to them. But again, I can't speculate as to precisely what their motives would have been.

Commissioner MULLOY. Do you think that it was important to them in terms of getting the investment that had fallen off a couple of years before they did the WTO? Do you think it was important for them to get into the WTO in order to keep the investment flowing into China in terms of companies that would invest there and not only sell there but also sell outside China? Do you think that had any part in their thinking?

Mr. DAVIDSON. Again, Commissioner, I really can't speculate one way or the other. All I can say is it's the view of this Administration that—and I understand Mr. Chang's caveats—but the imposition of the rule of law in many ways is going to be beneficial to U.S. businesses operating in China and selling products to China, as well as I think will have beneficial effects in the Chinese system generally, so——

Commissioner MULLOY. Mr. Chang, do you have any comment on that?

Mr. CHANG. To answer your question, which I think is a great question, first of all, I think you're right. They wanted to make sure that the flow of foreign investment continued. Second of all, I think that they were worried long-term about their access to foreign markets because one-way trade could not last forever. The top leaders, though I don't think anybody else in China, wanted to use WTO accession as a prod to the state-owned enterprises and the banks to modernize themselves.

But I think that it's largely a question of face, which you referred to, and that was very important to them. It's just like getting into the U.N., getting the Olympics, that type of thing.

Commissioner MULLOY. Thank you.

Chairman D'AMATO. Thank you. We are just about out of time, but I have two more Commissioners with maybe one quick question each. Commissioner Becker?

Co-Chairman BECKER. Yes. This is almost a follow-up question in that same regard and it goes to USTR. Were you here when the steel panel testified?

Mr. DAVIDSON. I was not present, no.

Co-Chairman BECKER. Okay. Well, Mr. Usher really directed some of the difficulties to selling steel out of this country to Japan and Japan is a member of the WTO. We hear a lot about the accession of China into the WTO and concern about whether the right implementation language is being put in place, and second, even if it is, whether they are going to live up to it or honor it in some way. Mr. Usher testified that they just can't sell steel into Japan, and Japan is a member of the WTO. I know USTR has worked with this heavily over the years. Charlene Barshefsky spoke at length about her frustrations in being able to open up the Japanese market.

So I guess really what I'm saying is, having that experience with Japan, who's been a longtime member of the WTO, and opening their markets up, are we dealing with this in any way different in China that gives you the hope that you expressed that this was going to be an honorable agreement and that they would open their markets up for trade from the United States?

Mr. DAVIDSON. Commissioner Becker, I appreciate your comments. In answer to your specific question, I would say that the requirements that we are asking of the Chinese are unprecedented, that the procedures that we're putting in place and what we're asking of them goes beyond what we've asked of other countries acceding to the WTO.

Now, this clearly is the largest non-market economy that we're dealing with, so I think that those unprecedented requests are completely justified. And so we have tailored the accession package to what our concerns are in terms of Chinese compliance, and so I think we've done that in an appropriate way. But in answer to your question, yes, I think we've used experience and some of our concerns, particularly dealing with the aspects of a non-market economy acceding to have unprecedented requirements in terms of compliance.

Chairman D'AMATO. Commissioner Wessel?

Commissioner WESSEL. Just a couple of quick points and questions. Mr. Lewis, I guess, raised the question earlier about the assessment I and would love to have your reaction to the request from the USTR, the previous USTR, I should point out, to the ITC that in analyzing China's accession to the WTO the ITC indicated that our trade deficit would increase, which would seem to call into question some of the benefits that might accrue to us as well as, I think, underlies some of China's reasoning for moving into the WTO because they thought that they would gain substantial benefits.

Mr. DAVIDSON. Well, Commissioner Wessel, I think the answer that I would give to that at this point is that the significant benefits that our exporters will receive in terms of access to the Chinese economy and the ability by having them in the WTO to use those enforcement mechanisms and the processes that we're putting in place, I think will be a significant benefit to American exporters, farmers, workers, businesses, et cetera.

Commissioner WESSEL. What about the displacement of imports in terms of some of those same entities, our farmers, workers, and businesses will also face the imports coming in, which could be in a dramatically increased level?

Mr. DAVIDSON. I'm not familiar with the previous administration's statements on that position, but again, I could foresee significant benefits to American exporters from this agreement and that's the focus that we've had throughout this process.

Commissioner WESSEL. And Mr. Chairman, if we could also submit questions for the record to our witnesses, it would be helpful. My understanding, for example, on the forced labor issue, some of your investigations have been open for seven to ten years and that leaves a lot of question, I think in our minds and probably in the members of Congress's minds, about how effective our current legal structure is, as well as the resources, and we will have to recommend some things, I think, in those areas.

Chairman D'AMATO. Yes. We will have a number of questions for the record and we hope that you will be able to respond to those questions.

One follow-up I'd like to ask Mr. Chang is given this assessment that the deficit with China might well increase as a result of WTO accession, does that indicate—are you in agreement with the idea that the expectations as to our ability to penetrate the Chinese market have been exaggerated as a result of this process?

Mr. CHANG. I would not agree with the assessment that the trade deficit with China would increase in their favor. Given the terms of the WTO accession, that would seem counterintuitive. I certainly did not hear that assessment and certainly would like to know more about it. But it seems to me that just given what China has promised to do and what the multinationals will insist on receiving, it just seems that the trade deficit has to balance out better than it has in the past few years.

Chairman D'AMATO. Thank you very much, and that concludes our hearing. I want to thank all the witnesses for your indulgence.

Mr. DAVIDSON. Thank you.

Chairman D'AMATO. It was an excellent hearing. We thank you very much, and you'll probably get invited back as a result of that. Thank you.

We will start our next panel in about four or five minutes, so Commissioners, be aware.

PANEL III: AIRCRAFT/AEROSPACE/AUTOMOBILES—AUTO PARTS ISSUES (RELOCATION OF JOBS, MARKET PENETRATION AND TECH TRANSFER)

Chairman D'AMATO. We have miles to go before we sleep here. This segment of the hearing is going to be chaired by Commissioner Becker. Go ahead, Commissioner.

Co-Chairman BECKER. Let me welcome you here. We're very pleased that you were able to join us today. We have representatives from the UAW and certainly from the aerospace, both from the company and the Machinists Union. We'll go ahead and start. We'll move as quickly as we can.

The first person—we'll take them in the order of the way they're sitting at the table, from the left, Robert Thayer, the Executive Council Member, the General Vice President of the International Association of Machinists, and that is not the way they're sitting. Mr. Thayer is right in the center.

STATEMENT OF ROBERT THAYER, EXECUTIVE COUNCIL MEMBER AND GENERAL VICE PRESIDENT, INTERNATIONAL ASSOCIATION OF MACHINISTS AND AEROSPACE WORKERS (IAM)

ACCOMPANIED BY:

RICHARD SCHNEIDER, OVERALL BOEING COORDINATOR
OWEN HERRNSTADT, DIRECTOR, INTERNATIONAL DEPARTMENT
STEPHEN SLEIGH, STRATEGIC RESOURCES DIRECTOR

Mr. THAYER. Thank you, Mr. Chairman. My name is Robert Thayer. I'm the General Vice President for the International Association of Machinists and Aerospace Workers. The IAM represents over 730,000 workers [sic] in North America in a variety of industries, including aerospace, shipbuilding, ship repair, electronics, woodworking, defense, and transportation.

One of my responsibilities as the resident General Vice President is to oversee the IAM's aerospace department. The IAM represents more aerospace workers than any other union in the world. IAM members work for prime and sub-tier contractors, producing, assembling, and maintaining almost every imaginable product that is involved in the aerospace industry. IAM members have helped to build some of the world's most successful aerospace companies, the Boeing Corporation, Lockheed Martin, Pratt Whitney, and General Electric, to just name a few.

Given our membership's employment in the aerospace industry and the implications in that industry with respect to China, we very much welcome the opportunity to appear before you today. Accompanying me today is Owen Herrnstadt, Director of the IAM's International Affairs Department, and Richard Schneider, our overall Boeing coordinator.

The IAM is mindful that a healthy and vibrant aerospace employment in the U.S. contributes to our nation's economic security as well as to our nation's defense. Sadly, though, for years, we have witnessed a decline in the stature of the U.S. aerospace industry as foreign competitors rise. While there are many factors for this decline, one of them is the increasing transfer of our jobs and the technology which we have developed as workers and paid for as taxpayers to other countries by the U.S. aerospace industry.

One of the countries who is building a vibrant aerospace industry, partially on the basis of transferred production and joint ventures with the U.S. aerospace industry, is China. Each of the people accompanying me, as well as myself, have seen firsthand China's aerospace industry. We'll be glad to share with you our views during the question and answer period.

In the coming years, the increasing competition from China and the related transfer of our aerospace jobs and technology to China will result in serious security concerns as U.S. workers in this vital industry continue to be laid off and as China's demands for the transfer of vital production and technology from the United States increase.

China's well-documented violations of human rights and its disrespect for internationally recognized labor standards also cannot be overlooked. In keeping its workforce from enjoying fundamental human rights, like the right to join a free and independent trade union, and other basic democratic rights, China also undermines the basic rights enjoyed by workers in the U.S., and at the IAM, we are very aware that U.S. companies profit from the moral and economic depravation endured by China's workers.

In October of 1998, the individuals in the IAM that are present here today, as well as 12 other individuals from the IAM, went on a fact finding labor delegation to China. The delegation included four of the IAM's top officers, including myself. They were joined by IAM staff and representatives from almost every location in North America where the IAM represents workers from Boeing.

This IAM delegation was made up of machinists who actually build the airplanes. They possessed the expertise of journeymen who know with intimate detail all the aspects of aerospace manufacturing. Their firsthand accounts of what they saw in China, combined with their knowledge of both manufacturing and the processes involved, greatly add to our knowledge of the aerospace industry in China.

Together with counterparts from the Boeing Corporation, the IAM visited facilities at the Shanghai Aircraft Corporation, Xian Aircraft Corporation, and Shanghai Aviation Industrial Corporation. These visits included walk-throughs in selected sites, and during the mission, our delegation also heard presentations from senior officials at each of these companies.

We participated in meetings between senior officials of the company and, of course, the IAM, and on several occasions during these meetings, the IAM delegation explicitly heard Chinese bluntly call for Boeing to move work to their facilities in China. Their requests were often combined with not-so-subtle reminders that Boeing's competitors were only too willing to make special deals in return for China's purchase of its aircraft.

During our mission, we also made special note that, in general, China's aerospace workforce was paid a fraction of that which is paid to U.S. workers. Additionally, we noted that there were no signs of any visible independent trade unions in any of the facilities we visited, nor were there any signs of any meaningful collective bargaining activity.

The IAM delegation met a few weeks later after returning home from our mission. During that meeting, participants discussed what they heard and learned firsthand from that mission. Their observations are summarized by the following five points.

First, China seeks to add to its developing aerospace industry. During our mission in '98, IAM participants couldn't help but notice the massive facilities that had been built specifically for the aerospace industry in China.

Second, China has the capacity to greatly improve its already functioning aerospace industry. There is no question that China has the capacity and the ability to become a major aerospace producer. As one IAM participant on the tour of China's aerospace facility concluded, China can do anything they want. They have the technology, the manpower, and the research capacity. Another IAM participant noted that China's aerospace industry was capable of integrating most technologies into the manufacturing process. IAM delegates also noted the sophistication of the apprenticeship and training programs at China's aerospace companies. IAM participants also noted that U.S. aerospace companies have virtually abandoned apprenticeship and training programs.

Thirdly, China continues to demand that the U.S. aerospace companies transfer their production and technologies to it in return for market sales and access. As mentioned at the outset of this testimony, IAM participants on this mission were struck by how bluntly China's aerospace industry representatives spoke about the transfer of production from U.S. aerospace companies.

Fourth, China's use of offsets and offset-like arrangements increasingly have negative consequences on the U.S. workforce. The negative impact that offsets are having on the U.S. workforce is overwhelming. Since 1989, over 500,000 jobs have been lost in the aerospace industry in this country. During that same time period, close to one million jobs have been lost in the U.S. in the aerospace and other related industries. Thousands of these jobs have been lost directly due to offset and offset-like agreements.

And fifth, the United States Government continues to effectively do nothing about the situation, to the detriment of the U.S. aerospace and aerospace-related workers and our national security. Adding to these numbers are the dire effects that these transfers are having on the U.S. supplier base, which employs thousands of aerospace workers. In addition, the competition that China gives the U.S. in the aerospace industry will also have a negative effect on our national security by deskilling the U.S. workerforce.

The IAM has been raising the dangers of the U.S. aerospace industry's reliance on offsets for a number of years with industry and with our government. Currently, the U.S. Government appears to be content to relegate to U.S. corporations the sole responsibility of negotiating with other nations' governments over this important issue. This inaction poses a serious threat to the U.S. aerospace and related industries as China is granted permanent normal trade relations and accession to the World Trade Organization. We refer you to our written submissions for fuller discussions on these issues.

The IAM learns about U.S. companies that move our jobs offshore on an almost daily basis. Our members who have built these businesses are then left behind to figure out how the company that they had devoted their lives to could do this to them. Many jobs we have seen disappear in this country only to reappear in another country are in the aerospace industry. Instead of working out a way to protect workers that have been so loyal to them, U.S. companies are only too willing to give away their jobs.

It has been said today, multinational companies have no heart and no soul. Many of them also have no conscience, either. Why else would they move our work offshore? Why would they move our work to a country like China, which tortures its citizens merely for speaking about fundamental human rights, like forming a free trade union? Still, China does it and our government not only permits it but encourages it through its various trade agreements and this is outrageous.

U.S. aerospace workers are the best in the world and they will compete with any workers in the world. But the fact remains, how can they compete in any industry, including aerospace, where their work is being transferred to satisfy offset agreements? How can they compete with workers whose fundamental rights are denied, and how can they compete when their own industry and government turns their back on them?

These are the fundamental questions that the IAM delegates who observed firsthand China's aerospace companies asked themselves when they returned to the United States from China. They are still asking the same question three years later. I and my colleagues from the IAM look forward to your questions, and again, thank you for the opportunity.

[The statement follows:]

PREPARED STATEMENT OF ROBERT THAYER

I. INTRODUCTION

The International Association of Machinists and Aerospace Workers (IAM) represents over 730,000 workers in North America in a variety of industries, including aerospace, shipbuilding and ship repair, electronics, woodworking, defense, and transportation, just to name a few. The IAM represents more aerospace workers than any other union in the world. IAM members work for prime and sub-tier contractors producing, assembling, and maintaining almost every imaginable product that is involved in the aerospace industry. IAM members have helped build some of the world's most successful aerospace companies—like Boeing, Lockheed Martin, Pratt & Whitney, and General Electric, just to name a few.

Given our membership in the aerospace industry, the IAM has a vested interest in ensuring the competitiveness of the U.S. aerospace industry and in preserving the jobs of our members in this highly competitive industry. We are also mindful that healthy and vibrant aerospace employment in the U.S. contributes to our nation's economic security as well as our defense.

Sadly, for years we have witnessed the decline in stature of the U.S. aerospace industry as foreign competitors rise. While there are many factors for this decline, one of them is the increasing transfer of our jobs and the technology, which we have developed as workers and paid for as tax payers, to other countries by the U.S. aerospace industry.

One of the countries who is building a vibrant aerospace industry—partially on the basis of transferred production and joint ventures with U.S. aerospace—is China. In the coming years, the increasing competition from China and the related transfer of our aerospace jobs and technology to China will result in serious security concerns as U.S. workers in this vital industry are laid off and as China's demands for transfers of vital production and technology from the United States increase.

China's well-documented violations of human rights and its disrespect for internationally recognized labor standards also cannot be overlooked. In keeping its workforce from enjoying fundamental human rights—like the right to join a free and independent union—and other basic democratic rights, China also undermines the basic rights enjoyed by workers in the U.S.

At the IAM, we are very aware that U.S. companies "profit" from the moral and economic deprivation endured by China's workers. As stated before this Commission earlier this summer, AFL–CIO Secretary-Treasurer Richard Trumka explained, "They [U.S. multinationals] can pay workers depressed wages, force them to work long hours, and expose them to unsafe working conditions without having to worry about organizing drives in their factories or the prospect of facing independent workers' representatives at the bargaining table."

II. IAM'S FIRST-HAND LOOK AT CHINA'S AEROSPACE ACTIVITIES

The IAM offers this Commission its conclusions based on personal, first-hand observations of China's aerospace industry. In October 1998, the IAM sent 15 of its top representatives on a fact-finding labor delegation to China. The delegates included four of the IAM's top officers, one of whom is responsible for the IAM's overall aerospace activities and the IAM's Overall Boeing Coordinator. They were joined by IAM staff and business representatives from almost every location in North America where the IAM represents workers from Boeing.

This IAM delegation was made up of machinists who actually build airplanes. They possess the expertise of journeymen who know with intimate detail all aspects of aerospace manufacturing. Their first-hand accounts of what they saw in China combined with their knowledge of both manufacturing and the processes involved greatly add to our knowledge of the aerospace industry in China.

Together with counterparts from the Boeing Corporation, the IAM visited facilities of the Shenyang Aircraft Corporation, Xian Aircraft Corporation and the Shanghai Aviation Industrial Corporation.

These visits included "walk throughs" of selected sites. During the Mission, our delegation also heard presentations from senior officials at each of these companies. We participated in meetings between senior officials, the company, and, of course, the IAM. On several occasions during these meetings, IAM delegates heard calls for the transfer of work to facilities in China. "Requests" were often combined with not-so subtle reminders that competitors were only too willing to make special "deals" in return for China's purchase of its aircraft.

During our Mission, we also made special note that in general China's aerospace workforce was paid a fraction of that which was paid to U.S. workers. Additionally, we noted that there were no signs of any visible independent trade unions in any of the facilities we visited. Nor were there signs of any meaningful collective bargaining activity.

The IAM delegation met a few weeks later after returning home from our Mission. During that meeting, participants discussed what they had learned first-hand from the Mission. These observations are summarized by the following five points:

1. China seeks to add to its developing aerospace industry;

2. China has the capacity to greatly improve its already functioning aerospace industry;

3. China continues to demand that U.S. aerospace companies transfer their production and technology to it in return for market sales/access;

4. China's use of offsets and offset-like arrangements increasingly have negative consequences for the U.S. workforce; and

5. The U.S. government continues to effectively do nothing about the situation, to the detriment of U.S. aerospace and aerospace related workers and our national security.

III. OBSERVATIONS

A. China Seeks to Add to Its Developing Aerospace Industry

During our Mission in 1998, IAM participants couldn't help but notice the massive facilities that had been built specifically for the aerospace industry in China. It was also clear through material that was shared with us that China is sincerely intent upon greatly expanding its aerospace industry.

This should come as no surprise. After all, the Chinese aerospace industry dates to the 1930s.[1] As noted by the U.S. International Trade Commission (USITC), ". . . the nation's aviation sector intends to pursue a principal role in commercial aircraft manufacturing."[2]

China's aerospace objectives are not limited to manufacturing single products. While China aerospace already performs a great deal of work for U.S. aerospace concerns, it is looking for increased work. For example, Chinese "manufacturers indicate a willingness to take on a variety of tasks from assembly work to component and subassembly manufacture. . . ."[3] Further, aviation industry leaders want "China to secure more work in the fabrication of complex assemblies such as body sections and nose subassemblies."[4] China's aerospace "hopes to strengthen its role as a supplier with the addition of resources for manufacturing and development and increased subcontract work from Western aircraft producers."[5]

B. China Has The Capacity to Greatly Improve Its Already Functioning Aerospace Industry

There is no question that China has the capacity and the ability to become a major aerospace producer. As one IAM participant on the tour of China's aerospace facilities concluded, "China can do anything they want. They have the technology, the manpower and the research capacity." Another IAM participant noted that China's aerospace industry was capable of "integrating most technologies into the manufacturing process."

IAM delegates also noted the sophistication of the apprenticeship and training programs at China's aerospace companies. IAM participants viewed this as a commitment by China's aerospace companies that they were willing, ready, and able to train a workforce to meet the challenges of the future in the aerospace industry. In viewing China's commitment to training in the industry, IAM participants noted that U.S. aerospace companies have virtually abandoned apprenticeship and training programs. These participants openly wondered if this lack of commitment on the U.S. aerospace industry for training U.S. workers was indicative of their view of the future for U.S. aerospace workers.

Although the IAM delegation only toured a fraction of the aerospace industry in China, the industry itself is enormous. According to the USITC, the Aviation Industries of China (AVIC) estimates in 1997 at $3.1 billion in "18 factories involved in the production of aircraft and components, 34 related equipment manufacturers, 29

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[1] U.S. International Trade Commission, *The Changing Structure of the Global Large Civil Aircraft Industry and Market: Implications for the Competitiveness of the U.S. Industry*, Investigation No. 332–384, November 1998 (hereinafter referred to as Investigation No. 332–384), at 5–1, citing Leslie Symons, "The Rise and Fall of Soviet Influence on the Chinese Aircraft Industry and Air Transport," ch. 16 in *Transport and Economic Development—Soviet Union and Eastern Europe* (Berlin: Osteuropa-Institut, 1987), p. 450.

[2] Ibid, 5–4 citing Aviation Industries of China officials, interviewed by USITC staff, Beijing, China, May 5, 1998.

[3] Ibid, 5–7 citing China National Aero-Technology International Supply Corporation officials, interview by USITC staff, Beijing, China, May 4, 1998.

[4] Ibid.

[5] Ibid, 5–4 citing China National Aero-Technology International Supply Corporation, Xi'an Aircraft Company, and Shanghai Aircraft Manufacturing Factory officials, interviews by USITC staff, Beijing, Xi'an, and Shanghai, May 4–8, 1998.

aeronautical research institutes, 4 aeronautical universities, and 8 trading companies."[6] In addition, according to USITC, AVIC employs "a total of 500,000" people.[7]

China's capacity for aerospace production is significant. According to the Boeing Company, China aircraft factories are currently working on a number of projects with Boeing, including:

—Shanghai: 737 horizontal stabilizers

—Xian: 737 vertical fins and 747 trailing edge ribs

—Chengdu: under contract with Northrop Grumman, produces the 757 empennage (horizontal stabilizer, vertical fin and tail section)

—Shenyang: 757 cargo doors and 737 tail section[8]

In addition, Boeing lists three joint ventures with China:

—1. Taikoo Aircraft Engineering Company Ltd, Xiamen: Airplane overhaul and repair.

—2. BHA Aero Composite Parts Co. Ltd, Tianjin: Beginning in late 2001, will manufacture composite parts for interiors and secondary structures for commercial aircraft.

—3. Boeing Spares Services Center, Beijing: Center for airline logistics, training support and services, with 30,000 part numbers available.[9]

The Chinese aerospace industry is also poised to accommodate changes in the market: "AVIC has guided the industry towards civil aviation in response to a decline in military orders and as a strategic move to advance China's capabilities in the commercial aircraft sector."[10] China has also set up another government organization, the China National Aero-Technology Import and Export Corporation (CATIC), which "oversees foreign subcontract work and joint ventures, as well as trade and aerospace products."[11]

Perhaps the best summary of China's capacity to produce aerospace products is found in the USITC's 1998 Report "The Changing Structure of the Global Large Civil Aircraft Industry and Market: Implications for the Competitiveness of the U.S. Industry."[12]

> . . . Chinese producers are capable of supplying quality products that conform to strict Western standards. Moreover, the industry has an advantage over other Asian aspirants in its many years of experience in building complete aircraft.[13] . . . In addition, China's more experienced and modernized suppliers understand quality assurance.[14] Although industry sources stress that time and close cooperation are necessary to ensure Chinese reliability on new programs, once a foundation is in place and workers are trained to the standards and production practices of Western producers, China's aircraft factories are able to produce high-quality parts, components, and subassemblies.[15] For example, while Boeing always begins with dual sources of supply when placing work in China,[16] Chinese factories have achieved the status of sole supplier on certain Boeing parts and complex assemblies,[17] an indication of Western LCA manufacturers' growing level of confidence in China's subcontracting abilities. Further, Chinese factories indicate an awareness of their weaknesses in quality assurance and are attempting to improve product quality through manufacturing experience with Western producers and by emulating the practices of successful Chinese suppliers.[18]

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[6] Ibid, 5–2 citing Aviation Industries of China, *Survey of Chinese Aviation Industry 1997/1998* (Beijing: Aviation Industry Press, 1997).

[7] Ibid.

[8] The Boeing Company, *The Boeing Company and China*, "http://www.boeing.com/companyoffices/aboutus/Boechina97.html"

[9] Ibid.

[10] Ibid, 5–2 citing Ibid.: "Aircraft Maker AVIC to Restructure," Paul Jackson, ed., *Jane's All the World's Aircraft 1996–97* (Surrey, UK: Jane's Information Group Limited, 1997), p. 55; and "Aviation Industries of China to Enhance Competitiveness," *Beijing China Daily*, Sept. 27, 1997.

[11] Ibid, 5–4 citing Jackson, ed., *Jane's 1996–97*, p. 54.

[12] Ibid, 5–9.

[13] Citing U.S. and Korean industry officials, interviews by USITC staff, Beijing, China and Changwon, Korea, Apr. 30 and May 8, 1998.

[14] Citing U.S. Government official, interviewed by USITC staff, Beijing, China, May 4, 1998.

[15] Citing U.S. industry officials, interviewed by USITC staff, Xi'an, China, May 7, 1998.

[16] Citing U.S. industry officials, interviewed by USITC staff, Seattle, WA, Feb. 10, 1998.

[17] Citing For example, Xi'an is currently sole supply on the 737 forward access door and 747 trailing edge ribs. Chengdu became sole supplier for the MD–82 nose structure.

[18] Citing Chinese industry officials, interviewed by USITC staff, Shanghai, China, May 8, 1998.

C. China Continues to Demand That U.S. Aerospace Companies Transfer Their Production and Technology to It In Return for Market Sales/Access

As mentioned at the outset of this statement, IAM participants on the Mission were struck by how blunt China's aerospace industry representatives spoke about transfers of production from U.S. aerospace companies. Indeed, at several meetings in China, transfers of production were raised.

This too should not be surprising. As concluded by the USITC's *Assessment of the Economic Affect on the United States of China's Succession to the WTO*, "China is particularly explicit and aggressive in demanding civil offsets in the commercial aerospace industry." [19]

Aerospace offsets demanded by China continue to grow. China's direct offset requirements include transfer of production to China in addition to the requirement of technology transfer. These transfers are "often an implicit requirement of doing business in China." [20]

Offsets have been addressed in U.S. bilateral agreements, such as the 1992 U.S.-E.U. agreement on Trade and Large Civil Aircraft.[21] An "offset policy" with respect to "defense purchases has been in effect in China since 1988." [22] As noted by the USITC, however, "China aggressively seeks offset compensation when negotiating non-military purchases and often includes an expressed preference for offsets in bidding documents for nationally and internationally funded procurement." [23]

D. China's Use of Offsets and Offset-Like Arrangements Increasingly Have Negative Consequences for the U.S. Workforce

The serious negative impact that offsets are having on the U.S. workforce are overwhelming. Since 1989, over 500,000 jobs have been lost in the aerospace industry. During the same time period, close to one million jobs have been lost in the U.S. alone in the aerospace and related industries. Several thousand of these jobs have been lost directly due to offset agreements.[24]

As China increasingly determines to capture part of the aerospace market using transfers of production and technology as leverage for market access, more and more U.S. workers' jobs will be at stake. Indeed, economists predict that in the coming years "an additional 469,000 jobs in aerospace and related industries could be at risk by 2013 because of offset policies and increased foreign competition." [25]

Even extremely conservative figures on the loss of jobs due to offsets are significant.[26] At the IAM alone, thousands of our members' jobs continue to be lost as company after company moves production offshore. And China continues to be the recipient of many of these jobs.

Adding to these numbers are the dire effects that these transfers are having on the U.S. supplier base—increasingly relied upon by prime contractors.[27] In other words, "the use of offsets will increase posing 'serious risks for the U.S. supplier base.'" [28] Moreover, offsets have resulted in "over-production capability" which, for the defense industry "negatively affects production in the commercial aerospace in-

[19] U.S. International Trade Commission, *Assessment of the Economic Affects on the United States of China's Succession to the WTO*, Investigation No. 332–403, Sept. 1999 (hereinafter referred to as ITC Investigation No. 332–403) at 3–22, citing International Association of Machinists and Aerospace Workers, written submission to the Commission, Mar. 9, 1999; National Research Council, *Policy Issues in Aerospace Offsets; Report of a Workshop*, p. 24; and National Research Council, *Trends and Challenges in Aerospace Offsets*, p. 107.

[20] Ibid, 3–27 citing Daniel H. Rosen, "Technology and Research and Development Requirements," *Behind the Open Door: Foreign Enterprises in the Chinese Marketplace*, p. 71.

[21] Ibid, 3–21, citing IV:3 of the GATT Agreement on Trade in Civil Aircraft.

[22] Ibid, 3–20 citing Trade Promotion Coordinating Committee, *National Export Strategy: Toward the Next American Century*, fourth annual report to Congress, Oct. 1996, p. 160.

[23] Ibid, 3–20 citing National Research Council, *Policy Issues in Aerospace Offset: Report of a Workshop*, p. 37; and USTR, 1998 *National Trade Estimate Report on Foreign Trade Barriers*, p. 52.

[24] Investigation No. 332–403 at 3–23, see also Robert Scott, "The Effects of Offsets, Outsourcing and Foreign Competition on Output and Employment in the U.S. Aerospace Industry," in National Research Council, *Trends and Challenges in Aerospace Offsets*, pp. 133–157.

[25] Randy Barber and Robert E. Scott, *Jobs on the Wing: Trading Away the Future of the U.S. Aerospace Industry*, Economic Policy Institute, Washington, DC, 1995.

[26] See, "Status Report of the Presidential Commission on Offsets in International Trade," January 2001.

[27] Summary of Comments of Dr. Kirk Bozdogan, *Workshop*, pp. 27–28; *Policy Issues in Aerospace Offsets: Report of a Workshop* (hereinafter, referred to as "*Workshop*"), National Academy Press, Washington, DC, 1997.

[28] Owen Herrnstadt, "Role of the U.S. Government on Offset Policy," *Trends and Challenges in Aerospace Offsets*, National Research Council, 1999, p. 202 ("Role of U.S. Government"), citing the comments of Dr. Kirk Bozdogan.

dustry" as "sub-tier producers that employ thousands of aerospace workers are also affected."[29]

When it comes to China, the issue of overcapacity and competition is exacerbated since U.S. workers must compete with a workforce that does not enjoy fundamental human rights and that earns far less than their U.S. counterparts. As noted by the USITC, "[A]n additional advantage China enjoys over aspiring airframe competitors is a large pool of experienced aerospace workers with wages,[30] an estimated 30 to 50 percent below those in Western Europe."[31]

The competition that China gives the U.S. in the aerospace industry will also have profound effects in terms of national security. Indeed, as more and more U.S. aerospace workers are laid off and production is moved offshore, U.S. aerospace workers will undergo a "de-skilling." In addition to the obvious national security implications of a vital defense industry leaving our shores, when the U.S. will have to reemerge in the defense industry, it will be time consuming and expensive as workers will have to be trained and new facilities built.

Other national security interests are present with respect to China and transfers of U.S. technology. Recall the arrangement with respect to McDonnell Douglas' sale of machine tools to the China National Aero-Technology Import and Export Corporation to be used for production of commercial aircraft.[32] Some of the tools were transferred to the Nanchang Aircraft Company which produces Chinese military equipment.[33]

E. The U.S. Government Continues to Effectively Do Nothing About the Situation, to the Detriment of U.S. Aerospace and Aerospace Related Workers and Our National Security

The IAM has been raising the dangers of the U.S. aerospace industries' reliance on offsets for a number of years with industry and our government. Last year, the Presidential Commission on Offsets was established to address offsets in both the defense and commercial industries. Unfortunately, the Commission only met once. Although the Commission is required by law to issue a final report later this year, no future meetings have yet been scheduled.

Other than the Commission which was created by Congress and Executive Order, our government has done very little to establish a comprehensive policy regarding offsets. Currently, the U.S. government appears to be content to "relegate to U.S. private interests the sole responsibility of negotiating with other nations' government over offset issues."[34] Abandoning the government's responsibility for setting a policy on offsets has proven to have been a disaster for industries like machine tool and ship building and repair. Its inaction is also posing a serious threat for the aerospace and related industries. This threat is greatly enhanced when it comes to countries such as China and the granting of PNTR and their "accession" to the World Trade Organization. Indeed, China represents a dangerous example of what can happen when the U.S. government ignores its role in developing a comprehensive policy on offsets that protects U.S. workers, the economy, and our nation's security.

V. CONCLUSION

The IAM learns about U.S. companies that move our jobs offshore on almost a daily basis. Our members, who have built those companies, are then left behind to figure out how a company they have devoted their lives to could do this to them.

Many of the jobs we have seen disappear in this country—only to reappear in another country are in the aerospace industry. Instead of working on a way to protect the workers that have been so loyal to them, U.S. companies are only too willing to give their jobs away.

It's been said that today's multinational companies have no heart and no soul—many of them have no conscience either. Why else would they move our work offshore? Moreover, why would they move our work to a country like China, which tortures its citizens merely for speaking about fundamental human rights—like forming a free trade union? Still, they do it and the fact that our government not only permits it—but encourages it is outrageous.

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[29] Bozdogan, *Workshop*, at 202.
[30] USITC Investigation No. 332–384, 5–10 citing Aviation Industries of China officials, interviewed by USITC staff, Beijing, China, May 5, 1998.
[31] Ibid, 5–10 citing Lewis, "Time Out in Asia," p. 39.
[32] U.S. General Accounting Office Report to Congressional Requesters, *Export Controls: Sensitive Machine Tool Exports to China*, November 1996.
[33] Ibid.
[34] Herrnstadt, "Role of the U.S. Government" at 211.

U.S. aerospace workers are the best in the world and they will compete with any workers in the world. But the fact remains, how can they compete in any industry—including aerospace—when their work is being transferred to satisfy "offset" agreements? How can they compete with workers whose fundamental rights are denied? And how can they compete when their own industry and government turns their back on them?

These are the fundamental questions that IAM delegates who observed first-hand China's aerospace companies asked themselves when they returned to the United States from China. They are still asking the same questions three years later.

Co-Chairman BECKER. Thank you very much.

Mr. Douglass?

STATEMENT OF JOHN W. DOUGLASS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA, INC.

Mr. DOUGLASS. Thank you, Mr. Chairman. With your permission, I would like to submit my written statement for the record and then I'll summarize it briefly for the Commission.

Co-Chairman BECKER. Very good.

Mr. DOUGLASS. I guess the place to start is to thank all of you Commissioners for the time you're spending on this subject and to thank you for calling me as a witness. This is an enormously complex subject and you're trying to address it in a world that is in a period of enormous change. The technology that we're trying to manage is changing rapidly. The whole geopolitical situation is changing rapidly. Old friends are now some of our most challenging trade rivals. Old enemies are supporting us in ventures around the world. So this is a very difficult time, and your combined judgment and the fact that you represent a lot of different aspects of our national fabric is a wonderful thing and I commend you all for the time you're spending on this.

Let me start by telling you a little bit about our industry and then I'll turn directly to the China issues that you have raised. AIA represents America's aerospace companies, large and small, and comprise about 200 companies today. AIA is the oldest association in the United States representing this sector of our economy. We go back to the Wright Brothers and the very earliest days of aviation. Our original name was the Aviation Chamber of Commerce when we were organized back in the very beginning of the last century.

AIA represents just about 800,000 workers all over the United States and we support an aviation and space industry performing about a $1 trillion in transactions per year. Somewhere between ten and 12 percent of the gross domestic product directly involves our industry. The products that we manufacture, and the way they're used in the airlines and in commercial space, are some of the most fundamentally important parts of our national economy.

Last year, the production part of the industry, which AIA represents, produced about $144 billion worth of product. That is a somewhat cyclic number; we peaked a couple years ago at $150 billion. Pertinent to what you all are doing is the fact that about $55 billion of that $144 billion was exported outside the United States last year. In fact, our industry had a net trade surplus of $28 billion, which is by far the single largest net trade surplus in the entire American economy. And two years ago, our trade surplus was equal to the trade surpluses of the rest of the economy put together. So it is a huge part of the import/export equation that I noticed you were talking to the previous panel about.

It is important to note that over the last few years, the U.S. percentage of the total global aerospace market has declined, and I would emphasize to you that today, my testimony is almost exclusively dealing with commercial aerospace products. We export no military aerospace products to China. So as we shift into the China part of the discussion, I'm really talking about commercial products.

We used to have about 70 percent of the global share of all of the commercial aerospace products. That's down to about 52 percent and that's primarily due to the rise of a robust aerospace industry in Europe. Very little of that loss of market share has gone to China or to other parts of the world. It's almost all shifted to Europe.

Now, as we go through this issue, there's a fundamental fact that I need to make sure everybody understands, and that is that when you talk about technology transfer in the commercial aerospace sector, you're talking about a technology situation where our commercial aerospace sector has no real technological advantage as compared to the rest of the world. There are a few sectors where we do have technological advantage, but in the commercial aerospace sector, the rest of the world is on roughly a parity with us.

Most of you have flown on an Airbus airplane. Most of you have flown on a Boeing airplane. Look at them the next time you're on there and see if you can see a technological difference from one to the other. This is a situation where in most of our commercial aerospace products, if we don't sell them somewhere in the world, there are other people who have a product of equal value who will sell, and that is one of the most fundamental points that I'm going to make.

Now, let me turn to China. Last year, we had in the aerospace industry a $1.7 billion trade surplus with China. I notice that you all were concerned about whether we had a deficit or a surplus with China. Well, in the aerospace sector, it's always been a surplus. As a matter of fact, several years ago—it is cyclic, because they, like us, renew their air fleet periodically as the airplanes wear out, and as late as 1998, we had a trade surplus with China of almost $4 billion.

Commissioner LEWIS. What year was that?

Mr. DOUGLASS. That was 1998, as I recall. We can, if the Commission would like, supply a lot of material for the record about the trade surplus from year to year.

Commissioner BRYEN. Do you have comparable numbers on European——

Mr. DOUGLASS. Yes, sir, we do. Just to put this—thank you, Mr. Bryen, for asking me that question, because just to put it in a context to our biggest trading partners, I just happen to have that information. In the year 2000, with the United Kingdom, we had just over a $2 billion trade surplus. With France, we had almost a $4 billion trade deficit. With Germany, we had about a $1.5 billion trade surplus. With Japan, it was about $2.25 billion. With Canada, it was just over a $2 billion deficit. With South Korea, it was a $2 billion surplus. And with Saudi Arabia, it was a $2 billion surplus. And then right behind those—those are ranked in terms of our volume of trade—you're going to see China coming a couple of nations down the list with a $1.7 billion trade surplus.

So China is clearly one of our largest trading partners in aerospace. It accounts for somewhere probably, on the low end, 20,000 to 25,000 aerospace jobs. On the high end, probably approaching 100,000 aerospace jobs of the 800,000 I talked about and the 700-and-some-thousand my colleague here has talked about.

China has 548 jet airline aircraft in their inventory. Three-hundred-and-fifty-seven of them were built here in the United States, and our estimate is that over the next 20 years, they plan to purchase somewhere around 1,800 new jet airliners. The value of that fleet is in the neighborhood of $145 billion, and that adds up to about $7 billion a year in positive trade surplus for the United States if we were able to capture that market.

So clearly, U.S. access to that market, to the aerospace market—and remember, we're talking commercial airliners and commercial space products, not military products—has an awful lot to do with the future of this industry and the future, indeed, of America's economy.

Let me turn a little bit here to the situation with commercial space. I was the commander of the U.S. forces in the central part of Europe in my last assignment on active duty and I was the number two American general at NATO headquarters in Brussels. One of the most fascinating things in my military career was when the Soviet Union began to fall apart and the Warsaw Pact began to fall apart, I was one of the officers who would often escort Soviet generals and Eastern European generals over to NATO and talk to them about what was happening and the geopolitical events of that day.

We would often turn our conversation to what brought this about. After 45 years of the Cold War, was it America's great nuclear arsenal? Was it the strength of the American and Western economies? Exactly what was it? And almost uniformly, they would answer that it was access to information about the West. Indeed, most of them would put it even more succinctly and they would say it was that ability to get a hold of Western TV and Western movies.

When one talks about commercial communication satellites and China's access to that market, clearly, you have to bear in mind that if we have a long-term desire to see a democratic form of government and free enterprise form of government flourish in China, we want them to have access to the information in the West that is provided by commercial communication satellites. The issues for us are to sort out whether or not these satellites would be American technology or would they be European technology, which are the two rivals for this market. And clearly, if you think about it for a minute, there is a huge economic and geopolitical leverage by having those satellites built here in the United States and I would be glad to go into that in some detail in the question and answer situation.

Let me also tell you that in my written statement, there's a pretty good little history of how we got to where we are today in our commercial satellite trade with China. We've all heard the phrase used "I'm not a rocket scientist" to talk about people's understanding of technology. That's a common phrase that people talk about. Well, in this particular problem, you really almost have to be a rocket scientist to understand it, and so that saying takes on a very interesting meaning.

One of the things that I've observed as a person coming from the defense community into the trade association community in the last three years, where these big trade issues about commercial products are preeminent, is how often people confuse satellites and rockets. We'll be talking about the Chinese using American satellites and all of a sudden the conversation will drift very quickly into somehow we're improving Chinese rocket technology. The jump from satellites to rockets often becomes a very quick thing, that if you don't stop and try to walk through it in some detail, and my written statement does that, you can very quickly get off the track.

The second point to be made in discussing this issue of satellite technology and rocket technology is that we're in an interesting situation today in which there is not a uniform view in the government about what is important and what is not. In the Department of Defense, which most people recognize as the final expert on what is really of value in terms of our nation's secrets, we have a system called a classification system that categorizes information into unclassified, secret, top secret, top secret code word, and so on. As a matter of fact, your Chairman and I have shared many adventures together in this farthest world of top secret code word when we both were members of the Senate Armed Services Committee staff.

And yet, you find much to do about this body of unclassified information. In other words, it's information that our military says should be open to everybody. It's moved around by NASA and so on. But it occasionally gets classified as "sensitive" by bureaucrats in other parts of our government.

One of the things that's characterized the debate on technology transfer about satellite technology is you've generally had the Commerce Department and the Defense Department aligned against the Department of State, which is a very interesting sort of governmental breakdown. I would just ask you all as you go about this very, very difficult task to always have your antenna go up when someone says to you they're talking about sensitive technology. Try to find out what they mean by that, because if it's not classified, in other words, it's not secret, it's generally open out there in the world. The industry doesn't try to control it. It's available through all kinds of techniques.

Co-Chairman BECKER. General, I don't want to cut you off. I was a grunt twice in the service. I've always wanted to tell a general——

[Laughter.]

Mr. DOUGLASS. Wrap it up.

Co-Chairman BECKER. Let's shorten it a little bit. There will be plenty of time for questions if you want to get into that.

Mr. DOUGLASS. Let me just, then, wrap it up by saying this, because all of this is in my written statement. I was the Assistant Secretary of the Navy, and as such, I was responsible for procuring everything we bought for the United States Navy and the Marine

Corps for four years. And one of the things that just absolutely flabbergasted me when I moved into that job was when I looked at the American shipbuilding industry.

In 1946, America was the global leader in commercial shipbuilding in the world. When I took over as Assistant Secretary of the Navy, we didn't have a single commercial ship built in this country. We completely lost that industry through a series of government bungles and all kinds of problems. We cannot let that happen to our commercial aerospace industry. It will have enormous security implications for the military because what we'll find is we can never let our military aerospace technology go outside the United States. We've always got to have the ability to build new fighters, new bombers, new missiles if we need them, and so on.

The amount of technology support, the amount of human capital, as my colleagues will tell you here, that flows between military and commercial aerospace in the United States is huge, and so maintaining America's access to the global economy, including China, for commercial aerospace products is fundamental to the future of our economic and military security, and I'll be glad to answer any questions beyond that.

[The statement follows:]

PREPARED STATEMENT OF JOHN W. DOUGLASS

On behalf of the Aerospace Industries Association, I would like to thank Chairman D'Amato and the U.S.-China Security Review Commission for inviting me to testify today. The creation of your Commission attests to the fact that the Congress recognizes that the United States' relationship with China is of prime importance. Similarly, the U.S. aerospace industry considers China a priority as a major current and future market for our commercial aerospace business.

The Aerospace Industries Association, or AIA, represents the nation's major manufacturers of commercial, military and business aircraft, helicopters, aircraft engines, missiles, spacecraft, materiels, and related components and equipment. AIA currently has 68 full members and 120 associate members representing nearly 800,000 highly skilled workers in jobs that pay well above the average for the U.S. workforce. Aerospace technologies and products are also fundamental to maintaining our national security.

Mr. Chairman, let me begin by explaining how important the global marketplace is for our industry. Last year our industry's production totaled $144 billion. Of that, $55 billion, or forty-one percent, was exported. Our industry had a net trade surplus of $28 billion, which is by far the largest of any sector in the U.S. economy.

As impressive as these numbers seem, it is important to note that the 2000 figures for sales, exports, and trade surplus have all declined over the past three years. These downward trends are due to the fact that there has been a significant rise in sales of foreign-built aircraft, and our market share in commercial aircraft has dropped in the past fifteen years from 72 percent to just over 52 percent. The U.S. aerospace industry does not hold the same control over the global marketplace as it once did—there are competitors waiting to take over wherever opportunity arises.

Now, let me turn to China. Unlike other U.S. industries, last year the aerospace industry had a $1.7 billion trade *surplus* with China—mostly due to commercial aircraft. This surplus translates roughly to more than 22,000 jobs here in the U.S. As of last month, Chinese airlines operated 548 jet aircraft, 357 of which were made by U.S. manufacturers. Over the next 20 years our manufacturers forecast that China, including Hong Kong and Macau, will need 1,764 jetliners worth about $144 billion. This growth means that China will become the world's second largest market for airplanes over the next two decades (second only to the U.S.).

The rapidly expanding market for civil aircraft is due to two major factors. First, the railway and road infrastructure within China (especially in western China) is woefully underdeveloped. Consequently the demand for air passenger and cargo transportation will become increasingly important as China's economy develops and as it continues to expand its participation in the global economy. China's air cargo industry is currently in its infancy. Therefore, improved airport infrastructure, an open freight forwarder sector, improved service standards, streamlined customs processing, and seamless transfer of cargo between transportation partners will be necessary, and will also require major imports of equipment. These imports will have to include ground radar and air traffic control systems. And similar to benefits of general tourism, increased business from air cargo will spill over into U.S. companies that will fly into and out of China.

Second, China's increased economic and trade liberalization—as evidenced by its almost certain entry into the World Trade Organization later this year, its apparent interest in Open Skies agreements, and its eagerness to host the 2008 Summer Olympic Games—will translate into increased growth in aircraft purchases for use both within China and in the Asia-Pacific region overall. The number of Chinese willing and able to travel will increase significantly. As international business, economic trade, and tourism flow in and out of China, airline traffic to and from other Asian countries will expand. Furthermore, it is estimated that by 2019 there will be approximately 350 weekly flights between China and North America, helping our domestic airlines increase their business, and in turn prompting the purchase of more aircraft.

Commercial aircraft sales are not the only market opportunities that interest the U.S. aerospace industry. The growing need for communications within China and by China with the rest of the world has spurred the demand for satellites in the region. Just as the lack of ground transportation forces reliance on air transport, the fact that China's ground-based communication network is quite primitive means that it will have to rely heavily on satellite-based systems for telecommunications, Internet and television requirements.

We estimate that China plans to purchase at least $3 billion in communications satellites and related equipment over the next ten years. Although the U.S. government has been very reluctant to allow U.S. companies to sell and launch American-made satellites in China, there is even more potential for future sales and launches as China is brought into the global community with their accession into the WTO.

Let me give you a little bit of background on the satellite jurisdiction issue and the role China has played in our domestic debate over satellites. Before the Challenger shuttle disaster in 1986, the U.S. government had required commercial satellites to be launched by the shuttle. U.S. commercial launch capability consequently atrophied. After the Challenger disaster, President Reagan decreed that the shuttle would no longer carry commercial cargoes. About that time, demand for launch capability greatly increased, partly because of the growth of low earth orbit projects.

To help alleviate the shortage of launch capacity, President Reagan allowed the launch of American satellites on both Russian and Chinese rockets, under strict regulatory control. Presidents Bush and Clinton subsequently transferred commercial satellites from control under the Arms Export Control Act, and hence the jurisdiction of the State Department, to control under the Export Administration Act, and hence the jurisdiction of the Commerce Department. This followed the normal pattern of shifting control of products that had begun as primarily military products, to products widely used in the commercial marketplace, or so called dual-use products.

However, two unsuccessful launches of U.S. satellites on Chinese rockets resulted in subsequent post-launch failure investigations that included U.S. firms. Allegations were made that rocket technology might have been transferred to the Chinese as part of the investigation process. These allegations led to Congress transferring commercial satellite jurisdiction from the Commerce Department back to State by defining satellites as munitions. It should be noted, by the way, that at no time had rocket technology ever left the jurisdiction of the State Department.

I am not privy to the details of the two cases under investigation, nor would it be appropriate to comment on them if I were. However, I would like to express some skepticism over the notion that significant technology transfer can be accomplished in a few meetings or a few pages of comments on an investigation. I can only note that rocket programs involve thousands of scientists, engineers, technicians and workers, and incorporate thousands of individual parts and components. Getting everything to work together is a major challenge. Almost all new American, European, and Russian rocket projects have suffered failures during the first launches, in spite of having work-forces and companies that have far more experience in rocket programs than the Chinese. If engineering fixes and quality control were a simple matter of a few individuals looking at the problem, this would not be the case.

In any case, in 1999 the Congress did transfer satellites back to the munitions list. It seems to me that this has had three negative impacts on U.S. economic and security interests. First, by not focusing on China, but treating all trade in satellites and components as defense transactions, trade with our European allies has been disrupted. In fact, most of the 2,600 new licenses that State must cope with annually affect trade with Europe. Most of these would not have required separate licenses under Commerce rules. Hence companies are trying to cope with a military-oriented licensing system that takes an average of two to three months to review license requests in a commercial world that expects companies to be able to respond to bid requests in a matter of days. In frustration, Europeans design out American components, and we see our industry becoming weaker and theirs becoming stronger. And this dilemma comes at a time when our own military is increasingly dependent on commercial technology and commercial communications networks to meet its own needs.

Second, all defense exports to China have been prohibited under the Tiananmen Square sanctions enacted over a decade ago. As satellites were defined by law as defense items in 1999, a U.S. satellite manufacturer can only conduct business with China with a Presidential waiver. This transfer has also hit our supplier base in other markets. U.S. law with respect to items on the munitions list, including components, requires foreign countries to obtain permission from the U.S. government before transferring a U.S. product, including parts and components, to another country. Thus a European satellite manufacturer using U.S. components must obtain a Presidential waiver to export his satellite to China. Communications satellites are often produced in series, with multiple customers. Rather than take the risk that one of a series might be destined to China and run afoul of U.S. law, it is prudent to simply design out the U.S. supplier. Thus we not only lose the China market, but also the European one as well, and face new competitors even in the U.S. market. The sanction policy aimed at China has a boomerang effect on U.S. industry's ability to operate in many markets, including our own.

Finally, the practice of denying American manufacturers participation in satellite sales and launches in China has not only hurt our aerospace business, but has been directly detrimental to U.S. national security interests. Currently, U.S. law stipulates that the Department of Defense will monitor any launch of a U.S. satellite on a Chinese vehicle. These monitoring requirements also include any future investigations in the event of a launch failure. A bill that has been introduced in Congress to return commercial satellite licensing jurisdiction to the Commerce Department includes the same monitoring requirements.

These monitoring requirements, which were actually first imposed by executive order by the previous administration, assured that there would be no loss of U.S. technology in working with the Chinese. Perhaps equally important, our involvement with Chinese launches provided the U.S. government an extraordinary opportunity to evaluate Chinese rocket technology capabilities. Clearly when the Europeans sell a satellite to China and launch it on a Chinese launcher, we are neither in control of what technology is transferred, nor do we gain the insight as to current Chinese rocket capabilities.

Overall, we believe that as China modernizes its economy and opens its doors to the rest of the world, the requirements for air transport, tourism, air cargo, communications, and overall infrastructure offer an enormous potential market for the U.S. aerospace industry. I would acknowledge to my labor colleagues that it is quite likely that if indeed China is the world's second largest market for new sales over the next decade or two, it will certainly play some role in aerospace production. However, we believe that any arrangements that our companies make to source some product from China will be in the context of facilitating increased sales to China.

I would also like to point out that the bilateral agreement on civil aircraft between the U.S. and China that was agreed upon during negotiations leading up to WTO entry is very beneficial for U.S. industry, and discourage unreasonable demands on us for offsets and technology transfer. Currently, U.S. companies' ability to do business in China is severely limited because the right to import and export is restricted to a small number of companies that receive specific authorization from the central government. That has allowed the government to use aircraft purchases as a means of applying political pressure on the U.S. As part of the WTO agreement, China has agreed that any entity will be able to import civil aircraft and related parts and components into any part of China (this commitment is to be phased-in over three years). In addition, China will permit foreign enterprises to engage in a full range of distribution services—something that was not allowed before the agreement was negotiated.

Other terms of the civil aircraft agreement include elimination of all quotas and licenses, and the removal of local content requirements. The Chinese have also agreed not to condition imports or investments into China with requirements of technology transfer or the providing of offsets.

We believe that it is in China's best interest to abide by these obligations. As I have stated, China requires an enormous influx of aerospace products over the next several decades in order to facilitate their entry into the global marketplace. Such trade will require them to open their doors and live up to all of the commitments to which they have agreed.

In conclusion, let me say that the number one goal for the U.S. aerospace industry is strengthening our access to the global marketplace. We believe that U.S. economic and national security depends on our ability to overcome structural obstacles to that goal. In the case of China, these obstacles are generated by Chinese practices and by the slow response of our national policies to the evolution of the aerospace market. The barriers put up by China are being dismantled with their entry into the WTO. Our government now needs to look at changing outdated policies so that we do not lose business to our competitors overseas, without any gain for foreign policy or security interests.

Co-Chairman BECKER. Thank you very much.

Steve Beckman of the UAW?

STATEMENT OF STEVE BECKMAN, ASSISTANT DIRECTOR, GOVERNMENTAL AND INTERNATIONAL AFFAIRS, INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURAL, IMPLEMENT WORKERS OF AMERICA (UAW)

Mr. BECKMAN. Thank you very much, Mr. Chairman, members of the Commission, for inviting the UAW to appear today. This is a very important issue, one that is of great concern to UAW members. There are complicated issues here and we appreciate the time and energy you're putting into clarifying them for all of us, for Congress in particular.

My submitted statement covers a range of issues in which that the UAW has some expertise. I thought in my few minutes here I would focus on addressing the questions that the Commission raised in asking us to appear today. I'll just go through those questions, or those questions where we have something to offer, I think, for the Commission's use in areas where important decisions are going to have to be made.

First, we do not believe that the current relationship with China is producing results that are in the national interest, that U.S. national interests are not served by the current relationship. Our economic interests are not being served. The size of the trade imbalance demonstrates the economic inequities that exist. The problems in gaining access to the market in China for U.S. companies for exports, the ease with which imports come into the United States economy, this is not economically beneficial for American workers or the U.S. economy.

The relationship is not beneficial in terms of promoting democracy, either. The fact that the United States, for the most part, ignores the human rights and worker rights abuses in China, has taken no concrete action to change those policies, to use the economic leverage, the varieties of leverage the United States has to change that situation in China, is not good for American workers and is not good for the national interests of the United States.

Just briefly on security issues, the fact that a number of U.S. companies are in economic relationships with PLA factories and companies that are related to the PLA in China indicate that while maybe there are not classified U.S. secrets that are being transmitted, there are commercial techniques that are valuable to the Chinese military that are involved in those activities that are, again, detrimental to the national interests of the United States.

Are U.S. companies primarily interested in sales in China or in exporting back? Well, in the auto industry, largely, the companies are seeking to gain access to sales in the Chinese market because they have been completely excluded from exporting to that market. There are very small exceptions. There has been some smuggling, but the Chinese government is rapidly trying to control that in order to force those companies to produce in China.

That is the focus. But does that mean that the companies are only interested in producing for the Chinese market? Absolutely not. Just about every investment that's made in China in order to get over the barrier at the border has an export component to it. In the auto parts industry, in particular, a lot of investments are made at the scale of production that exceeds what is currently consumable in China and so they are going to be exporting a significant part of that production. In many cases, the products that they are producing in China don't really have a local market. They are anticipating that there will be a market at some point and so those products are largely exported.

To get an idea of what kind of capabilities exist in China, I was looking through some articles I have. Fifty percent of worldwide production of motorcycles currently takes place in China and about 15 percent of that production is exported. When Honda invested in the United States initially in the 1980s, they invested in motorcycle production because it was a more limited investment, simpler than producing cars. I think we can take from this example that China does have as an objective to create a very large and export capable industry in the auto sector, and as a result of that, we are very concerned about the potential for displacement of American workers here.

And China adopted in 1994, an auto industrial policy which establishes the industry as a pillar industry in China. Before that policy went into effect, the United States had a small trade surplus in automotive trade with China. We now have a deficit of $1.5 billion in auto trade with China and that deficit has been growing every year since the auto policy went into effect.

Will China live up to its WTO obligations? Is this going to really open the Chinese market for American producers and allow us to break into or allow U.S. products to break into the Chinese market without having to produce there? Not if history is any guide.

In 1992, the United States negotiated a memorandum of understanding with China. One of the provisions of that memorandum was that China would not adopt industrial policies that forced investment and promoted exports. In 1994, the auto policy was adopted. That is a prime example of China's track record of violating agreements which it has signed. China has also violated agreements with the United States on prison labor, on textiles, on intellectual property rights, and on market access more broadly.

So we don't expect the WTO accession negotiations to change that pattern. However, as was raised in the last panel, even if those commitments were, in fact, abided by, we don't have much hope that the WTO process offers much opportunity to change the way China behaves because we have experience with 25 years of negotiations with Japan on market access. In the last five years on auto products, there have been negotiations with Korea on access to the auto market.

WTO rules are not particularly amenable to changing private practices that result in the lack of access for products to those markets. As was said in the last panel, Japan has been a WTO member for a long time. We still don't sell a lot in the auto industry in Japan, despite the fact that our products are competitive and certainly compete on cost and quality with comparable Japanese products. We don't expect much to change there, and that is a serious problem with the negotiated agreement and a problem with the way the WTO will act.

What should the U.S. Government do if China does, in fact, violate its WTO commitments? Well, there are two things we propose in that area. One, we have to know what the rules are in China. We have to know what the laws are, we have to know what the practices are before we can take action, before we can determine whether violations have, in fact, taken place.

And while the administration says that they have gotten all this information out of China, the fact is, it's not a very transparent system and we don't really know exactly what the rules are, what the requirements are at the national level, at the provincial level, at the local level that govern how procurement takes place. How do those local governments decide what vehicles they're going to buy? We have to know all of that information. We have to be able to get access to that. So we need the U.S. Government to insist on continuing to obtain that information and to insist on continued movement in the direction of transparency in the Chinese system in order to make sure we have it.

Once we have that information, I don't think it'll be terribly difficult to find that violations have, in fact, taken place, but the U.S. Government has to exercise resolve to act under those circumstances. Our experience with the 1992 MOU and its violation is that the U.S. Government does not react. The United States Government never acted despite recognizing that the auto industrial policy was a violation of the MOU. For five years, six years, the United States Government took no action. We are concerned that that may be the administration's policy with respect to WTO violations, as well.

In addition, we need better laws in the United States for addressing the potential impact, the actual impact and potential impact of surges of imports from China. China is a very large economy. It's a non-market economy. Surges can take place very quickly and cause serious disruption quickly. We need to be able to do something about that effectively. We can't do that now.

And in addition, as China has adopted an auto industrial policy and an aerospace policy, we need to go through that same process here. Other countries have these policies in place. It's one of the reasons why you don't see the same kind of unbalanced economic relationship between China and other countries. We don't have those kinds of policies here in the United States and we need to promote industries like the auto industry, like the aerospace industry, because they provide tremendous value added in the U.S. economy and share that with the economy more broadly.

And finally, let me just add that the United States must remain extremely, extremely active in the area of dealing with China's violations of workers and human rights. This creates a very imbalanced economic relationship, an unfair economic relationship, one in which American workers will have no confidence in its ability to address their needs. China will make it much more difficult to achieve progress in the WTO once it accedes to the WTO and that just means the U.S. Government has to be that much more vigorous in its implementation of its obligation to support the creation of a working party in the WTO and to insist that the rules reflect the interests of workers as well as the interest of capital. China will be a problem in that area, but we believe it can be overcome.

With that, I look forward to the questions from the Commission and thank you very much.

[The statement follows:]

PREPARED STATEMENT OF STEVE BECKMAN

Mr. Chairman, members of the Committee, my name is Steve Beckman. I am the Assistant Director of Governmental and International Affairs for the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW). The UAW appreciates the opportunity to present its views on U.S. trade relations with the People's Republic of China and their consequences for the U.S. economy and security.

U.S. trade with the People's Republic of China has produced sharply higher U.S. deficits year after year and 2001 will not break that streak. Whatever may be accomplished by the policy of economic "constructive engagement" with China, it is not opening China's market to U.S. exports or reducing China's dependence on the U.S. market as a critical destination for its exports, nor is it creating opportunities for independent union activity for Chinese workers. Intense worker repression and deplorable human rights conditions are characteristics of the Chinese government's control over the economy and society.

U.S. imports from China are now five times the value of U.S. exports to China. As U.S. companies accede to Chinese government demands to invest in production facilities there and to transfer advanced technology to local producers, the trade imbalance will become far worse and the displacement of American workers from high value-added jobs will grow. This trading relationship is not serving the interests of American workers or our national economic interests.

The UAW has identified China's industrial policies for the automotive and aerospace industries as violations of the 1992 U.S.-China Memorandum of Understanding. That agreement committed China to end its import substitution policies and to refrain from adopting new ones. The auto industrial policy China adopted in 1994, with its import-restricting, export-promoting measures, made the auto industry a "pillar industry" for China's economic development. That policy has been recognized in many U.S. National Trade Estimates Reports, beginning in 1995, as a direct violation of the 1992 Memorandum. Despite this recognition, no U.S. government action was taken under U.S. trade law to force its elimination.

The provisions of the WTO accession agreement negotiated between the U.S. and China that cover automotive products have the same appearance as many "market opening" agreements that the U.S. government has reached with other countries with closed markets. In each instance, when such an agreement has been negotiated, the U.S. automotive trade deficit has worsened rather than improved. This has been the case for numerous agreements reached with Japan, for the North American Free Trade Agreement's coverage of Mexico and the recent agreements with Korea. We expect the provisions in the WTO accession agreement to produce the same result: despite reductions in tariffs and liberalization of quotas, China's market will remain effectively closed, limiting the increase in U.S. exports of vehicles and parts to that market; the assurance of open access to the U.S. market will encourage an even faster pace of investment in China by U.S. assemblers and parts producers; and, U.S. imports from China, especially of auto parts, will soar. We have already seen the U.S. automotive trade balance with China shift from a surplus of $0.5 billion in 1993 to a deficit of $1.4 billion last year.

China has accomplished this turnaround in automotive trade with the U.S. by forcing companies that want to sell in China to produce there and to use locally made parts and materials. General Motors, Ford and DaimlerChrysler all have assembly plants in China, as do many other multinational vehicle assemblers. Because of local content requirements, the attraction of low wages and the absence of worker rights protections, U.S.-based auto parts producers and their foreign competitors have also established production facilities in China. Parts producers, under considerable pressure from assemblers to lower their costs, are particularly prone to shifting production to China, where wages are a tiny fraction of U.S. levels. These companies are already in China and they have an interest in making their Chinese plants as profitable as possible. We believe that will lead to significant exports, displacing U.S. production and the jobs of American autoworkers.

The situation in the aerospace industry presents similar prospects for American workers. China has given preferential treatment in aircraft orders to companies that transfer production to China. These "offset" deals have shifted significant production to China in recent years, at the expense of American workers' jobs. Even worse, the companies have succumbed to Chinese pressure to transfer advanced aerospace technologies to China in return for market access. In this way, sensitive technologies, with defense as well as civilian uses, have been transferred and new competitors for U.S. companies have been created.

U.S. aerospace companies have gone beyond simply transferring technology to Chinese partners. In addition, they are training production and managerial workers in the advanced technology manufacturing techniques of the industry and building the infrastructure for industry growth and expansion. Under the Chinese government's direction, these developments are essential elements in the creation of a local industry that competes with U.S. producers. There is no doubt that the Chinese government aspires to expand and strengthen its aerospace industry.

The WTO accession agreement contains a provision committing the Chinese government not to require technology transfers, offsets or local content requirements as a condition for investment or sales. We believe there are loopholes in this provision that will allow the Chinese government to continue to insist on these kinds of deals for companies that want to do business in China. The WTO accession provision applies only to government actions, not to private agreements. Many Chinese state-owned enterprises have been privatized, so arrangements involving these firms and U.S. companies would not be affected by the accession agreement. However, the effective separation of these firms from government influence and control, in China's still government-controlled economy, is questionable. There are a number of mechanisms available to the various levels of government in China to influence the behavior of nominally private firms, rendering the agreement's technology transfer provision irrelevant.

The product-specific safeguard provision in the accession agreement has been identified as a response to the obvious potential for increased imports from China to cause U.S. worker dislocation. It has been described as an improvement over Section 201 of U.S. trade law, which normally covers such import surges. Despite that description, the potential benefit of this provision for American workers is entirely at the discretion of the U.S. and Chinese governments. The provision allows China to agree to voluntary export restraints and the U.S. to adopt import restrictions that apply only to China. The key word is "allows." Under what circumstances is the government of China going to agree to limit its exports to the U.S.? Given its history of avoiding initiating safeguard measures, when would the U.S. government initiate such an action solely against China? We expect that neither of these discretionary government actions will be taken. As a result, this provision provides no effective response to the demands we have made for automatic import surge protections in any agreement with China.

In addition to the inadequacy of the negotiated provisions of the U.S.-China WTO accession agreement, there is one very large area that is completely missing—provisions covering worker rights in China. The UAW has made clear for years that we would oppose any agreement that failed to ensure China's prior compliance with internationally recognized worker rights protections, the ability of workers to enforce compliance through domestic laws and regulations and China's support for including worker rights in the WTO, initially through the creation of a WTO working group on this subject. The agreement reached does none of these; in fact, this issue was never made the subject of negotiations.

The massive abuse of workers' rights in China has been well documented. In fact, the U.S. State Department's annual Country Reports on Human Rights and Practices has made clear that the worker rights situation in China is deteriorating. Child labor, prison labor, repression of independent unions, the lengthy imprisonment of independent union activists are all too common occurrences in China. American workers will never accept trade and investment that takes place under these conditions to be considered "fair." The fact that many American companies have invested in China to take advantage of these conditions, that the massive U.S. trade deficit with China is fed by these injustices makes their exclusion from the WTO accession negotiations all the more abhorrent.

The UAW believes that China's accession to the WTO, without its commitment to incorporating worker rights into the WTO work plan by creating a working group, is the single most effective way to prevent the WTO from taking this step. As long as the WTO rules contain protections for the rights of owners of capital, ensuring that broad rights for multinational corporations are enforced by governments, but fail to contain rights for workers that are at least as strong, workers worldwide will see the WTO as an instrument solely for the benefit of the wealthy and the economically powerful.

Our experience with the 1992 Memorandum of Understanding has added one more element to China's long history of violating its trade agreements and commitments. This calls into question whether there will be substantial U.S. trade benefits from the market opening agreements that China has reached. Bilateral agreements on prison labor, intellectual property rights, textiles, and market access have all been violated by China, eliminating the potential benefits of those agreements for U.S. interests. The recent statements of many Chinese government officials also lead to skepticism regarding the impact of the Chinese WTO commitments. Those officials have indicated that agreements on tariff reductions, quota increases and liberalized foreign ownership are no more than words on paper—they describe what is possible, but they will not necessarily determine what will happen. If the past is any guide, there will be far less effective market opening in China than proponents of WTO disciplines expect.

When violations of China's WTO commitments do take place, we believe that the WTO dispute settlement process will fail to address the inevitable trade problems that will arise. The WTO mechanism, which has been in place since 1995, has been slow to produce final decisions, cumbersome in its operations and opaque in its procedures. Because of the limited scope of the WTO's rules, which are biased in favor or more trade and less government regulation for worker, consumer and environmental protections, several of its decisions have challenged legitimate U.S. laws and regulations. It has also become clear that the ways in which discrimination against foreign products and services takes place in many countries, like China, through market structures and non-market relationships, cannot be successfully challenged in the WTO. By leaving these systems in place, the WTO puts open, rules-based countries like the U.S. at a disadvantage.

Being bound by the WTO process would also prevent the effective use of U.S. trade laws, such as Section 301, from addressing unfair Chinese practices that are not directly covered by WTO rules. Even though U.S. cases on such issues, including worker rights and toleration of restrictive business practices, could be filed and pursued, retaliation which raised U.S. tariffs or limited access to the U.S. market would not be allowed by the WTO.

China's auto industrial policy will have been in place for seven years before its formal structure is transformed by WTO accession. It is accomplishing its objective of attracting multinational investment and technology transfer to China. The U.S. government's claims that a WTO accession agreement would prevent China from developing a competitive automotive industry through unfair policies and practices and discriminatory treatment have proven to be simply wrong.

A continuation of the "pillar industry" auto policy in China will mean a growing trade imbalance and greater pressure on American autoworkers' jobs. As it is very hard to win protection for a U.S. industry through domestic procedures, we are especially concerned about this potential. There are some actions that, at a minimum, must be taken by the U.S. government to lay the groundwork for preventing substantial job losses for American autoworkers. The U.S. must insist on a full accounting of all Chinese government programs, at the national, provincial and local levels, related to auto industry development and commitments to the elimination of export performance requirements and other similar unfair practices, in reality as well as on paper. In addition, vastly improved U.S. safeguard measures to respond to injury or the threat of injury related to imports from China must be available to American workers. The size and the non-market structure of China's economy make such protections essential. The U.S. government must be ready and willing to act quickly when imports from China cause job displacement for American workers and injury to domestic producers.

The UAW is also concerned about China's ongoing policies toward aerospace trade and investment that promote its industry. As a large, government-controlled economy, China's demands for technology and production offset deals are rarely resisted by U.S. companies. As a result, civilian aircraft assembly is already taking place in China, as is production of a variety of sub-sections of complete aircraft, aircraft parts and components. Some of this production displaces U.S. exports and some is shipped back to the U.S., displacing production for the U.S. market. In both cases, American jobs in the aerospace industry are lost.

To ensure that further job losses in this critical industry do not continue, the U.S. government must, again, at a minimum, insist on China's full accession to the Civil Aircraft and Subsidies Codes in order to address all forms of government inducements for local production and to establish transparency in aircraft procurement decision-making by government-owned and other entities. The U.S. must also obtain a complete listing of all government support programs, direct and indirect, for China's industry.

The U.S. government has not taken action to end these unfair Chinese government practices in the past. There is no reason to believe that accession to the WTO by China would increase the U.S. government's leverage to eliminate these practices or prevent China from effectively pressuring U.S. producers to continue to transfer production and technology, and the jobs of American workers, to China in return for sales opportunities.

What is needed, then, is for the U.S. to develop strategies for promoting production and employment in these critically important industries, just as China has adopted industrial policies in the automotive and aerospace industries. The new skills and technologies developed in these industries contribute to advances in related and other manufacturing industries. The value-added they generate contributes to improving living standards for all Americans. It will take positive actions by the U.S. government to defend and promote jobs in these industries; without such actions, the U.S. economy overall will fail to produce the equitable, sustainable economic development that workers expect and deserve.

There are other factors that influence U.S. trade and investment with China and must be considered in any overall assessment of the impact of U.S. economic policy toward China on U.S. national interests. One of these factors is the restructuring in China's economy, which will lead to the privatization or sell-off of state-owned enterprises. Currently, many of these operations are receiving massive government subsidies to keep them running. While there are long-standing international trade rules on subsidies, the treatment of past subsidies that benefit newly privatized firms is not clearly established. China could have thousands of such firms conducting a substantial amount of international commerce. We believe that the subsidies embedded in the cost structure of such firms could give them an advantage in international trade.

Another important factor is the People's Liberation Army (PLA), which is a major economic force in China. Its factories account for sizable production of traded goods, but there is a limited amount of information available on the PLA factories. How will the WTO's rules be applied to these operations? It has been reported that there is an effort underway in China to reduce the PLA's role in the Chinese economy; how will WTO rules be applied to products made in formerly-PLA factories that may become state-owned enterprises or privatized firms? Because the economic impact of these operations is large, the situation in China presents a new and different set of problems. U.S. national security interests certainly will be affected by the establishment of joint ventures between U.S. corporations and privatized, former PLA companies.

The financial crisis that engulfed Asia in 1997 continues to affect workers in the U.S. as a result of its impact on production costs in Asia and competition among Asian countries for investment and global markets. The measures adopted by Thailand, Indonesia and Korea to obtain loans from the International Monetary Fund ensured that domestic austerity would keep workers' living standards depressed. Production there has focused on export markets, especially to the U.S. market, in order to earn the foreign currency needed to repay IMF and other international loans. American manufacturing workers suffered from the intensified import competition at depressed prices due to dumping and Asian currency devaluations. The interests of workers in the U.S. and Asia have been harmed in the process and the U.S. trade deficit has grown dramatically.

U.S.-based multinational corporations and the international financial community have been significant beneficiaries of this hardship for workers. Many U.S.-based corporations have been able to acquire financially strapped Asian firms at bargain prices. Dollar-denominated costs for their Asian production have fallen sharply, along with the purchasing power of the wages of workers there. Yet, consumers in the U.S. may not see any of that cost reduction, as these savings can be shifted to the bottom lines of the multinational corporations. In addition, U.S.-based firms that were previously prevented from investing in Asia by local capital controls now find it easier to establish production facilities, as the IMF has insisted on further capital market liberalization. In this context, it is worth keeping in mind that many analyses of the Asian financial crisis have acknowledged that the inflow of foreign short-term financing was a critical factor in precipitating the crisis last year.

The relevance of this situation for U.S. trade with China is that many of the Asian countries affected by the financial crisis have become more competitive with Chinese producers' exports to the U.S. market. To maintain their U.S. sales, Chinese companies will be pressing the Chinese government to keep their exports competitive by any means necessary, including a currency devaluation. The already outrageous U.S. trade deficit with China and other Asian countries would be widened even more by this kind of competition. As the technological sophistication of the products made throughout Asia increases, the resulting dislocation in the U.S. becomes more serious for highly skilled workers and the U.S. economy.

Finally, there is the situation of workers in China, which is particularly disturbing to UAW members. China has no independent unions and the use of forced labor, through the military and prison system, as well as child labor is widespread. Sadly, the situation in China appears to be growing even worse for workers who dare to attempt to create an independent voice in the workplace. Recent arrests and lengthy prison sentences demonstrate the resolve of China's government to repress efforts to create an independent union movement. American workers must not be forced to compete with products made under these horrendous conditions without recourse to the provisions of U.S. law that address workers' rights, just because China becomes a member of the WTO.

It is the responsibility of the U.S. government to ensure that such unfair competition is prohibited, by incorporating worker rights provisions as core elements of all trade agreements, by vigorously enforcing U.S. trade laws that incorporate worker rights protections and by insisting on the inclusion of core labor standards in the rules of the WTO itself. Governments must not be allowed to suppress the cost of labor, just as they must not be allowed to suppress other costs of production, to gain an advantage in international trade. The severity of the abuses in China and the size of the Chinese labor force demand that this injustice be remedied immediately.

Mr. Chairman, thanks for providing the opportunity for the UAW to appear before the Commission to address the bilateral trade relationship between the U.S. and the People's Republic of China. U.S. national and economic security are of the utmost interest to UAW members. We look forward to assisting the work of the Commission and in answering any questions you may have.

Co-Chairman BECKER. Thank you very much for very thorough and interesting presentations. I'm sure we've got some questions.

PANEL III DISCUSSION AND QUESTIONS AND ANSWERS

Co-Chairman BECKER. Commissioner Wessel first.

Commissioner MULLOY. I just want to ask a question of Commissioner D'Amato, or Chairman D'Amato. In setting up this hearing, I look and I see that we have the steel industry and we had the union. I see we have the aerospace people and we have the union. Later, we have the electronics manufacturers and we have the union. Here, we only have the UAW. Where are the automobile manufacturers?

Chairman D'AMATO. The hidden answer to that is they aren't here.

Commissioner MULLOY. Because?

Chairman D'AMATO. We invited them and we invited their trade association. That's what they're in town for, the trade association to represent them, but they declined to testify after repeated invitations. That's the answer to it.

And for your information, we're going to conduct an investigation of the trade and investment patterns of the automobile industry with regard to China. We're going to have to do that. This is a permanent Commission and we're going to have a permanent role in this trade investment relationship. It's unfortunate that some of these companies don't feel that they can afford to be public in their views as to the relationship, and that is very disturbing and indicates to me there may be some problems that really need to be investigated. That would be my assessment.

Commissioner MULLOY. Can I just ask, Mr. Beckman, do you have any idea why the automobile people wouldn't want to appear here?

Mr. BECKMAN. Well, I'd be happy to speculate on why they might not be here.

[Laughter.]

I think the auto companies have received a lot of attention for the investments that they have made in China and they have made some claims about how wonderful it's going to be for American workers and there are going to be exports associated with their investments there, and yet the reality is that we don't see that happening. In fact, if you look at the trade numbers, the value of U.S. exports of auto parts to China have diminished since major investments were made in China, and we have some reason to believe that what exports those companies are responsible for into China are coming from other places besides the United States, despite the claims made by those companies.

I think they are concerned about the questions about how much they're going to be exporting from those facilities back to the United States. They currently aren't doing a lot, but the question is what their plans are and they may not want to publicly speculate about the potential for exports from those markets, to the United States market from China.

We obviously believe that a public discussion of these issues is very valuable and we don't have anything that we refrain from providing for the public record. We wish they were willing to do that. Obviously, they are not, and as a result, the discussion is not as interesting, not as full, but as I say, I'm happy to speculate on any number of issues about what their interests may be and how to explain their role in this economic relationship with China.

Commissioner MULLOY. Thank you.

Commissioner REINSCH. Could I ask the Chairman, are we going to investigate everybody who turns down an invitation to appear? Is that our policy?

Chairman D'AMATO. No, that's not our policy.

Commissioner REINSCH. It would be a long list, I suspect.

Chairman D'AMATO. We think that the automobile trade is probably one of the most important manufacturing trades in this country. I believe that we've had a longstanding series of disputes with the Japanese, as you may recall as an executive branch official, a lot of them not satisfactorily resolved. So——

Commissioner REINSCH. I'm sorry they're not here. I agree with you, it would have been nice to have them, but——

Chairman D'AMATO. It would be nice.

Commissioner REINSCH. —I'm not sure that we need to retaliate.

Chairman D'AMATO. Retaliate is not what I'm talking about, Commissioner. I'm talking about getting to the facts of the situation. I don't know what retaliation would involve, but that's certainly not what we're involved in.

Commissioner DREYER. Refusal to buy their cars.

Chairman D'AMATO. Or buy any cars exported from China, I don't know. I think we need to find out what's going on in all our major sectors. That's our mandate and that's what we're going to pursue. As long as I'm Chairman, we're going to pursue it.

Co-Chairman BECKER. For the record, though, along the same line, Boeing received an invitation which was declined, I believe, is that correct? Boeing declined to testify. And if we want to roll the clock back, we sent an invitation to Huffy Bike at the first hearing in which they were invited to attend, and they had facilities that they had transferred from the United States to China and they refused to attend.

Mr. DOUGLASS. Mr. Chairman, I think it is fair to say, though, that I represent Boeing here today.

Co-Chairman BECKER. I understand that. I'm just saying, if we're talking about the union and we tried to match—we did try to match up the union and the company and specific invitations were sent. Without reading into anything what that means, I mean, the fact is, there has been—they have declined in several instances.

Mr. Wessel?

Commissioner WESSEL. Thank you, Mr. Chairman.

General, I'd like to understand from you the issue of offsets. Can you tell me what the industry's general view is on offsets, not only with regard to China but——

Mr. DOUGLASS. Yes, sir. You know, up until this last year, I think you could easily characterize it as saying that the industry hated offsets but saw it as a necessary evil because of the kinds of global competition we faced. When our competitors would offer all kinds of incentives, some of which we can't offer by law, the offset was often the only way that we could counter some of the inducements put forward by our competitors, and, of course, my colleagues here, who I enormously respect, don't like that. But we don't like it, either.

This year, because we have set a policy of trying to find much more common ground with the kinds of comments that you've heard from my two colleagues, we set as one of our top ten objectives to try to convince our government to carry forward the policy that offsets should be banned on a multilateral basis across the globe, and we think if all of the trading partners involved in aerospace would sign some kind of agreement to stop the offset situation, then the problem would be solved and our industry would be enormously willing to go along with that.

But the basic difference, obviously, on offsets boils down to this. If you look at the portion of the offset that creates a job in the other person's country, you look at it as jobs lost. But if you look at it from the other point of view, that you wouldn't get the sale in the first place, so if you're going to sell an airplane and five percent of the content is offset, you know, on an overseas, then you've got 95 percent jobs here that you wouldn't have gotten if you didn't have that offset policy.

But in general, if we could get a multilateral agreement across the board, I think you'd see the unions and industry glad to see that happen.

Commissioner WESSEL. To that end, and as you pointed out earlier, if I remember, aerospace is our nation's number one positive contributor to our trade situation, what is the administration doing? What have you sought to do to try and spur a multilateral agreement on offsets?

Mr. DOUGLASS. Well, we've certainly made our position clear to both the previous administration and to this administration. And in a more precise and concrete way, which I think this Commission would resonate with, two years ago, the Aerospace Industry Association led an effort to get both candidates for President at that time to promise a Presidential commission on the future of the aerospace industry with offsets being one of the major issues that we needed to take under consideration. We also supported formulation of a Presidential commission on offsets and have supported it.

Finally, we worked very closely with our colleagues up here on Capitol Hill to actually get a law passed that says the President has to have a commission, a Presidential commission on the future of the aerospace industry in which offsets would be considered, and I believe that, based on what I've been told, President Bush is about to announce the formation of that commission sometime in early September. The Congress has already named its six commissioners.

Commissioner WESSEL. Mr. Thayer, do you have any comments on the offset issue?

Mr. THAYER. Yes. If I could indulge the Commission to respond to something my good friend John said in his presentation, I didn't realize he was representing Boeing. I wish you were with us in the 1998 mission that we took over to China.

But I'll ask you the same thing, to put your antennas high when someone says that there is no technological transfer of technology in the commercial industry, and I'd ask the Commission to kindly look at page eight of our comments that were submitted. In a U.S. General Accounting Office report on the machine tool exports to China in November of '96, the second paragraph, other national security interests at present, with respect to China and the transfer of U.S. technology, recall the arrangement with respect to McDonnell Douglas sales of machine tools to the China National Aero Technology Import/Export Corporation to be used for the production of commercial aircraft. Some of these tools were transferred to the Nanchang Aircraft Company, which produces Chinese military equipment.

And make no mistake about it, that the Chinese government is looking through the offset arrangements to capture much technology—in our journey through China, in our viewing of those factories, I think it's safe, and my colleagues could comment, that the technology being used in many cases is late 1950s/1960s technology of where we were back in that time frame and they want to bring that technology forward.

One company official, in my recollection, even asked if we had any way that we could assist them in getting a five-axis CNC, a numerically controlled machine, because there was restrictions by the U.S. Government of selling five-axis. They could buy two-axis or three-axis machines, but they couldn't buy the five-axis machine and that's what they needed to carry out their expansion of their technology. So there is a transfer of technology taking place.

Mr. DOUGLASS. Mr. Chairman, just to set the record straight, I did not mean to convey—I think my colleague misunderstood what I said. I did not mean to convey that technology is not transferred in the aerospace industry. It is routinely transferred in lots of occasions, and I know that this is of concern to my colleagues that are here at the table.

What I said, and let me be very precise about it, the technology that exists in the United States aerospace industry to produce commercial aerospace products is roughly on a par to what exists in the rest of the world, and if you speak specifically to what my colleague has brought up, which is manufacturing technology, you know, these five-axis machines and so on, most of the time, we'll find that manufacturing technology in our trading partners is higher than it is here in the United States for the simple reason that their industry is newer than ours.

If you were to go to Toulouse, for example, and see the manufacturing technology at Airbus and come back to the United States and look at some of ours, you would readily see that if the Chinese wanted to get the latest manufacturing technology, they would not come here, they'd go to Toulouse, and that's one of the things that I push our government to address, is to help us make sure that American workers have access to the best manufacturing technology that exists in the world.

Commissioner WESSEL. Let me understand, if I could, though, and I understand that most of our activities so far have been commercial in nature with China, although you did allude that there may be some small amount of military sales, I believe you said predominately commercial. In enhancing their abilities to manufacture, whether it's through offsets, et cetera, aren't we also enhancing their military capability, understanding we're not yet at the point of integrating avionics, but we are helping them on the airframe production, and if they, China, wants to enhance its military air capabilities, transferring this technology can be used in those areas, as well, is that correct?

Mr. DOUGLASS. There is always some overlap between commercial aerospace technology and military technology and you can draw that reasonable assumption, Mr. Commissioner. The issue that you have to look at is the relative scale and the relative impact to national security on either side of the equation.

If you deny this huge market to us and you just give it to Europe, they get the technology anyway and they get the same result for their military and we get nothing. One has to ask yourself, why would we do that? Why would we do that to the American workers? It means no jobs. When you get into the space products, it's even more dramatic.

And one of the things, Commissioner, that you have to remember, you have to remember this always, is that when they are using our products, it gives us an enormous long-term relationship which has benefits on both sides of the equation. As a matter of fact, one of the issues that I deal with constantly in which you have to make these very difficult judgments is there are rogue nations around the world far different than China that have American commercial aerospace products that they bought before they got on the "bad boy" list, and sometimes we have to make very difficult judgments, let's say when we find flight safety problems. Do we notify those countries or don't we notify those countries? We don't want their common folks to be killed in crashes because we don't tell them the latest safety updates and things of that nature.

So these issues are not always what they appear on the surface. You have to look in a macro sense what is to be gained and what is to be lost, and that's why the work of this Commission is so important and that's why I'm so impressed with the time you're spending and the quality of your questions and I commend you for it.

Commissioner WESSEL. Mr. Thayer, I also believe, wanted to respond, but I know my time is up.

Mr. THAYER. If I could indulge and ask that my colleagues here, Dick Schneider and Owen have a brief response to John's statement. Dick?

Mr. SCHNEIDER. Well, first of all, I am Dick Schneider. I'm the overall Boeing coordinator for the IAM, responsible for all our Boeing plants in North America, and so I travel around the country and Canada and I listen to our members speak, and everywhere I go, their number one issue is job security. Over the years, they've witnessed their jobs go offshore, they've witnessed their jobs go to Mexico.

And historically, we have asked Boeing—we began to ask Boeing in the early 1980s to take us on a visit to China. Show us what you're doing over there, because they told us that the job loss to China was only 47, and that's Boeing's number. So, consequently, in 1998, we had the opportunity to go on a joint mission to China with the Boeing Company and they showed us what they thought they should show us and nothing more.

But we did have opportunity to see firsthand what I like to call the offset game. The first night in Beijing, the first banquet with the Chinese government, and it's not a private company, it's the Chinese government, I sat at the main table with the Boeing Company and the Chinese officials and listened firsthand to those Chinese officials tell Boeing, we would like to buy some 767s. However, you know what we want. If we buy the planes, you have to give us a portion of the manufacturing. That's the offset game.

Boeing is a great company and I enjoy doing business with them. Our members enjoy working for them. We've had a contractual relationship with them since 1936. When we began that relationship, our members were building canvas-covered biplanes, and now they build the most highly sophisticated aircraft in the world.

It is true that China is a growing market and requires a lot of aircraft in the next 20 years. The question is, who's going to build those aircraft, because we have certainly seen the diminishment of the jobs that our workers and our members perform lost. We see our membership numbers, as depicted by Bob Thayer, diminish in the aerospace industry.

Offsets may be small now, at least that's what the companies tell us, and when we talk about the aerospace industry in the world, we're primarily talking about in commercial Airbus and Boeing. That is it. That is it.

Upon conclusion of our visit to China, and we witnessed what China could do, and they can do anything they want to do, and what they're looking for is manufacturing experience, assembly experience, design experience, financing, which they're getting from Boeing and Airbus, management experience, and marketing experience, and most of all, technological exchanges, and they're getting that, also.

The Chinese people are a great people. They're an intelligent people. They're being trained for this industry, and in Boeing's own words, China's goal is to build airplanes to meet their demand and for export.

Well, our biggest competition right now is Airbus, and it's funny, coming in here yesterday, I sat next to the operations manager for United Airlines and I asked him quite candidly, how come you bought 100 Airbus airplanes? Why didn't you buy Boeing? And his comment to me was, "Well, if you can convince Airbus to stop giving the planes away, we'll stop buying them."

We've got a lot of darts being thrown at us in the U.S. commercial airplane industry, and I'm talking about Boeing. You've got, on one hand, competition from Airbus, who are discounting their aircraft up to 40 and 45 percent. Boeing can't do that. They don't get any assistance from this government. And on the other hand, they've got the issue of offsets.

Ladies and gentlemen, Commissioners, what the world sees in the United States aerospace industry is one giant shopping mall because they know when they buy an airplane in this country, they can open the store doors, go to the shelves, and pick out virtually anything they want and they're going to get it. There's no control. Nobody's watching industry. Nobody's helping industry. And at this juncture, industry doesn't want that help.

Now, to say that the U.S. aerospace industry would be more than happy to abolish the offset game if, in fact, Airbus would do the same, it's not going to happen. So what's going to transpire is industry is going to be left on its own accord to monitor itself, give U.S. jobs and technology away, and nothing is going to transpire except the loss of the U.S. aerospace industry in this country and the loss of jobs of members that I represent. Thank you.

Co-Chairman BECKER. Commissioner Bryen?

Commissioner BRYEN. Thank you, Mr. Chairman.

I have to confess, I'm a little bit confused. On the one hand, we just heard that our aerospace sales are really one of the bright spots in trade, not only with China but other countries, as well. It's a success. And on the other, we're complaining about export controls as inhibiting our ability to do business. It sounds like it's not inhibiting anything, that the fact of the matter is, at least from the point of view of exports, we're being quite successful. I'd like to have your comment.

Mr. DOUGLASS. Well, in the last three years, our positive trade surplus has declined by 35 percent, so the trend in the last three years is clearly in the wrong direction.

The export control issue is primarily affecting commercial space. That's been the focus in recent years. But it does extend into the commercial aerospace industry whenever there is a product which is considered to be a dual-use product, Mr. Commissioner, and I could give you examples that are so ludicrous about the problems that we have, that I think our industry colleagues do support us in export licensing.

For example, during the war in Kosovo, we made arrangements with the Italians that they would do air-sea rescue in the Adriatic if any American pilots went down. They came to us and said to our Air Force, we do need to get some flares so that we could drop flares at night to see where the pilot is, and our State Department said, no, you cannot have American flares, which were manufactured 20 years ago, to rescue American pilots. That's to a NATO ally, the Italians.

We also for two years denied an Italian commercial airline company an export license on a landing gear knob. Now, we could give all the landing gear knob technology that exists in the West to our most hated enemies, and what the hell would they do with it?

And so there are examples that go on and on and on like that that are serious problems in which American companies just can't sell overseas because they're all tied up in bureaucratic red tape here, and it mostly affects space right now, but it does affect commercial aviation.

Commissioner BRYEN. I think the evidence points the other way. I completely agree with you, if there are cases like you cite, I mean, those are obviously——

Mr. DOUGLASS. Sir, I could speak for six hours and give you examples on that.

Commissioner BRYEN. I'm not going to invite you to do that.

[Laughter.]

Commissioner REINSCH. I'd be happy to have you do it.

[Laughter.]

Mr. DOUGLASS. Bill knows. I've bent his ear plenty of times.

Commissioner BRYEN. But I think the issue I'm trying to get at is that we're in a big competition, both in the space field and in the airplanes for sales around the world. In many of the satellite cases, it's not built by the U.S. only but it's often by consortia of U.S. and European manufacturers building these things. And in one case, one of the U.S. companies was, until two years ago, owned 49 percent by European aerospace interests and companies.

So I think it's a much more complicated picture than what you're explaining to the Commission, and I'm not even convinced that we don't have some technological advantages. Because we do have this nice trade surplus, we must be doing something right out there.

In the area of the co-production issue, which is what concerns the colleagues from the labor organizations and particularly in regard to China, are the Europeans offering, particularly Airbus, offering co-production deals there that are equivalent to what the U.S. is offering?

Mr. DOUGLASS. I'm not familiar with what Airbus is offering the Chinese in terms of co-production deals, Commissioner. I could take that for the record and see what we have back in our knowledge base on that.

Commissioner BRYEN. Do any of the union members have any knowledge on that?

Co-Chairman BECKER. As long as we're talking about knowledge on that, do we have a legal opinion, are offsets illegal? Is that a legal practice?

Mr. THAYER. It's legal——

Mr. DOUGLASS. Yeah, it's not illegal, Mr. Chairman. There are some things——

Co-Chairman BECKER. We've had testimony before a different commission that implied that this was illegal, that everybody——

Commissioner REINSCH. No, they're pernicious, but they're not illegal.

Mr. DOUGLASS. That's right. That's right. What is illegal in our country that some countries do allow is gifts and kickbacks and things of that nature to the purchasing officials in foreign countries. If American industry officials are found to be doing those kind of things, they have been in the past and could be in the future put in jail. That's not true in all of our competitors.

Co-Chairman BECKER. I understand that. I was just going specifically to the offset question.

Commissioner WESSEL. Is that the same thing in the military?

Mr. DOUGLASS. I beg your pardon, sir?

Commissioner WESSEL. In the military, is it both commercial and military?

Mr. DOUGLASS. Yes. The rules are essentially the same. As a matter of fact, almost all of the—the bulk of the offsets are in military, not civilian, products. Where we get offsets in civilian products are where the airline that is purchasing the equipment tends to be owned by the country. Now, in the case of China, we do see that situation, but in other parts of the world where the government of the country in question owns the airline, so they say to us, if we buy your plane, what are you going to do in our country in terms of production. But there are lots of places in the world where that is not said in the commercial world. It's strictly a commercial business deal.

There's one other point that I think needs to be made here. In all deference to my colleague's comments about Boeing, Boeing is the largest manufacturer of civil aircraft in the United States, but the components that go into a Boeing aircraft are made all over the United States by numerous other companies. All of those companies have views on these issues. Some of them are union shops, some are not. So when I'm talking here, I'm not talking exclusively about Boeing. I'm talking about the entire industry, the engine manufacturers, all of the other components that go into a commercial plane.

Mr. THAYER. If I could, Mr. Chairman——

Co-Chairman BECKER. Yes?

Mr. THAYER. Therein lies the problem, as John illustrates, the corporations. It's not illegal to set up offset arrangements with China, and the problem lies in that the corporations are the only ones. There's no government involvement to control what's happening out there, whether it's Airbus or whether it's another manufacturer, a Lockheed versus a Boeing. We need—in settlement of that issue is the government needs to take the lead role in setting up an industrial policy that on how we're going to address this whole issue of offsets.

A country like China that has 1.25 billion people to employ, you don't have to be a rocket scientist to understand that they want our technology to ultimately build that plane independent of the United States, getting nothing from the United States in doing it. Are they at that level now of being able to do it? No, but they're fast approaching that level.

There was a time they would be satisfied if the piece of the action or the offset was putting the skins on the wings or doing some work on a component. When they start demanding that some of the offsets have to be including introductions to the avionics in the cockpit, what does it tell us? It tells us they want to produce planes. They want to buy them from us. They want some of the action.

We saw them, where what they called a master was showing the students in their apprenticeship program, five and six Chinese workers, male and female, learning from the master how to work this jig and how to do this. They want to take their own industry and sell planes down the road.

Mr. HERRNSTADT. If I could add to that briefly, if the Chairman would indulge me just for a minute or two, my name is Owen Herrnstadt. I obviously work with both Bob Thayer and Dick Schneider. We have been working to educate people about the offset issue for a number of years and I just want to comment very briefly on what has been termed a prisoners dilemma that our members constantly face. Either they lose part of their jobs in return for a possible sale or they are being told they may lose the entire sale and, therefore, lose even more jobs.

We don't know if that's true or not. You might want to take a look at the recent International Trade Commission's report on large civil aircraft, which does contain some language regarding that. Keep in mind, however that much of the information comes from manufacturers. Therefore, I'm not sure how objective it really is.

The real question for us is the issue of a prisoners dilemma—whether it's with China or any other country—is not a satisfactory situation for us. You just heard Dick Schneider talk passionately about our members in the aerospace industry. You heard our Executive Council Member Robert Thayer talk about how job security is still—still—one of the number one issues that our members face.

And what we've been asking for is that our government not abdicate its role in defining an industrial policy, whether it be on offsets or on any other trade issue. Offsets are incredibly complicated, as has been acknowledged by this panel and by some of the Commissioners themselves. And the real issue is trying to figure out exactly what offsets are and what offset-like activities are.

The technical definition of offsets concerns government mandated transactions, but we know that it takes place between private parties. And the question is trying to determine what these transactions are and how it will impact upon not only our workers but upon the U.S. public itself, and that's why we talk so passionately about this issue and why we are so fearful that this issue, if not taken care of in the short term, will become a long-term disaster, particularly for the aerospace and related industries.

We have seen other great industries in this country decline immensely, the U.S. shipbuilding and ship repair industry being one of them, and we want to make sure that this industry is protected, not only for our members and for our workers, but for our nation and our national security in the future.

Co-Chairman BECKER. Very good. You have one more question?

Commissioner BRYEN. Just an observation, Mr. Chairman. In the conversation about launch vehicles, Chinese launch vehicles, the sensitivity is the fact that the same launch vehicle, basic launch vehicle which is used for commercial satellites is also used by China for its ballistic missiles, which you fully know.

Mr. DOUGLASS. Yeah, but what's the connection, Commissioner?

Commissioner BRYEN. The connection is that the more launches and the more help you give them to improve that capability, the more threat there is to the U.S.

Mr. DOUGLASS. Sir, I used to be a launch—involved in the launch business down at the Eastern Test Range. When I was a young Air Force officer, I was in charge of the worldwide tracking system. When we put one of those missiles in the drink, you cannot imagine what we went through trying to find out the problems. And this notion that somehow when the Chinese put one in the drink that they get some huge windfall of information, because it was an American satellite sitting on the tip end of the thing, is sophomoric, sir, at best.

Commissioner BRYEN. Let me tell you what happens. There was an international team who were sent to China to evaluate the failure of the Long March 3. This team consisted of an American, top American engineers, and engineers from Europe and Australia, as well, I believe, and they spent quite a bit of time doing the diagnosis and a systems analysis of that failure. It wasn't just a casual transaction. And it was essentially underwritten by the insurance companies who were of a mind not to launch anymore in China because they had a couple of failures, or three failures, actually, and they were concerned about quality control and other issues.

The result was that information was transferred to the Chinese and without an export license and without proper authorization that some believe, and these some are in the Defense Department believe transferred a lot of valuable information on fault analysis and on what went wrong.

Now, whether, in fact, and it's still a contentious issue, whether, in fact, it was enough to give them information to improve Long March in a significant way, I don't know. I do know that subsequent Long March launches have been flawless.

Mr. DOUGLASS. Sir, there are two very simple questions to get to the bottom of that. If that had been a French satellite and there had been no Americans in that meeting, are you suggesting it would have turned out differently? I mean, you know, having us there——

Commissioner BRYEN. I don't know that the French are launching Chinese satellites.

Mr. DOUGLASS. I'm just saying to you, as you said, it was an international situation.

Vice Chairman LEDEEN. What's the point, General? Have the French threatened to launch an ICBM against Los Angeles?

Mr. DOUGLASS. No, no, that's not the point. You all are implying here that somehow because it was an American satellite, that there was something unique about the technology transfer discussion which came from that team to the Chinese, and then——

Vice Chairman LEDEEN. No, sir, that is not—you keep saying that, but that is not what's being asserted. Your paper claims that fools like us can't distinguish between a missile and a satellite, but we're talking about a rocket and what was repaired was the ability to accurately launch a rocket. I mean, the rocket crashed and destroyed the satellite.

Mr. DOUGLASS. My point to you, though, Mr. Commissioner, is if we Americans were not present and that same situation took place, how would it have turned out differently?

Commissioner DREYER. General, one of the things that I think would have turned out differently, the French would not have divulged any information.

Mr. DOUGLASS. Well, ma'am, maybe you know something I don't know, and I certainly respect that you might. Just having been in this business, especially as an internationalist for the last 40 years, I know how these international teams and things work, and also knowing how difficult—we've had numerous examples here in the United States where we've had several missiles go in the drink and then we have a perfect record for 30 or 40 in a row. I was on some of those accident teams when I was a young kid, and for me, if I could stand up and say, boy, that accident investigation turned everything around, I don't really believe that. I believe the manufacturers themselves, they listen to a lot of advice. There's a lot of discourse that goes on and people go off and fix the thing.

My only point here is that case, in my opinion, and I do very respectfully consider myself to be one of the most knowledgeable persons in the United States about the general topic, has been greatly exaggerated, and I've been on both sides of this issue, as a military officer, Congressional staffer, and now as a representative of industry. And all I can do is sit here as an American that loves his country and tell you what I think is best for our country, ma'am.

Co-Chairman BECKER. But we've made the point. Let's move on from that line of questioning.

Here's who we have now, and the time is running. Commissioners Dreyer, D'Amato, Mulloy, Ledeen, Reinsch, and Robertson. You're the only one that's left out. So why don't we move in that direction and let's keep it as pointed and as short as we can because we've got about 20 more minutes.

Commissioner MULLOY. Mr. Chairman, if you wanted to cut it at four minutes apiece, that might be a way we could all get in.

Co-Chairman BECKER. I think we need to cut it to about two minutes because we have a little bit of overrun, but Commissioner Dreyer, go ahead.

Commissioner DREYER. First of all, I would suggest that even though it's possible to outlaw formal offsets, it's going to be very difficult to get rid of offsets because many times watching these negotiations go on, for example—Jim Lilley will know about this—the Taiwan negotiations with MATRA about building the high-speed transportation system, a lot of what went on there was informal and under the table and you're never going to get rid of that, even if you do pass formal laws.

The question I would ask all three of you to address just very briefly is the question of quality control. When McDonnell Douglas first started having tails manufactured in China, they discovered a number of problems. That was, of course, early on in the process. Do you consider that what you know best about that is manufactured in China is on a par with the same item manufactured in the United States?

Mr. BECKMAN. We do know that some of the vehicles that are being assembled in China and parts that are being produced in China are exported to Europe, to the United States. It certainly seems that the quality of those products is comparable to those that are produced elsewhere. So I think the companies that are using China as an export platform have put in the necessary technology and the necessary training to accomplish that objective, and that's why we see the conditions under which Chinese workers work and the pay that they receive to be such an unfair basis for competition, particularly given the role that the Chinese government plays in enforcing that regime.

Mr. DOUGLASS. I would say that they have the capability of producing quality products for the commercial aerospace world. In general, our experience has been that when they first came into the International Civil Aviation Organization a number of years ago, they had some serious deficiencies in the way their civil aviation operated. They have tended to follow ICAO rules. They tried to bring themselves up to the rules of the organizations that they join. So I think they do have the capability.

I would say on this offset issue, ma'am, that for every job we've lost to China, we probably lost 100 to Europe. So, I mean, putting it in perspective, offsets to China is a very small issue as compared to the overall structural problem of American aerospace being competitive on the global economy against our European colleagues.

Commissioner DREYER. Mr. Thayer?

Mr. THAYER. You may want to refer to Boeing, if you look at our submission today, the attachment on the back of page nine. It lists all of the parts that Boeing has asserted to us is being built over in China.

Commissioner DREYER. I don't have an attachment to page nine, but——

Commissioner WESSEL. We don't have that.

Mr. HERRNSTADT. If I may, we'll furnish it to you. It's actually a table that was taken from the International Trade Commission's report on large civil aircraft. For some reason, it wasn't in your report, but it is in the report at the back of the table. This is not our table. It was contained in the ITC report.

Commissioner DREYER. But the quality is equal? Not the capability I'm asking about, it's the actual quality of the item turned out.

Mr. THAYER. I would think the quality is.

Commissioner LEWIS. Could you please make sure we all get one of those? Thank you.

Mr. THAYER. I think the question will be raised again as we turn over, if we continue on this path, more of the higher technology. Then the question is, on the simpler type things, the quality is there.

Co-Chairman BECKER. All right. Chairman D'Amato, you are next.

Chairman D'AMATO. Thank you very much. First of all, I appreciate the panel's coming and having this dialogue with us. Certainly, General Douglass, it's nice to have you here.

Mr. DOUGLASS. Thank you, sir.

Chairman D'AMATO. I think there's nobody that I know of in this business that is more qualified and that I have more respect for to handle this association than you do. I absolutely have complete confidence that all you are doing is in the best interest of this country.

I have a question vis-a-vis the Europeans. It seems to me the Europeans are our biggest problem here in dealing with offsets and dealing with this market. It is true, isn't it, that the Europeans heavily subsidize their Airbus and they would not be able to effectively compete with us without those subsidies, is that true?

Mr. DOUGLASS. They have a different form of social economic support to their industries and they do some things that we do not do in the United States, like giving low-interest loans for the development of commercial aerospace products, which would be unheard of in this country.

We all know the great debate that's going on right now in our defense budget and so on. I just sometimes smile to think of what it would be like if I were up there testifying to the Hill, as I was last week, asking for a big appropriation for Boeing's new sonic cruiser, for example. But in Europe, they are providing low-interest loans. If the business deal on their new big jet doesn't work out, they don't have to pay the money back. That does give them a certain ability to do things that we don't have here, so we do not see that as a level playing field.

Chairman D'AMATO. No, it's not a level playing field. My understanding, I've been to Toulouse, I've been through that operation. I know a little bit about the European mentality. They will do from the government level what they need to do to be competitive with us. Forget about the WTO rules.

Now, in the GATT agreement and in transferring over to WTO, we have this national security waiver issue. It seems to me that there is no industry in the United States that is more central to our national security than the aerospace industry, so it seems to me that if—correct me if I'm wrong—that if the Europeans are engaged in this kind of unlevel playing field, capturing the China market, then any kind of subsidy or other device that this government can use to assist the aerospace industry in getting into the China market seems to me is fair game, and also, would it not be true, would be a part of the waiver procedure that takes us out of WTO dispute panel rigamarol that the Europeans may put us through to eliminate our kind of competition.

I mean, I don't think that we have the kind of cooperative arrangements between the industry and the U.S. Government to make this kind of competition, this kind of game with the Europeans, level in the China market. If we were to provide the kind of subsidies, direct government subsidies to Boeing to get in the China market, it seems to me that we would be well within our rights to say this is a national security exception in the domain of the WTO because the Europeans do this and they'll do whatever they need to do to compete with us. Does that make sense to you?

Mr. DOUGLASS. Well, I'd have to think about it a little bit. What I've been generally advising Congress, and I testified on this last week before the Aviation Committee, is that our strong suit is, as my colleagues here have said, is the productivity and the ingenuity of the American aerospace worker. This is where I very strongly agree with some of the comments they've made. I don't agree with all of them, but it's our workers and our management teams are the best in the world, and if we're given a level playing field, the American aerospace industry will stay strong and will capture the majority of the global market. I have no question about that.

But what we've got to do is invest in research and development to develop the kinds of commercial products we need for the future, and one of the most difficult structural problems we have here in the United States today is that the commercial technology, by and large, is developed by NASA and the FAA and it's declined every year for the past ten years and it's now—NASA's investment in technology is one-fifteenth of one percent of the GDP, and our European colleagues have promised to put $90 billion in the next five years into their commercial aerospace industry.

So the government's investment in the kinds of basic technology we need to be competitive in the future, it needs to be enhanced, and that is the single most important thing that we could do that would help my colleagues here, help the companies, and make us more competitive.

Chairman D'AMATO. I'll call on you in just a second, Mr. Thayer, but I want to pursue this one more point. I would like to see, and maybe you can help develop this, what kind of instruments and tools could be put into place by the Federal Government here with regard to the aerospace industry if you wanted to have a level playing field with the Europeans. In effect, the effects that they have on their ability to compete across the board, what would a comparable set of tools be that should be developed by us to make us competitive? I think that's a useful exercise, at least to see what it is that would make it a level playing field in terms of the U.S. Government-business relationship, which I know would be controversial.

But it seems to me we're talking about the crown jewel, one of the crown jewels of this nation's manufacturing sector, without a doubt, maybe the crown jewel, and we've had a declining surplus over the last three years, as I understand it, which means that we're going in the wrong direction. What does it do to turn us around? That's what I'd like to know.

Mr. Thayer, did you have——

Mr. THAYER. I'd just like to address the other part. The central issue for the people we represent is if Boeing or Lockheed or anybody gets the sale in China, the question is, who's going to build the plane? We see our jobs going offshore. We see our jobs going away.

So central to the issue is, fine, Boeing gets the sale, but we don't get to build it. We're the taxpayers. The people we represent provide the resources for the very research and development that you're talking about.

What we need is, first of all, is the corporations to be responsible and share with all of us, including the workers, how much is out there in offsets? What are those agreements that they've got? None of us are going to be able to get our arms around it as long as they're not willing to share the real issue of how much is out there in offsets.

Co-Chairman BECKER. And it's my understanding that the Chinese keep raising, extending this continually, even today and as we speak, keep asking for more and more. Is that not right?

Mr. THAYER. That's exactly, and, you know, there's another nation, in Korea, where they've just taken on the FX fighter, and there's an article where they're raising the offset demands from 30 percent to 70 percent.

Commissioner LEWIS. Who's raising that demand, the Koreans?

Mr. THAYER. The Koreans, raising it from 30 percent to 70 percent. There was a quote in there where Boeing says Boeing is being more constrained by the United States Government regulations against wholesale transfer of the sensitive technology, especially weapons systems. But it says South Korea won't miss out. We have a lot of technology to transfer, said this individual, head of Boeing's career program. So what we're fearful here with China, we're already seeing an expansion of that in current deals with Korea.

Mr. DOUGLASS. Mr. Commissioner, it is important, though, for the Commission to understand the details of this, and that is when he says these percentages, that does not mean that that percentage of that airplane has to be built in that country. What it means is if, let's say the plane costs $100 million, it means, if they have 30 percent offset, it means we have to then go buy $30 million worth of something from them.

So in some cases, these offsets get into other parts of the industrial base. In other words, we might buy $30 million worth of socks or bananas or whatever and no aerospace jobs are transferred——

Mr. BECKMAN. Or steel or cars.

Mr. DOUGLASS. —so to make a direct correlation is not correct.

Chairman D'AMATO. Let me just make one final point. Part of the problem, it seems to me, is that we deal, as I guess we should in the ideal world, sector by sector. We don't approach this situation from a nationalistic point of view. I mean, nationalism is not as fashionable today as globalization. Of course, nationalism is pretty fashionable in China, as you may have noticed. They don't have any problem with nationalism there. I don't have any problem with nationalism.

But if we want to exert our leverage and influence in the aerospace field, then we have many, many other forms of leverage and tradeoff in other sectors that we don't use right now. There are, maybe, ways that we can use the kind of leverage that we have in other sectors to effect the kinds of results that we want in the aerospace area.

Mr. DOUGLASS. Remember, Mr. Chairman, though, and again, we have to put this in the right context. The overwhelming majority of these offsets are on military products. In other words, they want to buy an F–15, they want to buy an F–16, they want to buy a Joint Strike Fighter, something like that, and so they say, before we buy it, you have to give us this offset arrangement.

The idea that the government is not involved in that is not exactly true. The Pentagon is very deeply involved in that and they're involved in the initial sale and the arrangements and so on.

Where we're talking here, though, there is a certain part of the commercial economy in which offsets do get involved and that is where we are selling to a national airline. But this is a very small percentage of the overall aerospace production. So you need to put this in the right context.

Mr. THAYER. But I really don't think anybody knows on the commercial side. That's the big question. Who does know? The Pentagon may know something on the military, but who knows on the commercial? Has anybody got any information to share with us, because I believe that's what the Commission referred to earlier, was to try to assemble and get their arms around this whole issue. So it's another question of suppressing information through these agreements that the companies are left and have the freedom to just go out and wholesale do what they want with the foreign countries.

Co-Chairman BECKER. Let me say with a degree of assurance, this Commission has been duly impressed with the problems of the offsets and we're not going to let go of this issue. Let me move the questions along here. Commissioner Mulloy?

Commissioner MULLOY. General, my understanding is in the bilateral agreement that Ambassador Barshefsky negotiated with the Chinese, there is a provision about prohibiting the Chinese from requiring forced transfers of technology from the United States to China as part of making sales.

Mr. DOUGLASS. You mean part of the agreement for accession to the WTO?

Commissioner MULLOY. Yes.

Mr. DOUGLASS. Yes, sir. There is a special provision in that agreement dealing with commercial airplanes and it does attempt to move them to a position, as I understand it, closer to what you just described.

Commissioner MULLOY. Now, I've been following the negotiations in Geneva and my understanding now is that the Chinese want to interpret that provision so that it does not apply to state-owned enterprises, which are an awfully big part of the Chinese economy, that it only would apply to the Chinese government and not to the state-owned enterprises. Does that seem like that would fulfill the intent of what we were trying to get in that provision?

Mr. DOUGLASS. Probably not, but it's typical. I mean, in any negotiation—I used to negotiate with the Russians all the time and I'd shake hands and we'd shot down some vodka and they'd go back to Moscow and say, here's what it means, and we'd come back to Washington and say, here's what it means, and if you held the two up, you would see big differences.

You know, this is a normal way that things occur. I think it is fair to say, though, that we feel pretty strongly that China's entry to the WTO would facilitate American access to the Chinese aerospace market and would create a structural environment that would be to our advantage.

Commissioner MULLOY. My view is, I'm not unsympathetic to the bind that you guys and Boeing are in in terms of these demands that are being made, because your point is, well, if you don't do it, the Europeans are going to get the sale. But it seems it puts a pretty high priority on us trying to find some way to get an agreement either with the Europeans or in some way multilaterally directed at this particular issue.

Everybody always says, well, the Chinese, we have a big deficit, but it's socks and it's textiles and it's toys and things that Americans don't want to make anyway. But the worry is that it's moving up the food chain in terms of what we're buying and that the crown jewels of American technology are being transferred as part of making sales and that this is not viable long-term for America to have a good industrial base. That's, I think, the worry that's out there.

Mr. DOUGLASS. Sir, the only thing that I could draw a parallel to that was mentioned a little bit by my colleagues at the table was some years ago, as Japan began to get into the commercial aerospace industry, there was this concern that the aerospace industry would kind of go the route of the automotive industry and we'd see the skies of America filled with Japanese-built commercial airliners. Well, 15 years have gone by and that's just not happened.

I think most experts believe that if you had to rank the concerns of the industry about who is going to challenge us for supremacy in aerospace, China would be way, way, way, way down. You would see the Europeans at the very top of the list, and then you'd see some other countries like Canada and Brazil and other countries that are moving heavily into the regional airline business and capturing our markets here and the global economy and there's almost no one in the business that I know of in terms of long-term global competition that thinks China is going to be a major player for many years.

Commissioner MULLOY. Do either of the other witnesses have any comments on the general thrust of that provision that we have in the bilateral and then whether it's going to be at all effective?

Mr. THAYER. Just a quick comment. General, I think that Japan shifted its emphasis and did a superb job of taking of the United States' electronic industry, because there's anything you can't buy that hasn't got a Japanese stamp on it electronically.

Again, if the government does not get involved in whatever agreements are there so that those—and we know we need to be involved and we're involved in doing what we can with this global economy. But the government has to become directly involved in setting up a policy, the procedures by which to operate, and under what conditions the companies are going to be offering these offsets over in the other countries. Without that involvement, it's just not going to happen.

Commissioner MULLOY. Steve?

Mr. BECKMAN. The WTO provision is not, in the end, going to help because of the complex ownership relationships in China. Whether it's the state-owned enterprises that are excluded or privatized enterprises that are excluded, there will be a way for avoiding the compliance with what we had anticipated would be the result.

And as General Douglass said, this is a frequent result of U.S. negotiations, but I don't think it's a result of all negotiations. I think it's the result of our negotiations, the U.S. Government's negotiations. This is the result often because our negotiators do not pay enough attention to what they're negotiating. They don't pay enough attention to the details and they don't understand what other people are going to use those details to provide.

So the WTO is not going to be a support here, and our testimony included some description of why that provision would not be successful.

I do want to say, though, that while General Douglass said that access is really what will be accomplished by the WTO accession and access doesn't mean exports, access means the companies can participate in that market. And one reason why Japan did not become the kind of player that people anticipated is that Japan was not interested in having capital investment in Japan by the U.S. companies. They didn't want to have those companies there competing with the domestic producers. They wanted us to give the technology to the Japanese companies and the Japanese companies themselves would become the players in the industry.

China is not asking that. China is willing to let Boeing make investments, willing to let U.S. companies make investments there. They make them do joint ventures so that Chinese companies will gain the access to the technology, will develop the expertise, but they're not restricting access to the market in capital the way the Japanese government and companies did.

While independent Chinese companies may not become dominant players in the aerospace industry, that doesn't mean that production in China and exports from China will not become important elements in the global aerospace industry. Right now, exports from China are not a major factor in the international automotive industry. But ten years down the road, is that going to change? I don't think there's any doubt.

Commissioner MULLOY. Thank you. Thank you, Mr. Chairman.

Co-Chairman BECKER. Commissioner Ledeen?

Vice Chairman LEDEEN. Just really fast. I want to underline what Pat Mulloy said about this is not a zero-sum problem. It's not either we sell it to them or the Europeans will. I mean, there are multilateral solutions and they don't exist today in large part because the American government dismantled the international system that was in place, and so we've got to try to build some kind of relationship up all over again.

I'd just like to ask all of you if you have any insight into the question of Chinese productivity compared to American productivity. You've all said the most important part of the story is the enormous productivity of the American worker. If one were to track Western turnkey factories, parts manufacture from the United States into China, how would the productivity match up?

I doubt you have any information at your fingertips. If you have any information about this, we'd like it. If you don't have any but you can think of ways that we might profitably investigate it, we'd like those suggestions. That's all. Thanks very much.

Mr. BECKMAN. Briefly, one of the things that's happened in the auto parts industry in the United States and internationally is that, increasingly, the competition is not on the basis of productivity, it's on the basis of lowering costs. If you look at the productivity data on the U.S. auto parts industry, you'll find that productivity is going down. Why? Because the U.S. companies are competing by reducing wages, reducing costs in a variety of ways.

Rather than improving productivity, they're substituting cheap labor for capital, and China offers tremendous opportunities to do that. So certainly in the auto industry, this is a real factor in the competition. It's not just on the basis of productivity, and the advantage of the U.S. companies in productivity is not necessarily a defense or an adequate defense in what transpires.

Certainly, it has been our experience, and is the case in the situation with offsets that people are raising, that the U.S. companies are more than happy to put in the same technology in China and take advantage of that, train a limited number of workers who can produce for the international markets, and then there's no way the United States workers can compete. If the equipment is the same, the training is the same or better, and all that's different is the wage costs, we're in big trouble.

Co-Chairman BECKER. Commissioner Reinsch?

Commissioner REINSCH. I've had so many conversations with Owen, John, and Steve over the years, I think I know what they think, and I suspect they know what I think.

Let me just do two things. One, commend General Douglass for his valiant effort to explode some of the myths surrounding the satellite episode. As you can tell with this group, it's uphill, but hang in there because you're right. If you want to submit more information, there's at least one of us who would be glad to have it, and I hope we can find other opportunities to get into that subject in greater depth.

On offsets, I was struck by something that General Douglass said that I want to pursue for a moment, which was your understanding, or that you had heard that the Bush administration was going to reinstitute, if you will, the Offsets Commission. That's a little bit different from Mr. Thayer's testimony, but it may be a little more up to date. If so, I think that's good news.

One of the suggestions I'd make to the Chairman is that this might be an issue that we should weigh in on. That was a helpful commission that was doing good work developing, I think, or at least on the verge of developing good work, good numbers, some useful research. It had participation from both labor and management. And if it's not going to get started up again, I think it would be helpful for us to suggest that it ought to be. It is, after all, a statutory requirement, so one would think that there would be some work done on it.

If General Douglass is correct, then there's no need to do anything, but I'd suggest we check into that and see, and if there are no plans to reconstitute it and start it up again, perhaps we should send a letter or do something along those lines. I think it's a useful effort. Thank you.

Co-Chairman BECKER. Commissioner Robinson?

Commissioner ROBINSON. I'm at some risk now with my fellow Commissioners, as we have a rapidly eroding half-hour lunch period, and I suppose I'm one of the knuckle draggers——

Co-Chairman BECKER. It's gone.

Commissioner ROBINSON. —that Bill's just referred to, General. But I would have two quick related questions for Mr. Thayer and Mr. Beckman.

Like your Steelworker Union counterparts who appeared today, are you concerned about U.S. Government financing via Ex-Im Bank, the U.S. role in international financial institutions in the financing of projects in the Chinese aerospace and automobile sectors, or the financing of projects that are enabling such facilities, that is, U.S. equipment that is assisting those sectors, that could end up harming the interests of both IAM and UAW members and possibly even broader U.S. interests?

A similar part of that question would be, are you paying attention to Chinese aerospace and automobile manufacturers that may be raising funds for the expansion of their facilities in the U.S. stock and bond markets from China? Thank you.

Mr. THAYER. The last part of the question, if I could, we're not aware of anybody keeping track of that. And then the first part of your question, if the subsidies are going to ultimately lead to keeping good jobs in this country to make that sale, then certainly we don't oppose it.

Mr. BECKMAN. I'm not aware of any Chinese companies in the auto sector that have registered on U.S. stock markets, but we are not keeping close track of that. There aren't a lot of big, independent, competitive Chinese companies in the auto industry.

We do keep track of Ex-Im Bank and World Bank and other project funding in China and there have been some infrastructure projects we've been particularly concerned about. We weighed in on the Three Gorges Dam, and there have been some small projects that have received funding that we've been concerned about. There's not a lot of support, Ex-Im support, for the auto investments that have been made thus far in China, but we certainly do keep track of those decisions and we would be just as concerned as the Steelworkers if we thought there was any support for capacity expansion being driven by U.S. exports of machinery or other contributing elements to building capacity in China in this industry.

Co-Chairman BECKER. Commissioner Lewis, you have the last chance to go to bat.

Commissioner LEWIS. Mr. Thayer, you said that on your trip to China, when you went looking at the aerospace industry there and you saw what Boeing wanted to show you, were you under the impression that there were other things that you were not shown?

Mr. THAYER. Oh, absolutely. I think Dick Schneider made that remark, but absolutely.

Commissioner LEWIS. If you would have any suggestions for us as to how we can help you get the information about the number of offset jobs that are involved, because you felt that the number of jobs that they said that were transferred were much less than was the reality, we'd appreciate any suggestions you have for us.

I have a question for you, Mr. Beckman, but I'd like you to give me a written answer because there isn't time to do this. General motors agreed to transfer $1 billion of technology to China and to source within ten years all of the needs from Chinese manufacturers. Will the WTO accession agreement outlaw that, and what concerns do you have about that? That's my question for you in general, and I have a comment.

We're running a trade with China where we sell them about $15 billion and they sell us about $100 billion. So it's about an $85 billion deficit. In China's saying we want offsets, or their buying Airbuses, can't our government use the incredible trade leverage that we have with China in terms of negotiating with China about their purchase of aircraft from the United States rather than from European manufacturers?

Mr. DOUGLASS. Sure.

Commissioner LEWIS. Isn't it something the government should do? I remember Henry Jackson used to say that the negotiations between the American oil companies and the Arab countries was inherently unequal because you had governments negotiating with companies, and it's the same thing here.

Mr. DOUGLASS. We certainly want to see our government stand up strong for us to create a level playing field. The degree—and we do appreciate the support that they give us in these international situations. Would we like to see them do more? The answer is yes. There is a certain point, though, where you're dealing with—and I'm talking in general now, not specifically about China—you're talking about a commercial——

Commissioner LEWIS. No, I'm talking specifically about China, where you're not dealing just commercially, you're dealing with the government.

Mr. DOUGLASS. Well, in general, I guess the answer I would have to give you is the more support we get from the government, the more we'd appreciate it, given the geopolitical situation that exists today, yes, sir.

Commissioner LEWIS. Thank you very much.

Commissioner LILLEY. Mr. Chairman, I can't remain quiet on this one. I was in the government for many years.

Chairman D'AMATO. You did all that?

Commissioner LILLEY. One of the things that Larry Eagleburger said, get off your duff and support American business and make sales, and we went the extra mile for Boeing again and again and again. In fact, I took my wife on one of your 767s into Lhasa to prove to them they could land on one engine.

Mr. DOUGLASS. That is kind of why I hesitated a minute there. I didn't mean to imply any criticism that you didn't do that.

Commissioner LILLEY. We waited very hard. We waited and went right after the Tiananmen business. We got your black boxes kept in China. They wanted to ship them out to Hong Kong.

Mr. DOUGLASS. That's kind of why I hesitated. The implication there is, could they do more? Well, you know, you can always do more——

Commissioner LILLEY. Of course you can, but——

Mr. DOUGLASS. But I think, in general, the government has done a good job.

Commissioner LILLEY. I wouldn't shortchange your representative, because you've got a representative in China now who is not a four-star admiral but is a businessman and his job is to sell American business and he does it very well.

Commissioner LEWIS. Jim, and we have $85 billion worth of leverage.

Commissioner LILLEY. Well, when you get into that, Ken, you've really got to think that one through. It sounds good with the numbers.

Commissioner LEWIS. The numbers are there.

Commissioner LILLEY. The numbers are there, but when you start getting into the details of how you use it, it gets very intricate and very tricky. I can tell you this, I mean, if you can figure out what the Chinese want the worst, and I think we have a sense of that right now, there's a trade-off between them getting that and us doing something for our friends over here.

I mean, certainly if—I was there doing Beijing Jeep Chrysler, and Jim Mann wrote a very good book on this one telling about the problems we had, the sickening offset problems we had with these guys, where you have to get a certain percentage in China bought whether they were competitive or not. This is not only illegal, it's unethical. I mean, a whole string of things. But the people told me, we're going from 40 to 80 percent. And then they built a similar Jeep right next door. They stole all our technology and built it and it's a tricky, nasty little game and you've got to watch what they do.

Commissioner LEWIS. Well, the Japanese tried it with, what, the FX fighter, and we stopped it.

Commissioner LILLEY. We had this problem in Korea. I was very deeply involved with offset business in Korea.

Mr. DOUGLASS. One comment, though, about this in general that I think is appropriate here, I spoke earlier about the technological equivalence between the United States and Europe. I was not speaking directly to what I would call the quality of American products compared to European products. I believe, because of the quality of the workforce we have here, the quality of our engineering force and so on, over the long haul, the inherent quality of the commercial airplanes manufactured in the United States still has an edge to it. And if you talk to the Chinese airline people, as I have, generally speaking, left to their own desires, they will buy American.

Commissioner LILLEY. I'm glad you said that, because that was my sales pitch all the way through. We're better than anybody else.

Mr. DOUGLASS. That's right.

Commissioner LILLEY. —to get the head of CAAC (Civil Aiviation Administration of China), Wei Zhou [ph.], linked to us.

Mr. DOUGLASS. It's more of a durability, you know——

Co-Chairman BECKER. I think we all missed the boat, just a little bit of the thrust of some of the testimony here. We may have had selling business hard in China before. We may have a businessman in there now running it. But we need to devote some of the energies and some of the concerns about workers here in this country and about maintaining a good solid base and an industrial base in this country, and I think a lot of the testimony has been directed towards that and I don't think we're addressing that enough.

Mr. BECKMAN. I think the fact that there's a businessman and that we're promoting business in China sis not the same as promoting U.S. exports. I mean, we're not promoting necessarily U.S. production. We're promoting the interests of companies that want to make money in China.

Commissioner LEWIS. Steve, I remember Mort Bahr told us that President Clinton convinced the Saudi Arabian government to buy AT&T products, but they supplied Spanish-made goods. So AT&T had the contract, but they weren't produced here.

Co-Chairman BECKER. I think we're down to maybe a half-a-sandwich for lunch, and a very quick one at that. I want to thank the panel. It's been very interesting and engaging. Thank you very much.

[Off the record at 1:30 p.m.]

(AFTERNOON SESSION, 2 P.M., THURSDAY, AUGUST 2, 2001)

PANEL IV: AGRICULTURAL TRADE ISSUES

Chairman D'AMATO. The Commissioners insisted on lunch. I'm trying to control their diet, but not being very successful. Maybe you can give us some ideas on how we can control their diet.

Commissioners, we're in order. We're fortunate this afternoon to have a very strong panel of witnesses on the matter of United States agricultural involvement in, access to, penetration of, as well as treatment by the Chinese as a result of the recent agreement on WTO, and in heralding the WTO agreement with China, it was argued by many that agriculture would gain greatly by access to the Chinese market, the potential tapping of China's 1.3 billion people.

In the past, China has imported limited amounts of agricultural goods, preferring self-sufficiency, but our understanding is that this situation has been changing and they are not self-sufficient and may become more dependent on imports as we go along. American agriculture being a huge engine for exports over the years, well positioned, we hope to take advantage of this market. We're very anxious to hear your views of it.

We have today Robbin Johnson, who is a Vice President of Public Affairs of Cargill; Mr. Henry Jo Von Tungeln, Chairman of the U.S. Wheat Associates and Wheat Export Trade Education Committee; Dwain Ford, First Vice President of the American Soybean Association; and Chuck Lambert with the Cattlemen. Then we also asked our interlocutor and recent author, Mr. Chang, to sit in and participate as he can here in this panel.

So why don't we go ahead. What we will do is just go from left to right, if that's okay, with you starting off, Mr. Lambert, and try and summarize your remarks to eight to ten minutes, if you can, and then we'll have questions of the Commissioners for the whole panel when you all complete.

STATEMENT OF CHUCK LAMBERT, Ph.D., CHIEF ECONOMIST, NATIONAL CATTLEMEN'S BEEF ASSOCIATION

Mr. LAMBERT. Thank you, Mr. Chairman and members of the Commission, for holding this hearing to discuss issues that are of vital importance regarding long-term trading relations with China.

I'm Chuck Lambert. I'm Chief Economist for the National Cattlemen's Beef Association and I'm here on behalf of more than 250,000 cattlemen and cattlewomen that belong to our organization and to our State affiliates.

NCBA commends your leadership and continuing efforts to examine ongoing change and the results of those changes and concerns that impact farmers and ranchers as we work to find ways to improve our relationship with China. NCBA has long supported free but equitable trade and we support the opening of two-way international beef markets.

With the population of more than 1.2 billion and up to 400 million middle-class consumers, China is a consumer market with enormous potential. Any trade agreement that involves one out of every five inhabitants on planet Earth is impossible to ignore, and just because of the sheer magnitude of the numbers involved.

The NAFTA agreement impacted, of course, all the populations of North America, about 400 million people, and it's hard to imagine that China has nearly three times the population of the combined NAFTA countries.

The primary benefit of NAFTA for the U.S. beef industry has been elimination of the tariffs in the Mexican market, and with a population of about 100 million people, our sales to Mexico last year for beef were about $600 million. Keep in mind that there are about 400 million middle-class consumers in China. China consumes as much or more pork than we do here in the U.S. and consume a lot of chicken, but their beef consumption is relatively low. So we view this as a very good opportunity to diversify their markets, especially in this emerging middle-class consumer population and in the tourist trade in China.

Looking at it another way, beef consumption in China increased about 2.2 pounds, according to the Department of Agriculture, from '95 to '97, and if you take that across the 1.2 billion population in China, that increase was more than our total beef exports last year, and we exported about ten percent of our total production. So there is growing demand in China and we feel we're well positioned to take part of that in that market.

Even without tariff reduction that will begin once China joins the WTO, last year, we sold about $100 million, $91–$92 million worth of product to Hong Kong and China. If you look at what has taken place in other markets, like Japan, where we sold $1.8 billion worth, and Korea, about $540 million, and based on our track record in these other Asian markets where we have negotiated opening of these markets within the last ten or 15 years, we feel that we can participate in a strong growing market in China, as well.

NCBA and the beef industry, we're strong supporters of permanent normal trading relations with China and the China agreement. The gains that are in that agreement will not kick in for us until China completes its accession to the WTO, and for the beef industry, those are very important.

Also, we feel that the China agreement sets some very strong precedents as we go into the next round of WTO negotiations. For example, China has agreed to reduce their beef tariffs to 12 percent from a current level of 45 percent by 2004. Their variety meat tariffs will go from 23 percent to 12 percent.

This sets a very important objective, because we are looking to reduce tariffs in Japan, which are currently 38.5 percent, Korea that are 40 percent, and even our own tariffs that are 27.5 percent. So having this benchmark out there of 12 percent in the China market is an important objective as we go into the next round of negotiations.

It's kind of interesting to note that in aspiring to join the WTO, that China has gone much further towards liberalizing their market or setting lower tariff levels, and in the case of Europe, of eliminating their export subsidies. In contrast, many of the longstanding members of the WTO and our longstanding trading partners have not gone as far as China has been willing to go in order to join the WTO.

China has also agreed to phase out its state trading entities, or STEs, and some of our major trading partners, like Canada and Australia, continue to hold on to their government sanctioned state trading monopolies. So I think there are some important precedents set in this agreement that we can tie to.

Because it has already agreed to many of these changes, we feel that China can be a strong ally as we go into the next WTO round, along with some of the developing countries, along with our traditional friends in the CAIRAS and MERCOSUR countries.

Opening trade channels also yields dividends beyond the commercial or monetary value of the commerce that takes place. There is an old song that says, no one knows what goes on behind closed doors, and I think the same is true for closed economies. Before the opening of the China market or many of these very tightly held, tightly closed countries, we really didn't know what was going on in those countries.

As China's economy becomes increasingly open to world trade, it will also become more open to international visitors and investors. Ideas and concepts and social values will be exchanged as well as commodities and goods and services. China's internal and international policies will come under closer scrutiny from the international media, and as a result, the actions of its leaders will be increasingly influenced and constrained by global opinion, and long-term improvements in human rights and basic freedoms will also result.

China is not unique in running a huge deficit with the U.S. That is largely a function of macroeconomic policies, strong economic growth in the U.S., a strong dollar, and not trade policy. And I don't want to indicate that there won't be problems. We have problems with our other trading partners and China will be no exception. But at least now, with having them in the WTO, there's a framework for bringing those problems to a panel for a dispute resolution process and bringing China into the WTO will help bring them into the fold and have them subject to the same constraints and same processes that the rest of the world lives with.

I thank you for this opportunity and I look forward to answering any questions.

[The statement follows:]

PREPARED STATEMENT OF CHUCK LAMBERT, PH.D. [1]

Thank you, Mr. Co-Chairmen and Members of the U.S.-China Security Review Commission, for holding this hearing to discuss the vital importance of developing long-term secure trading relations with China. NCBA commends your leadership and continuing efforts to examine the ongoing change and the resulting issues and

[1] Initiated in 1898, the National Cattlemen's Beef Association is the marketing organization and trade association for America's one million cattle farmers and rachers. With offices in Denver, Chicago and Washington D.C., NCBA is a consumer-focused, producer-directed organization representing the largest segment of the nation's food and fiber industry.

concerns of cattlemen and women as we work to find ways to improve our ability to more effectively market U.S. beef.

NCBA encourages an open and honest discussion of all issues facing the cattle industry, such as is being provided by today's hearing. This debate is vital to the democratic policy development process—both within NCBA and to the nation at large. NCBA has long supported a "free but equitable" trade philosophy and the opening of two-way international beef markets. We thank you for the opportunity to submit our views.

Importance of Trade

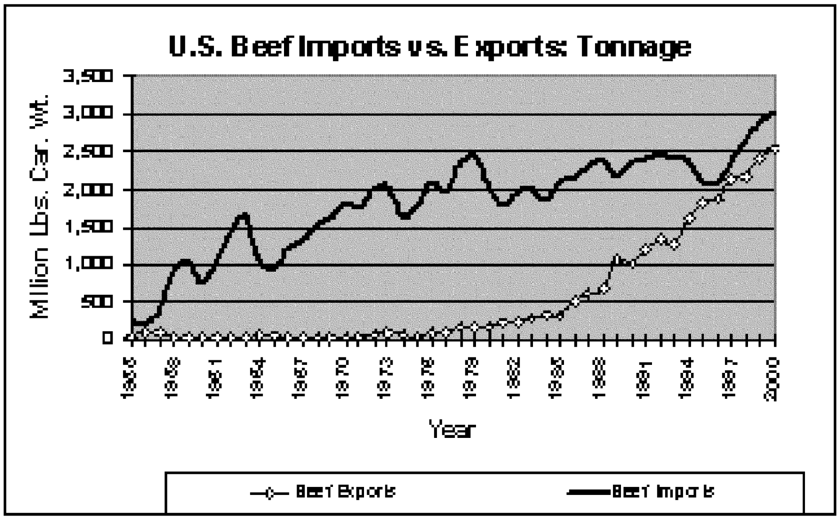
Livestock producers are constantly competing for a larger share of the domestic market and since 1999 we have seen encouraging signs that after 20 years of decline, U.S. beef demand is increasing. However, our "home" market contains only about 4 percent of the world's population. Our greatest potential for expanding market share is in international trade. As the beef industry continues to improve its efficiency, productivity, and quality of its commodity, we are becoming increasingly dependent on the rest of the world to buy our products and ensure economic growth. The U.S. beef industry has worked hard to promote beef exports, which now accounts for more than 12 percent of the value of wholesale beef sales. On a tonnage basis we export nearly 10 percent of what we produce.

As this reliance on international markets has grown, the effects of political and economic strife in our key export markets have contributed to the volatility of U.S. cattle prices. The 1998 calendar year—a year of recession in most Asian markets—was the first time that more than one million metric tons of U.S. beef and beef variety meats have been exported. New record exports were again established during 2000. Compared to 1999, exports of beef and beef variety meats during 2000 increased 7.7 percent in volume and 10.6 percent in value.

So far in 2001, recession in Japan and slow growth in the U.S. have impacted other Asian economies, especially Korea. U.S. beef exports during January through May 2001 have declined by 10.2 percent in tonnage and 15.2 percent in value compared to exports during the same period in 2000. Declines in exports to Japan, Korea, Taiwan, and Hong Kong/China have contributed to the overall decline. Continued economic prosperity in Mexico, which (with concerns about increasing unemployment there related to the slowing U.S. economy), has resulted in the one bright spot for U.S. beef exports during 2001. U.S. beef exports to Mexico during January through May 2001 increased by 16.1 percent in tonnage and nearly 22 percent in value compared to then-record exports during the same time in 2000.

Beef imports also increased 5.6 percent in volume and nearly 12.3 percent in value during 2000 compared to 1999 and the increase during the first five months of 2001 is on pace to set new import levels this year. Record U.S. beef prices and improving U.S. beef demand coupled with the strengthening of the U.S. dollar relative to currencies from most major beef importing and exporting countries, have contributed to the widening trade deficit on a tonnage basis. On a value basis, the U.S. is still a net beef exporter with a $1.2 billion trade surplus.

Although increasing modestly, the current beef trade deficit on a tonnage basis is minor relative to historical deficits. Compared to deficits prior to the mid-1990s the current deficit is small. U.S. beef exports have increased more than five-fold since the 1980s when the Japan Beef-Citrus agreement was negotiated. Most of the growth in U.S. beef exports can be attributed to negotiated market access (Korea and Mexico via NAFTA) and liberalization (tariff reduction in Japan and Korea from the Uruguay Round). U.S. negotiators must be authorized to negotiate the best deal possible to have any hope of further reducing tariffs or of gaining access to the EU beef market.



The United States is currently the least restricted and largest beef import market in the world purchasing 15 percent more beef than the second largest importer, Japan. The United States also became the world's largest beef exporter in 2000. Beef markets in other developed countries remain virtually closed to U.S. beef, such as in the European Union (EU) by non-tariff barriers, or protected by high tariffs as is the case in Japan and Korea. A strong, clear and irrevocable message must be sent by U.S. negotiators to Cairns Group and Mercosur beef exporting countries—major exporters of beef to the United States—that *no* increased access to the U.S. beef market will be forthcoming until meaningful access and tariff reduction is achieved in other major beef importing countries.

The United States must enter all beef trade negotiations with access for U.S. beef being a top priority. NCBA realizes that for international trade to expand and work to the advantage of U.S. beef producers, it must also be equitable. NCBA is sensitive to the fact that past agreements have not always worked to the competitive advantage of America's beef cattle producers. Past agreements could have been more favorable for U.S. cattlemen, but it is easy to second-guess our predecessors with the benefit of hindsight.

While this is the hand that we have been dealt under current agreements, NCBA will continue to work to assure producers' interests are protected as we seek improvements in existing agreements, as well as in any new agreements. As an industry, we have worked to expand exports of beef and beef variety meats from approximately $500 million twenty years ago to $3.6 billion in 2000—more than a sevenfold increase. This progress is encouraging, but also highlights the importance of taking advantage of every opportunity to move beef into international trade. Implementation of the negotiated agreement that has been negotiated with China and concluding the process of bringing China into the WTO is critical to that end.

The China Agreement

With a population of 1.2 billion and nearly 200 million consumers with middle-class incomes, China is a consumer market with enormous potential. Any market potential and any trade agreement that involves one out of every five inhabitants on planet earth is impossible to ignore just because of the sheer magnitude of the numbers. For example, NAFTA impacted the total population of Canada, Mexico and the United States—a combined population of approximately 400 million. China has three times the population of the combined NAFTA countries.

The primary benefit of NAFTA for the U.S. beef industry was elimination of tariffs in the Mexican market. Mexico has a population of just less than 100 million and U.S. beef sales to Mexico during 2000 totaled nearly $600 million. There are estimated 400 million middle-class consumers in China—more than four times the entire population of Mexico.

Another example:

—According to USDA data from 1995 through 1997 per capita beef consumption in China increased by 2.2 pounds per capita. This small increase in beef consumption per person totals to 2.64 billion pounds when multiplied across a population of 1.2 billion—more than total 1999 U.S. beef exports.

Sales of U.S. beef and beef variety meats to the Peoples Republic of China and Hong Kong during 1999 totaled $91.5 million, with $15 million sold directly to China. By comparison, 2000 sales to other primary Asian markets included nearly $1.79 billion to Japan and $537 million to Korea. Per capita beef consumption in China during 1998 was projected at slightly more than 10 pounds compared to 20 pounds in Korea and 26 pounds in Japan. Based on the United States' success in expanding beef demand in other Asian markets, the long-term potential for increased sales of U.S. beef to China is excellent.

The agricultural agreement signed by the United States and China during April 1999 pertains to Sanitary/Phytosanitary issues. In laymen's terms specific to meat, China agreed to recognize USDA Food Safety Inspection Service (FSIS) inspection of meat exported to China. In the past a representative from China would inspect U.S. packing plants and very few plants were approved. Under the new agreement any FSIS-approved plant is supposed to be eligible to export to China.

FSIS began issuing export certificates in early December 1999 following final signature of the China SPS agreement (as a side deal) in Seattle. In the beginning there were concerns that Chinese port authorities would accept these certificates. NCBA and other meat organizations worked aggressively with the Administration to communicate with representatives of the Chinese government the importance of fully implementing the SPS agreement. Notification to port authorities that FSIS certificates are acceptable has been completed and the formal notification and rulemaking process has begun. For the most part, port authorities and U.S. exporters have received notification regarding importers that are approved for licensed trading rights.

The U.S. beef industry (and the rest of agriculture) has the potential for huge gains in the broader trade package that was finalized with China and approved by the U.S. with the votes supporting Permanent Normal Trading Relations with China last fall. These gains will not begin until China's final WTO accession process is completed. A process that, hopefully, is concluded during the WTO ministerial this November.

Specific to the beef industry, tariffs on some major beef categories will decline from a current rate of 45 percent to 12 percent in 2004. For many countries beef variety meats, tariffs would decline from a current level of 23 percent to 12 percent in 2004.

The overall China trade package also includes elimination of state trading entities (STEs) that currently purchase most products imported by China. If the broader agreement is signed, STEs will no longer have a monopoly on agricultural commodities because private trade for all commodities except tobacco will be permitted. Distribution and trading rights for meat and poultry will be completely phased in at the end of three years. For the beef industry, this means that U.S. exporters will be able to sell directly to buyers (retail, food service, hotels, etc.) in China. The U.S. Meat Export Federation already has training facilities in place for Chinese retailers and chefs, and the U.S. is well positioned to participate in market liberalization.

In addition to providing huge commercial potential, the China trade agreement also sets some very important precedents as we enter the next round of WTO negotiations. It is interesting to note that as an aspiring WTO member China has agreed to much greater liberalization than is currently practiced by many long-standing WTO members and other major U.S. trading partners.

Some examples:

—1. China has agreed to reduce beef tariffs to 12 percent as stated earlier. This establishes a very important objective for the next round as we negotiate tariff reduction with Japan (current tariff levels of 38.5 percent), Korea (current tariff levels of 40 percent), and even the U.S. (current tariff levels of 27 percent above TRQ).

—2. China has agreed to eliminate export subsidies while the EU is by far the largest user of agricultural export subsidies. And finally;

—3. China has agreed to phase out STEs while some of our other strong allies, Canada and Australia, cling stubbornly to their grain-trading government monopolies.

In addition to some developing countries, the Cairns Group and Mercosur countries, China may very well be one of the strongest U.S. allies during the next round of WTO negotiations.

Response to Commission Questions

1. *Do current bilateral trade policies toward China serve the national security interests of the United States? Why or Why not?*

Yes. Increased trade is an essentially constructive engagement. The U.S. and China's other major trading partners are not just exporting commodities, goods and services through commercial channels. We are also exporting ideas and the principles of democracy, capitalism, and human rights.

There is an old song that says, "no one knows what goes on behind closed doors." The same can be said about closed economies. As China's economy becomes increasingly open to world trade, it will also become more open to international visitors and investors, under closer scrutiny by international media. As a result, actions of its leaders will be increasingly constrained by global opinion. Long-term improvements in human rights and basic freedoms will result. With 20 percent of the world's population, China is impossible to ignore. U.S. security interests will be much better served by a China that is inter-dependant on global trading partners than a China that is not engaged and is isolated from the rest of the world.

2. *What accounts for China's huge and growing trade surplus with the United States? And is U.S. bilateral trade relationship substantially different from other major trading partners?*

China is not unique in running a huge and growing trade surplus with the U.S. because the U.S. trade deficit has increased with most major trading partners in recent years. The basis for these growing deficits is largely macroeconomic policy, not trade policy. The U.S.-China agreement was related to changes in China and did not change U.S. policy regarding China's access to our market. The same is true with other major trading partners. U.S. trade policy did not change during the last three or four years to increase access for Japan, Europe and our other major trading partners but trade deficits also increased with those countries. Changes in trade policy are clearly not the reason for those growing deficits.

The U.S. trade deficit increased with all major trading partners, including China, during recent years because the U.S. economy experienced one of the longest periods of sustained growth in history. Sound fiscal policy resulted in balanced budgets and even budget surpluses. Fiscal policy coupled with non-inflationary monetary policy and a technological revolution in information technology allowed the economy to maintain growth for an historically unprecedented period of time with very modest inflation and low interest rates. From the first quarter of 1998 through the first quarter of 2000 real (inflation adjusted) Gross Domestic Product (GDP) grew at a rate of 3 percent to 6 percent on an annualized basis with growth in one quarter as high as 8 percent.

These macroeconomic factors resulted in a strengthening U.S. dollar relative to currencies of our major trading partners. Increasing consumer incomes during the 1990s, especially during the late-1990s, and very high levels of consumer confidence resulted in increased demand for goods and services (both domestic and imported) among U.S. consumers. The strong dollar relative to the currencies of most other trading partners resulted in more of these goods and services being purchased from international suppliers. None of this should be interpreted as a call for a weaker dollar. It isn't. It just reflects economic reality that a strong dollar, a robust economy and willing and able consumer spending have been the primary factors in record U.S. trade deficits, not distortions from trade policy.

The U.S. agreement with China is not essentially different from other bilateral agreements negotiated by China with other WTO members. Because of national treatment standards agreements with each of the 140 or so WTO members essentially defaults to the "best" agreement negotiated by the other countries. The U.S. agreement for agricultural commodities basically became the template for other WTO member agreements with small deviations to address unique bilateral issues with China on a country by country basis.

Another reason that the U.S. trade deficit with China has continued to grow in recent years is that the benefits for U.S. exports have not yet gone into effect—and won't until China joins the WTO. In the case of beef, we anticipate a significant increase in exports once tariffs decline to 12 percent from current 45 percent levels and once U.S. exporters have access to wholesale and retail marketing channels in China. The same scenario will play out for many other U.S. agricultural commodities and for other non-agricultural U.S. sectors. By the end of the implementation period, U.S. exports to China will increase resulting in a smaller trade deficit. The key to reducing the U.S. trade deficit with China is to finalize the WTO accession process and have U.S. exporters begin to reap the benefits of tariff reduction and market access granted by the U.S.-China trade agreement.

3. *Do any such differences have any national security implications for the United States?*

As indicated above there are very few differences in the U.S.-China agreement compared to agreements with other major trading partners, at least with respect to beef. There are no identifiable national security implications.

4. *Views regarding China's ability to live up to bilateral trade obligations as assumed as part of its entry into the WTO.*

China has admittedly assumed a very aggressive agenda for market liberalization that will result in a major restructuring of its agricultural and overall economy. The recently concluded side agreement allowing China to subsidize the agricultural sector up to 8.5 percent of net farm income may help mitigate internal political pressures that are sure to result as this restructuring continues. There are no doubt huge factions within China with a vested interest in stopping, reversing, slowing or stalling change. U.S. officials and industry must continue to work closely with Chinese leadership supporting the new trade agenda to assure that China lives up to its obligations. The price of failure is too great to not facilitate its success.

NCBA will closely monitor China's implementation of commitments embodied in the trade agreement and work with U.S. officials to assure that implementation proceeds in specified timelines. It is critical for the U.S. beef industry that China acceptance of USDA's inspection documentation, tariff reduction and access to retail and wholesale marketing channels proceed in accordance with the agreement.

5. *Actions the United States should take if China fails to live up to its WTO obligations.*

The U.S. beef industry can speak from experience in dealing with major trading partners that are unable to live up to their WTO obligations. It is first critical to note that once China becomes a WTO member the organized structure and processes of the WTO will at last be available for addressing and resolving trade disputes with China. Prior to accession no such structure existed.

The framework of the negotiation process has already facilitated implementation. In the case of Chinese port authorities failure to accept FSIS inspection documentation, NCBA and other meat organizations worked aggressively with the Administration to communicate with representatives of the Chinese government the importance of fully implementing the SPS agreement. The consultation process worked and the situation was resolved. NCBA has also been successful in working with government officials to negotiate settlements regarding cattle and beef trade with other major trading partners including Canada, Mexico, and others utilizing the framework of WTO and NAFTA consultation processes.

There are other examples, however, where the consultation process has not been successful in resolving disputes. In the case of Korea, the U.S. has won a WTO case regarding beef access issues. Both countries are currently working to resolve these issues through the WTO dispute resolution and arbitration process.

The U.S.-EU beef case is probably the poster child for the WTO dispute settlement process. The beef industry has had the unique experience of having taken a case through the entire WTO dispute settlement process and won, but first, a bit of background on the case. The EU has essentially banned imports of U.S. beef since 1989. This thinly disguised trade barrier was implemented in the name of consumer protection in spite of ample scientific evidence that production technologies approved by FDA and widely used in the U.S., but prohibited in the EU were safe. The U.S. government complained in the GATT, but the EU, as was permitted at that time blocked dispute resolution.

After the WTO replaced the GATT, the U.S. filed its formal complaint in January 1996, claiming the EU beef ban was a non-tariff trade barrier. Australia, and New Zealand joined the United States in the action. Canada filed a separate case, and the final report addressed issues raised in both (U.S. and Canadian) cases. These were, in effect, test cases for the application of the Uruguay Round Agreement on the Application of Sanitary/Phytosanitary Measures.

Following a series of legal actions and appeals, a WTO arbitrator upheld all previous rulings and gave the EU until May 13, 1999 to bring regulations into compliance with WTO guidelines. Under WTO procedures the EU was then obligated to modify its regulations by May 13, 1999 to comply with the ruling or the United States could retaliate. Unfortunately the EU was unable to modify its regulations and on July 29, 1999 the U.S. began implementing retaliatory measures against exports from the EU valued at $116.8 million.

The objective of the U.S. beef industry has always been to regain access to the European beef market, not retaliation. Retaliation will not benefit the beef industry because duties are on products not related to beef. U.S. and EU negotiators are continuing to explore possible compensation packages that would benefit the beef industry more than current retaliation and allow trade to proceed while the EU continues to work towards compliance with their WTO obligations. The alternatives of compensation or retaliation are viewed only as a means to an end—access to the EU market for conventionally produced U.S. beef—not the primary objective.

Based on the criteria of market access as the primary objective, one could say that the WTO dispute settlement process has not worked—we still do not have access to the EU beef market. However, compensation and retaliation are also possible outcomes for any WTO case and the U.S. has implemented tariffs of 100 percent on $116.8 million of EU goods consistent with alternatives provided in the WTO dispute settlement process. They provide a "burr under the saddle" to push the EU to compliance. From that perspective, the WTO dispute settlement process has worked, though the industry has not yet achieved its objective.

The point of all of this is that wherever trade exists there will be trade disputes and agricultural issues are particularly contentious. This has been the case with all other major U.S. trading partners and it will definitely be true with China. China will agree to abide by the same rules and dispute settlement processes as a WTO member that approximately 140 other countries have agreed to observe.

NCBA strongly supports continued United States participation in the WTO and we welcome China's full membership and participation. Based on the beef industry's experience, among the strengths of the current WTO system is the well-defined process for initiating a dispute case and for determining the final ruling/settlement. The current system is much improved over its GATT predecessor in this respect. The strict science-based rules established for resolving these issues is another major strength of the current dispute settlement process. We are very pleased that China is on the threshold of WTO accession and will become an equal participant in well-defined dispute settlement process.

6. *Conclusions, other views and necessity and importance for the United States of building a strong, stable and lasting relationship with China.*

With a population of 1.2 billion China is a consumer market with enormous potential. Any agreement that fosters improved relations with one out of every five inhabitants on planet earth is impossible to ignore. China is not just opening its markets, it is becoming more open to ideas and exposed to principles of basic rights and freedoms. As China's economy becomes increasingly open to world trade, it will also become more open to international visitors and investors, under closer scrutiny by international media and as a result, actions of its leaders will be increasingly influenced by global opinion. U.S. security interests will be much better served by a China that is inter-dependant on global trading partners than a China that is not engaged and is isolated from the rest of the world.

Building a strong, stable and lasting relationship with China and facilitating China's accession to the WTO is critical to long-term U.S. security interests. Most trading partners have disputes at some time or another and China will be no exception. As a WTO member, China has agreed to abide by the same well-defined dispute settlement process as other WTO members. The U.S. and other global trading powers must work closely with Chinese leadership to assure that China lives up to its obligations. The price of failure is too great not to ensure its success.

Request for Action

NCBA appreciates the initiatives that have been undertaken to gain access to international markets and to resolve lingering issues that restrict the ability of the U.S. beef industry to offer its products to international consumers on equal footing. I appreciate this opportunity to participate in the process of evaluating the importance of trade with China and accession of China to the WTO. NCBA stands ready to provide additional input on this and other trade issues, such as those involving the EU and approving legislation to provide trade promotion authority. Thank you for the opportunity to present this information.

Chairman D'AMATO. Thank you very much, Mr. Lambert.

Mr. Ford?

STATEMENT OF DWAIN FORD, FIRST VICE PRESIDENT, AMERICAN SOYBEAN ASSOCIATION

Mr. FORD. Thank you, Mr. Chairman and members of the committee. I am Dwain Ford, a soybean and corn producer from Kinmundy, Illinois, and I currently serve as the First Vice President of the American Soybean Association, which represents over 27,000 producer members on national issues of importance to all U.S. soybean farmers. On behalf of ASA, I commend you for holding this important hearing and thank you for inviting us to participate.

The impact of increased Chinese imports of U.S. soybeans on U.S. farm prices and producer income has been clearly demonstrated in recent years. In 1999 and 2000, China's purchase of U.S. soybeans significantly increased, from $472 million in 1999 to $1.1 billion in 2000. For 2001, the export value of soybeans to China is expected to be $1.28 billion. In 1998 and 1999, when economic problems in Asia, Russia, Eastern Europe, and Latin America stymied demand as global outputs of all oil seeds increased, it was continued exports to China that helped temper the price fall.

Last marketing year, China passed Japan as the largest importer of U.S. soybeans, with total purchases of 5.2 million metric tons, or 191 million bushels. And in this current market year, China will increase its purchases by another half-million metric ton, or nearly 20 million bushels. In fact, soybeans are now the largest U.S. agriculture export to China.

Even more impressive than the current imports, however, is China's potential for increased imports of U.S. soybeans and other agriculture products. Its population of over 1.2 billion is becoming increasingly urban and demand for rising diet and higher in vegetable oil and protein.

China's per capita consumption of soybean meal is only 17.2 pounds annually, compared to 174 pounds in Taiwan. If consumption rose to one-half of Taiwan's level, China would require an additional soybean imports of 1.77 billion bushels, about 64 percent of annual U.S. production.

While these exports are of significant importance to the American soybean farmer, they are of equal importance to the Chinese importers, processors, feed millers, livestock producers, and consumers. U.S. soybean exports are supporting rapid development of a rapid soybean processing and feed milling industry dedicated to the processing and conversion of soybeans into livestock feed. Our exports provide to the livestock producers a protein source for growing more efficiently swine, poultry, fish, to provide more and better quality food to the Chinese people.

Not only do our soybean exports create jobs, they contribute to a more nutritious diet for those consuming the meat, milk, eggs, and soy-based foods produced from them. Few exports play such an important role in the development, well-being, and economic and political stability of a country.

With U.S. soybean prices and producer income so closely tied to China's import policies, negotiation of advantageous terms for trade in soybeans as a condition of China's ascension in the WTO has been a critical goal for our industry. In 1994, ASA conditioned its support for the Uruguay Round agreement on commitment from the administration that oil seeds and oil seed products would be a key priority in these negotiations. Oil seed processors and producers have worked closely with the U.S. negotiating team during the past six years to ensure that the accession will provide significant increase to the access in the Chinese market.

And in testimony before Congress, ASA has repeatedly placed China WTO accession at the top of our list of actions needed to make the current market-oriented domestic farm program viable.

These efforts have been justified, with China and the United States completing negotiations that are satisfactory to the American soybean industry.

Not only has China agreed to bind its duties on soybean and meal at three percent and five percent respectively, it will reduce its end quota tariff on soybean oil from 13 to nine percent. Its overquota tariff on soybean oil will reduce from 85 to nine percent by 2006, and the present monopoly on imports of soybean oil controlled by state trading enterprises will also be eliminated by 2006. In addition, soybean farmers are assured that tariff levels on soy will not exceed those of competitor oil seed crops or oils.

By reducing and binding tariff levels, these terms ensure that U.S. soybean producers and processors will have access to the Chinese market on a predictable basis. This will prevent any arbitrary decision to suddenly raise duties or impose quotas, which could and does happen under the present regime. In addition, these terms represent the going-in position for the next round of the WTO negotiations.

ASA will work with U.S. negotiators to improve them in coming years. In addition, we may find China to be a key ally on the WTO on issues such as export subsidies, reform of state trading enterprises, and protecting trade and the products of biotechnology. Such support on biotechnology is very important, as China is currently developing regulations and use of biotech enhanced products, which include soybeans. It is critical to our soybean exports that China resolve these rules in a rapid, transparent, and non-trade-distorting manner that will ensure the important market is in no way disrupted.

Membership in the WTO goes far beyond the trade advantages our soybean farmers gain from a more open market with more equitable tariffs and greater transparency. Membership is a major step forward for China as it moves its trade policy from one of fiat and arbitrary decision to the rules of international law.

While there will be difficulties in the transition period as the fine points of the rules are more closely interpreted and applied in practice, the changes will be profound in themselves and as a basis for further growth in the democratic process we all support for China.

We must be ever diligent during the transitional period to ensure complete and accurate compliance with the rules. This means that artificial trade barriers disguised as arbitrary rules for the import of biotech enhanced soybeans and unjustified phytosanitary regulations that serve as a border restriction for imports are aggressively challenged, where necessary, and respond to them with trade.

We appreciate the support of this committee on this vital issue and we pledge our continued efforts. Thank you, Mr. Chairman, and I would be glad to respond to any questions.

[The statement follows:]

PREPARED STATEMENT OF DWAIN FORD

Good morning, Mr. Chairman, and members of the committee. I am Dwain Ford, a soybean and corn producer from Kinmundy, Illinois. I currently serve as First Vice President of the American Soybean Association, which represents over 27,000 producer members on national issues of importance to all U.S. soybean farmers. On behalf of ASA, I commend you for holding this important hearing, and thank you for inviting us to participate.

The impact of increased Chinese imports of U.S. soybeans on U.S. farm prices and producer income has been clearly demonstrated in recent years. In 1999 and 2000, China's purchases of U.S. soybeans significantly increased, from $472 million in 1999 to $1.1 billion in 2000. For 2001, the export value of our soybeans to China is expected to be $1.28 billion. In 1998 and 1999 when economic problems in Asia, Russia, Eastern Europe, and Latin America stymied demand, and as global output of all oilseeds increased, it was continued exports to China that helped temper the price fall. Last marketing year, China passed Japan as the largest importer of U.S. soybeans, with total purchases of 5.2 million metric tons (191 million bushels), and in this current marketing year, China will increase its purchases by another half million metric tons, or nearly 20 million bushels. In fact, soybeans are now the largest U.S. agricultural export to China.

Even more impressive than current imports, however, is China's potential for increased imports of U.S soybeans and other agricultural products. Its population of over 1.2 billion is becoming increasingly urban, and demand is rising for a diet higher in vegetable oil and protein. China's per capita consumption of soybean meal is only 17.2 pounds annually compared to 174 pounds in Taiwan. If consumption rose to one-half of Taiwan's level, China would require additional soybean imports of 1.77 billion bushels, about 64 percent of annual U.S. production.

While these record exports are of significant importance to the American soybean farmer, they are of equal importance to the Chinese importers, processors, feed millers, livestock producers and consumers. U.S. soybean exports are supporting the rapid development of a modern soybean processing and feed milling industry dedicated to the processing and conversion of soybeans into livestock feeds. Our exports provide to the livestock producers the protein source for growing more efficiently swine, poultry and fish, with which to provide more and better quality food to the Chinese people. Not only do our soybean exports create jobs, they contribute to a more nutritious diet for those that consume the meat, milk, eggs and soy-based foods produced from them. Few exports play such an important role in the development, well-being and economic and political stability of a country.

With U.S. soybean prices and producer income so closely tied to China's import policies, negotiation of advantageous terms for trade in soybeans as a condition of China's accession to the WTO has been a critical goal for our industry. In 1994, ASA conditioned its support for the Uruguay Round Agreement on a commitment from the administration that oilseeds and oilseed products would be a key priority in these negotiations. Oilseed processors and producers have worked closely with the U.S. negotiating team during the past 6 years to ensure that accession will provide a significant increase in access to the Chinese market. And in testimony before Congress, ASA has repeatedly placed China WTO accession at the top of our list of actions needed to make the current market-oriented domestic farm program viable. These efforts have been justified, with China and the United States completing negotiations that are satisfactory to the American soybean industry. Not only has China agreed to bind its duties on soybeans and meal at 3 percent and five percent respectively, it will reduce its in-quota tariff on soybean oil from 13 percent to 9 percent. Its over-quota tariff on soybean oil will be reduced from 85 percent to 9 percent by 2006. The present monopoly on imports of soybean oil controlled by state trading enterprises will also be eliminated by 2006. In addition, soybean farmers are assured that tariff levels on soy will not exceed those of competitor oilseed crops or oils.

By reducing and binding tariff levels, these terms ensure that U.S. soybean producers and processors will have access to the Chinese market on a predictable basis. This will prevent any arbitrary decision to suddenly raise duties or impose quotas, which could and does happen under the present regime. In addition, these terms represent the "going-in" position for the next round of WTO negotiations. ASA will work with U.S. negotiators to improve on them in coming years. In addition, we may find China to be a key ally in the WTO on issues such as export subsidies, reform of State Trading Enterprises, and protecting trade in the products of agricultural biotechnology.

Such support on biotechnology is very important as China is currently developing regulations on the importation and use of biotech-enhanced products, which include soybeans. It is critical to our soybean exports that China resolve these rules in a rapid, transparent and non-trade distorting manner that will ensure that this important market is in no way disrupted.

Membership in the WTO goes far beyond the trade advantages our soybean farmer's gain from a more open market, with more equitable tariffs and greater transparency. Membership is a major step forward for China as it moves its trade policy from one of fiat and arbitrary decisions to the rules of international law. While there will be difficulties in the transition period, as the fine points of the rules are more closely interpreted and applied in practice, the changes will be profound, both in themselves and as the basis for further growth in the democratic process we all support for China.

We must be ever vigilant during the transitional phase to ensure complete and accurate compliance with the rules. This means that artificial trade barriers, disguised as arbitrary rules on the import of biotech-enhanced soybeans and unjustified phytosanitary regulations that serve as border restrictions to imports are aggressively challenged and, where necessary, responded to with trade retaliation.

As we are all aware, Mr. Chairman, U.S. soybean producers and industry members would not be able to benefit from this agreement when China joins the WTO without China having been granted Permanent Normal Trade Relations. Due to the efforts of such organizations as ASA, the active involvement of our USTR and the support of Congress, the status will be given to China once it becomes a permanent member of the WTO.

We appreciate the support of this committee on this vital issue, and pledge our continued efforts.

Thank you, Mr. Chairman. I will be glad to respond to any questions.

Chairman D'AMATO. Thank you very much, Mr. Ford.

Mr. FORD. I'm sorry for running over the time.

Chairman D'AMATO. Oh, that's quite all right.

Mr. Von Tungeln?

STATEMENT OF HENRY JO VON TUNGELN, CHAIRMAN, U.S. WHEAT ASSOCIATES AND THE WHEAT EXPORT TRADE EDUCATION COMMITTEE

Mr. VON TUNGELN. Mr. Chairman and members of the Commission, My name is Henry Jo Von Tungeln and I'm a wheat and cattle producer from Calumet, Oklahoma. I've been active in State and national agricultural activities for many years. I just assumed the role as Chairman of the U.S. Wheat Associates and the Wheat Export Trade Education Committee and I'm looking forward to working with these organizations on issues such as the ones we are here to discuss today.

For our organizations and U.S. wheat producers, the issues posed by this hearing are very important. It's also a case where we have very little choice. We face a very competitive world wheat market and we have to be there or get cut out of the picture. The wheat industry has paid a high price when our government has invoked sanctions, often unilaterally, to achieve policy goals and attempt to influence another country. These unilateral sanctions have been a disaster for wheat, which is a very political, fungible commodity. If the United States decides that it will not sell wheat to a country, there are always others that will quickly and happily step into the vacuum to make the sale.

In recent years, the China market has been a very volatile one in terms of wheat import levels. China is both the world's largest wheat producer and also the world's largest wheat consumer. During the early 1990s, the volume of China's wheat imports was as high as 15 million metric tons, while in recent years it has been under one million metric tons. China wheat production levels increased sharply in the 1990s, but their policies have recently changed and we expect to see them again become a significant importer with more market-driven policies.

The agricultural cooperation agreement between China and the United States includes a very significant tariff rate quota of 7.3 million tons for China's private sector and will increase to 9.6 million tons. This will be a target for exporters of U.S. wheat, but it will also be the focus of our competitors.

We see no realistic alternative to competing for the Chinese export business. It is in our interest and that of the Chinese, as well. Other suppliers will meet China's wheat needs if we are unable or unwilling to do so. While open competition is not without some frustration, we see it as far preferable to confrontation. When asked recently whether opening the China market under the WTO would enhance the profitability of U.S. wheat producers, I replied, it's our survival.

In response to the specific questions that the Commission has raised, number one was whether our current bilateral trade policies toward China serve the national security interests of the United States and why or why not, we would respond by saying there is an old saying that if trade doesn't flow across international borders, armies will. Yes, the opportunities for trade presented in the U.S.-China agreements both bilaterally and through their membership in the WTO will help foster a cooperative rather than adversarial relationship.

These policies will allow the U.S. to fully engage China in a meaningful relationship that will give the U.S. unprecedented opportunities to influence the causes of democracy and economic liberalization in China. A stable and growing economy will help foster economic and political security.

For U.S. wheat producers, the provisions in both the agreement on U.S.-China agricultural cooperation and the bilateral agreement for China's WTO membership have clauses that create opportunities for wheat exports on a competitive basis. The tariff rate quota system outlined in the bilateral agreement on WTO membership provides for minimum tariff levels of one percent within the quota on fixed levels of imports. The agreement on agricultural cooperation removes sanitary and phytosanitary barriers. Both agreements have the potential to boost exports and increase prices for wheat, helping to maintain a market for U.S. wheat and create vital income for U.S. producers.

Additionally, WTO accession would make China subject to the same trade rules that 135 other countries currently abide by and would give other countries a multilateral dispute mechanism to address trade concerns. The WTO accession would also subject China to trade rules that secure science-based sanitary and phytosanitary standards, transparency, and nondiscrimination. The opening of the Chinese market will provide greater opportunity to lead by example and serve U.S. national security interests by promoting economic growth and stability.

The second question you asked was what accounts for China's huge trading surplus with the United States and whether the China bilateral trade relationship with its major trading partners appear to be substantially different from those it enjoys with the United States, and if so, why.

The United States market is currently open to China. This agreement serves to open Chinese markets to American products and services. This agreement will give U.S. wheat producers a far greater sales opportunity to a country with 1.2 billion consumers, with a potential ten percent increase in total annual U.S. wheat exports. This represents almost 20 percent of the world's population and China's accession into the WTO will also continue to spur economic growth within China and increase demand for higher quality U.S. wheat.

Until a trade relationship provides for more balanced two-way trade, the surplus will continue to grow. It is our hope that as access to the Chinese market increases and provides greater opportunity for U.S. products, that surplus over time will decline. As you are well aware, the strong U.S. dollar and a hearty appetite by U.S. consumers for goods and services also negatively impact our trade surplus.

For wheat trade, the potential opening of the Chinese market will give us the opportunity to positively contribute to the U.S. trade balance, since China is a net importer. Chinese millers want U.S. wheat. We can provide better quality and cheaper wheat than millers in the large coastal cities can currently buy from domestic production.

U.S. political policy towards China, as opposed to their other trading partners, allows Chinese decision makers and government officials to perpetuate the perception that the U.S. seeks to slow China's emergence as a major economic power. Such policies that lead to these perceptions are ripe for elimination. These include, but are not limited to, the abstentions or nay votes for World Bank and selected procedures, withholding Export Bank loans and credit guarantees related to economic or security reasons.

Generally, U.S. unilateral sanctions are largely symbolic, undermined by our competitors, discourage private business decisions based on uncertainty, causing imports to originate from competitor markets and maintain the perception that the U.S. does not want the emergence of China as an economic power. In the end, however, unilateral sanctions only undermine our ability to export goods and services to China. Our competitors gain at the expense of farmers, workers, and businesses, and the U.S. perpetuates the label of an unreliable supplier.

I'm going to have to skip down a little bit here. You also asked about our views on what actions the United States would take if China fails to live up to its WTO obligations. The U.S. should first carefully examine failures or perceived failures, approaching the appropriate government agencies with responsibility for implementation with regard to particular imports.

Any other views or recommendations you have regarding the overall trade relationship with the U.S. and China and the implications and impact on American farmers, industries, and the economy of the United States. Our answer is, in the bilateral agreements for agricultural cooperation in WTO membership, there are clauses relating to U.S. technical assistance programs. This technical assistance is beyond the scope of the individual industry's abilities. The U.S. Government needs to develop a systematic program to help the Chinese government meet its WTO obligations. These assistance programs can range from training government officials to providing WTO-related legal assistance while it's necessary.

Mr. Chairman, I'm out of time. You have my statement in full and we'll——

Chairman D'AMATO. You're out of time, but you're not out of paper.

[Laughter.]

We'll have that for the record and we'll be glad to study that and we'll have some questions for you.

Mr. VON TUNGELN. All right.

[The statement follows:]

PREPARED STATEMENT OF HENRY JO VON TUNGELN

Mr. Chairman and members of the Commission, my name is Henry Jo Von Tungeln and I am a wheat and cattle producer from Calumet, Oklahoma. I have been active in state and national agricultural activities for many years.

I have just assumed the role of Chairman of U.S. Wheat Associates and the Wheat Export Trade Education Committee, and I am looking forward to working with these organizations on issues such as the ones before us today.

For our organizations and U.S. wheat producers, the issues posed by this hearing are very important. It's also a case where we have little choice. We face a very competitive world wheat market, and we have to be there or get cut out of the picture.

The wheat industry has paid a high price when our government has invoked sanctions, often unilaterally, to achieve policy goals and attempt to influence another country. These unilateral sanctions have been a disaster for wheat which is a very political, fungible commodity. If the United Sates decides that it will not sell wheat to a country, there are always others that will quickly and happily step into the vacuum to make the sale.

In recent years the China market has been a very volatile one in terms of wheat import levels. China is both the world's largest wheat producer and the largest wheat consumer. During the early 1990's the volume of China's wheat imports was as high as 15 million tons while in recent years it was under one million tons. Chinese wheat production levels increased sharply in the late 1990's, but their policies have recently changed. We expect to see them again become a significant importer with more market-driven polices.

The Agricultural Cooperation Agreement between China and the United States includes a very significant Tariff Rate Quota of 7.3 million tons for China's private sector which will increase to 9.4 million tons. This will be a target for exporters of U.S. wheat, but it will also be the focus of our competitors.

We see no realistic alternative to competing for the Chinese wheat export business. It is in our interest and that of the Chinese as well. Other suppliers will meet China's wheat needs if we are unable or unwilling to do so. While open competition is not without some frustration, we see it as far preferable to confrontation.

When asked recently whether opening the China market under the WTO would enhance the profitability of U.S. wheat producers, I replied "It's our survival."

In response to the specific questions that the Commission raised.

1. *Whether our current bilateral trade policies toward China serve the national security interests of the United States and why or why not?*

There is an old saying that if trade doesn't flow across international borders, armies will. Yes, the opportunities for trade presented in the U.S.-China agreements both bilaterally and through their membership in the World Trade Organization (WTO) will help foster a cooperative rather than adversarial relationship. These policies will allow the U.S. to fully engage China in a meaningful relationship that will give the U.S. unprecedented opportunities to influence the causes of democracy and economic liberalization within China. A stable and growing economy will help foster economic and political security.

For U.S. wheat producers the provisions in both the Agreement on U.S.-China Agricultural Cooperation and the bilateral agreement for China's WTO membership have clauses that create opportunities for wheat exports on a competitive basis. The tariff rate quota system outlined in bilateral agreement on WTO membership provides for minimum tariff levels (1%) within the quota on fixed levels of imports. The agreement on Agricultural Cooperation removes sanitary and phytosanitary barriers. Both agreements have the potential to boost exports and increase prices for wheat, helping to maintain a market for U.S. wheat and create vital income for U.S. producers.

Additionally, WTO accession would make China subject to the same trade rules that 135 other countries currently abide by, and would give other member countries a multilateral dispute mechanism to address trade concerns. WTO accession would also subject China to trade rules that secure science-based sanitary and phytosanitary standards, transparency and nondiscrimination. The opening of the Chinese market will provide greater opportunity to lead by example and serve U.S. national security interests by promoting economic growth and stability.

2. *What accounts for China's huge trade surplus with the United States and whether China bilateral trade relationship with its major trading partners appear to be substantially different from those it enjoys with the United States and if so why?*

The United States market is currently open to China; these agreement serves to open the Chinese market to American products and services. This agreement will give U.S. wheat producers a far greater sales opportunity to a country with 1.2 billion consumers, with a potential 10% increase in total annual U.S. wheat exports. This represents almost 20 percent of the world's population. China's accession into the WTO will also continue to spur economic growth within China and increase demand for higher quality U.S. wheat.

Until the trade relationship provides for more-balanced two-way trade the surplus will continue to grow. It is our hope that as access to the Chinese market increases and provides greater opportunity for U.S. products that surplus, over time, will decline. As you are well aware, the strong U.S. dollar and a hearty appetite by U.S. consumers for goods and services also negatively impact our trade surplus. For wheat trade, the potential opening of the Chinese market will give us the opportunity to positively contribute to the U.S. trade balance since China is a net importer. Chinese millers want U.S. wheat. We can provide better quality and cheaper wheat than millers in the large coastal cities can currently buy from domestic production.

U.S. political policy toward China, as opposed to their other trading partners, allows Chinese decision-makers and government officials to perpetuate the perception that the U.S. seeks to slow China's emergence as a major economic power. Such policies that lead to these perceptions are ripe for elimination. The U.S. must drop sanctions related to the Tiananmen incident of 1989. These include, but are not limited to abstentions or nay votes for World Bank loans and selective procedures withholding Export-Import Bank loans and credit guarantees unrelated to economic or security reasons. Generally U.S. unilateral sanctions are largely symbolic, undermined by our competitors, discourage positive business decisions based on uncertainty, causing imports to originate from competitor markets, and maintain the perception the U.S. does not want the emergence of China as an economic power. In the end however, unilateral sanctions only undermine our ability to export goods and services to China. Our competitors gain at the expense of farmers, workers and businesses and the U.S. perpetuates the label of an unreliable supplier.

3. *In your view, whether any such differences have any national security implications for the United States?*

As national security is partly a function of economic well being, U.S. policies which encourage Chinese government officials and businesses to look elsewhere for imports have a negative impact on the economic well being of U.S. producers and national security. To that extent U.S. competitors in the wheat industry and others gain opportunities while U.S. producers are disadvantaged and potential income lowered. And, we support a policy of engagement which will foster positive changes within China.

4. *Your views on China's ability to live up to the bilateral trade obligations it is assuming with regard to the United States and its major trading partners as part of its entry into the WTO.*

The response to obligations to employ in the Agricultural Cooperation Agreement is an indication of China's ability to comply. While initially there were difficulties in implementation, such as poorly informed local officials and delays in processing imports, communications with authorities at national levels such as the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) and the national inspection and quarantine agency received positive responses. While recent wheat purchases have been small, they have entered the country successfully.

China's leadership realizes that recent high economic growth is not sustainable in the long term. The leaders instead now consider the quality of growth as most important with the view that the obligations of WTO membership are the leverage to make the necessary transition. In regard to the TRQ for wheat as part of the bilateral WTO membership agreement, our visits as recently as June 2001 to government officials in Beijing overseeing the industry confirm their intention to implement provisions in acceptable manner.

5. *Your views on what actions the United States should take if China fails to live up to its WTO obligations.*

The U.S. should first carefully examine failures or perceived failures, approach the appropriate government agencies with responsibility for implementation with regard to particular imports (for example in regard to wheat the State Development and Planning Commission, the State Administration of Grain and the Administration for Quality Standards, Inspection and Quarantine) and the MOFTEC.

If upon consultation there remains a lack of or perceived lack of implementation, the U.S. should approach the WTO for resolution of the case and prepare a list of targeted counter barriers that will substantially impact China's exports to the U.S.

6. *Any other views or recommendations you have regarding the overall trade relationship between the U.S. and China and the implications and impact on American farmers, industries and the economy of the U.S.*

In the bilateral agreements for agricultural cooperation and WTO membership there are clauses relating to U.S. technical assistance programs. This technical assistance is beyond the scope of individual industries' ability. The U.S. government needs to develop a systematic program to help the Chinese government meet its WTO obligations. These assistance programs can range from training government officials to providing WTO-related legal assistance. While it is necessary to safeguard U.S. industries' competitive interests, it is possible to conduct such programs constructively.

Competitor countries and regions such as Japan, Canada, Australia and the European Union are doing so. The lack of a strong, well coordinated and funded U.S. government program builds upon perceptions in China that the U.S. prefers to maintain and implement tough conditions rather than assisting China's transformation to developed country status and a potentially large and stable consumer market.

Mr. Chairman, we know that China will be a vigorous trade competitor of the United States, but we see no realistic alternative to engagement. The signs are that the Chinese leaders want to join the WTO and be a responsible trading country. We support that accession and have regularly been in touch with USTR and USDA on this process.

I have entertained the Chinese Ambassador in my home, and we have had their trade teams in Oklahoma. It is clear that there has been a serious debate within China over its future direction. In our view, it is in our national security interest to work with and encourage the present direction that China is taking to open up its market and join the WTO. Our organizations see their role as furthering this process and, at the same time, enhancing opportunities for U.S. wheat exports.

Thank you, Mr. Chairman. I will be happy to respond to any questions.

Chairman D'AMATO. Mr. Johnson?

STATEMENT OF ROBBIN S. JOHNSON, SENIOR VICE PRESIDENT, CORPORATE AFFAIRS, CARGILL, INCORPORATED

Mr. JOHNSON. Thank you and good afternoon. I also have a longer written statement to submit for the record, but let me try to briefly summarize its main points.

First, a little bit about Cargill's trading relationship with China. Our China business expanded greatly after President Nixon reopened trade relations with China in 1971. Overall, Cargill's trade with China now exceeds $800 million annually, about $550 million in sales to China and some $250 million in exports from China. We sell grains, oilseeds, fertilizer, orange juice, and other commodities to China and export cotton, steel, and corn from China.

China has been a good trading partner for more than 30 years. We are respected in China for honoring our contracts, and our Chinese trading partners, by and large, have done the same. There have been exceptions, like a recent barley shipment that was improperly detained in two Chinese ports for about seven months, but generally, it has been a good trading relationship.

The largest factor affecting U.S.-China agricultural relations has been how China has pursued its own food security. Starting in 1978, it made policy changes that stimulated agricultural production and broader economic development. Those changes have lifted 170 million Chinese people out of poverty, but it has been a policy of food self-sufficiency that has come at high costs.

With 22 percent of the world's population but only seven to nine percent of its arable land, China has stressed its land and water resources. The policy has resulted in higher food costs for Chinese people, with food import duties, as you have heard, as high as 45 percent, and a value added tax usually tacked on on top of that. It has been costly to Chinese taxpayers, as much as $12 billion in farm program costs in the 1997–1998 marketing year alone. And it has disrupted global markets, as China has shifted the adjustment costs of its policy changes onto trade flows, making world prices more volatile and lower than they otherwise would have been.

Perhaps the most important aspect of agricultural trade affecting U.S. security interests is how China defines its own food security. In the past, it has largely equated food security with food self-sufficiency. This is characteristic of most developing countries, as the failure to ensure reliable supplies of food staples can topple governments.

But the process of economic development changes the meaning of food security. Rising incomes diversify dietary expectations. It no longer is enough for China to ensure supplies of basics like grains, rice, and root crops. Consumers come to want more meat, milk, eggs, fruits and vegetables. This brings trade and comparative advantage into the food security equation.

How should the United States respond to this redefining of Chinese food security? The Cold War mentality often led to "food as a weapon" thinking. That notion probably culminated when, in response to the invasion of Afghanistan by the Soviet Union, President Carter imposed the Soviet grain embargo of January 4, 1980. That experience should have taught us that the food weapon was a blunt tool that did more damage at home than abroad. Other countries eagerly stepped in to pick up the food markets the U.S. abandoned, and U.S. grain exports today are 20 percent lower in volume and one-third lower in market share than they were prior to the Soviet grain embargo.

The alternative is to think of food as a cornerstone for economic cooperation. The member economies of the Asia Pacific Economic Cooperation Forum, or APEC, have endorsed the concept of an APEC Food System. AFS is a regional food security strategy centered on four principles, endorsed last year by the heads of state of the member economies.

The first of those principles is to renounce the use of food embargoes. To build more open access to markets, one must first assure open access to supplies.

The second is to abolish export subsidies. Developing countries need assurances that their farmers will be permitted to explore their comparative advantage without fear of competition that is buttressed by national treasuries.

The third is to identify impediments to expanded two-way food trade. Border protection for agricultural trade is ten times higher than for industrial trade, but this is often driven by domestic farm policies. As well, apparent concerns about food quality or safety can be used to mask protectionist practices, so creating more open food markets requires not only drastic reforms of border measures, but also the internal policies that underpin them.

Finally, involve the development banks in accelerating rural diversification. A constraint on agricultural reform, certainly in

China, is the fear that off-farm jobs won't be there for those people released from farming, leading to unemployment and a flight to overcrowded urban centers. Lifting this constraint requires more effective rural development strategies and the resources to implement them.

The APEC Food System has been endorsed by all regional leaders, including those from China and the United States, but it is up to those two countries to take the lead in implementing those regulations. They have the most to gain economically. They have the most to contribute in the way of policy adjustments. They have the ability to make it happen through their own collaboration. And they have the ability to take the APEC Food System global by supporting its concepts in the next WTO agricultural round.

You asked me three questions, rather than the longer list of my colleague here. Let me try to answer each of those briefly, and then we'll get to the real Q&A.

In effect, the first question is whether U.S. agricultural trade policy toward China serves U.S. national security interests. I would answer the question this way. Steps that the United States takes that encourage China to shift from defining food security as self-sufficiency to pursuing it through open regional trade serve U.S. national security interests in several ways. Such a policy shift promotes Chinese collaboration with its regional neighbors. It also promotes more rapid emergence of a broad-based middle class in China.

It will strengthen all of the economies in the region. The U.S. Department of Agriculture estimates that three-fourths of the welfare gains to be achieved within APEC through trade liberalization come from liberalization of the agricultural sector alone. And it will bring renewed export opportunities and economic growth, as you've heard from the other witnesses on this panel.

Your second question asks what accounts for China's large and growing trade surplus with the United States. A strong dollar and the strong U.S. economy have been important factors, but I think it is primarily—one of the factors is that the United States has been relatively more open to China's principal comparative advantage, labor-intensive goods, than China has been open to land-intensive exports from the United States, particularly grains, oilseeds, and beef products.

This last factor is related to the earlier discussion about food security. China is understandably reluctant to increase its dependence upon the United States for basic foodstuffs so long as there are questions about American willingness to be a reliable supplier. A clear U.S. renunciation of food embargoes for short supply or foreign policy reasons and a clear articulation of a narrow national security reservation on that commitment would go a long way to inducing in China the kinds of agricultural policy changes needed to replace self-sufficiency with a trade-based approach to food security.

Thank you. I will end my testimony with that.

[The statement follows:]

PREPARED STATEMENT OF ROBBIN S. JOHNSON

Introduction

Thank you and good afternoon. I am pleased to have this opportunity to talk about the role of agricultural trade in U.S.-China relations and its implications for U.S. national security.

I would like to cover four topics in my testimony: a description of Cargill's business, with emphasis on its China content; a survey of our commercial relations with China; a discussion of how China's concept of food security may change with economic development; and answers to the specific questions you posed.

Cargill's Business, with Emphasis on China

Cargill markets, processes and distributes agricultural, food, industrial and financial products and services. We operate with a global perspective, employing more than 80,000 people in 60 different countries and trading with many of the rest.

Conceptually, our role is to connect supply with demand over space and time. Our customers are primarily other businesses, so we strive to provide them solutions that help them succeed in their activities.

For agriculture, we sell farmers needed inputs, including feeds, fertilizers and agronomic services. We also provide them with marketing advice and merchandise the products of farms and ranches.

In food, we process basic commodities into food ingredients for manufacturers, retailers and the food service industry. That can include many items familiar to you from a food outlet like McDonalds. We supply most of the orange juice in their Japanese stores and around three-fourths of their global cooking oil needs for french fries. Our Excel subsidiary provides beef for their hamburgers while Cargill mills flour that goes into their buns. We supply liquid eggs for Egg McMuffins through a Sunny Fresh Foods subsidiary that recently was the first food company to win the Malcolm Baldrige Quality Award. And our corn milling business provides sweetener for the Coke McDonalds serves and for Pepsi and other beverages.

In industrial areas, we mine salt, produce fertilizers and manufacture steel. We also extract lubricants, ethanol and an innovative plastics resin from renewable farm products.

In financial markets, we trade currencies and energy, invest in distressed assets and provide a range of financial and risk management services to our own businesses and to customers.

What ties these many businesses together is that they are basic goods where our ability to add value helps raise living standards for the ultimate customers we serve globally. These skills and that vision took us to China 30 years ago.

Our business in China has expanded greatly since President Nixon reopened trade relations with China in 1971. Overall, Cargill's trade with China now exceeds $800 million a year—about $550 million in sales to China and some $250 million in exports from China. Cargill now sells grains, oilseeds, fertilizer, orange juice and other commodities to China and exports Chinese commodities such as cotton, steel and corn.

Cargill made its first on-the-ground investment in China in 1988 when we opened an oilseeds processing plant in Jinan, Shandong Province. Since then, our investments have grown substantially. We are now headquartered in Shanghai and have offices in Beijing and Hong Kong that support many of our businesses in China. In all we have operations in 15 locations throughout the country and employ about 450 people in these various locations, all but a handful Chinese.

We have built two wholly-owned feed mills, each with an annual production capacity of 250,000 metric tons, in Zhejiang and Jiangsu Provinces. We recently acquired four feed plants that operate under the Agribrands name, located in Shandong, Jiangsu, Hubei and Liaoning Provinces. And, we operate two leased feed plants in Guangdong and Sichuan Provinces to produce various animal and aquaculture feed products. Zhangwu Cargill-Renessen, a joint venture company in Liaoning Province, produces and sells high value feed corn to Chinese feed mills.

We have invested in joint venture fertilizer blending plants in Tianjin and Yantai, Shandong Province. We have opened a new branch office in Fujian Province to expand sales of the Yantai operation, and we are investing $35 million in a joint venture fertilizer production business in Kunming, Yunnan Province.

We also are integrating Dongling Trading Corporation, which we acquired when Cargill bought Continental's grain businesses. It will enable us to import and distribute grains and other foodstuffs in China in local currency, as well as originate and export various Chinese products.

In other words, we are involved in China in basic businesses in the food chain, just as we are elsewhere in the world.

Our Commercial Experience with China

China has been a good trading partner for more than 30 years. Over that time and the many changes in Chinese policies that have occurred, the vast majority of our dealings have gone smoothly. We are respected in China for honoring our contracts and commitments. By and large, our Chinese trading partners have done the same.

But in any large, longstanding trading relationship, there will be occasional differences. We have faced occasional problems in collecting payments from Chinese state-owned agencies. We also have experienced occasional arbitrary enforcement practices—like the seven months we just spent wrangling with China's quarantine agency over a barley shipment that was improperly detained in two Chinese ports.

Our larger problems, however, have been with our on-the-ground asset investments, which have generally proved unprofitable. Some of the problems we have created ourselves. Some arise from Chinese actions, which can result in changes in policy or market circumstances that are unpredictable, lack a clear rationale or are taken without adequate input from affected parties.

These problems are not just in the past. For example, we felt that agriculture was making good headway under the U.S.-China bilateral agreement when China suddenly announced a new law restricting genetically modified organisms. Announced without any implementing regulations, this action has created confusion and disrupted normal trade flows. Until the situation is clarified, U.S. suppliers following ethical business practices are excluded from supplying China's $350 million per month demand for soybeans.

These kinds of issues are not limited to China, of course. And we believe they will become less frequent and disruptive once China's accession to the World Trade Organization is completed and China develops more experience operating under rules designed to ensure a more level playing field and non-discriminatory treatment.

A range of commercial problems that is more systemic—and more relevant to the interests of this Commission—is China's policy of food self-sufficiency and how it has been pursued.

In 1978, President Deng Xiaoping implemented domestic reforms—and especially agricultural reforms—that began an economic renaissance. One of the elements of the plan was to achieve complete food self-sufficiency. The policy has to a large degree worked. It has helped lift 170 million people out of poverty in just 20 years. It also has insulated China from the vagaries of political action in the United States.

But, China's success has come at a high cost. With 22 percent of the world's people but just 7 to 9 percent of its arable land, its self-sufficiency policy has strained the country's natural resources.

The costs are economic as well. The tariffs China has imposed on food imports are as high as 45 percent. And there is another layer of value-added taxes that are then imposed in addition. Chinese consumers pay these costs in their food bills and the resulting drag on their economic growth.

The cost of supporting high crop prices also has been an albatross for the Chinese government. Last year, the quota procurement price paid to farmers in Jilin Province for their corn was about 30 percent higher than what corn farmers in the United States or Argentina were paid. Losses to China's state-owned grain enterprises were reported to have exceeded $12 billion (100 billion RMB) in the 1997–98 marketing year.

So, Chinese consumers are really being hit twice—once through higher prices and a second time through higher taxes to support state-owned grain enterprises.

These problems extend beyond food to inputs in the food chain, like fertilizer. China does not grant domestic trading rights to foreign fertilizer producers. Instead, we must sell to a state-owned entity like Sinochem. Then, we have to buy the fertilizer back from the SOEs to supply our blending plants. It is inefficient at best, and the Chinese farmer and ultimately the Chinese consumer must pay the added cost.

Because China is such a large factor in global food consumption, its arbitrary and uneconomic policy shifts can be highly disruptive to farmers and consumers elsewhere. That can directly affect the purchasing power of other nations and the wealth of producing nations.

In 1994–95, for example, China was a large net importer of grains. Spooked by a temporary spike in grain prices and by the appearance of Lester Brown's book, *Who Will Feed China*, the Chinese government backed away from some reform steps it had taken and reverted to subsidizing domestic grain production all the more. That triggered more production, reduced consumption at home and caused a swing to exports. That swing from 5–10 million tons of corn imports to comparable levels of corn exports severely depressed world prices and ballooned both U.S. and Chinese farm program costs.

For oilseeds, China had been importing soybean meal from the United States, Brazil and Argentina to go into feed rations and palm oil from Malaysia and Indonesia for cooking oil. It then decided in the mid 1990's to encourage domestic oilseed processing, boosting its own processing capacity 300 percent behind a tariff-escalation scheme that imposed 3 percent duties on raw soybeans but 13 percent on soybean products. This abruptly and arbitrarily created excess soybean crushing capacity in the Americas while depressing palm oil imports, imposing huge adjustment costs in both industries.

Similarly, China sent the world cotton market roiling when it unloaded 300,000 tons of subsidized cotton from its warehouses on the market in 1998. And then did it again about six months later. It may have reduced the price of cotton shirts at Banana Republic, but for the struggling cotton farmer in Tanzania or Uzbekistan or Turkmenistan, or even the United States, the effect was devastating.

Food Security Redefined

This leads to a critical point to be made about agricultural trade that has important implications for U.S. security considerations. It is simply this: while bilateral agricultural trade is an important commercial opportunity, the larger issue is how China decides to pursue its own food security.

As mentioned earlier, food security has long been a critical component of China's national security. This is typical of policy thinking in many developing countries: if a government cannot feed its people, its hold on power is threatened. This can make regimes more repressive to maintain political control or more aggressive to gain leverage over food supplies.

But the process of sustained economic development that began in 1978 has changed the meaning of food security for China. When people are poor, food security simply means access to food staples—grains, rice and root crops. As incomes begin rising, two fundamental trends redefine the food security equation. First, rising agricultural productivity decreases farm employment, both in percentage of the work force and in absolute numbers. To absorb this surplus labor, economies must diversify into manufacturing, which triggers a search for markets and leads toward exports and growing integration with the global economy. China has moved well down this path.

The second trend caused by rising incomes is a dietary shift. As people earn more money, they seek to upgrade their diets with more meat, milk, eggs, fruits and vegetables. Food security becomes less a question of supplying necessities and more an issue of providing a varied diet at reasonable cost. Comparative advantage begins to compete with self-sufficiency as the best path to food security. China has moved well into this debate.

In other words, China's progress toward economic and dietary diversification is redefining what food security really means for its future. Earlier, the Asian tigers experienced a similar shift. Taiwan, for example, cut its level of food self-sufficiency in half over the last 20 years as its per capita GDP more than doubled from about $5,000 to over $13,000. Korea nearly did the same as its per capita GDP rose from $3,000 in 1981 to $9,000 today.

China's overall per capita income is still low, probably under $1,000 today. But along its coastal regions, economic growth and urbanization are bringing hundreds of millions of Chinese to the threshold of economic and dietary diversification.

How should the United States respond to this redefining of Chinese food security? The "cold war" mentality often led to "food-as-a-weapon" thinking.

That notion probably culminated when, in response to the invasion of Afghanistan by the Soviet Union, President Carter imposed the Soviet grain embargo of January 4, 1980. That experience should have taught us that the "food weapon" was a blunt tool that did more damage at home than abroad. Other countries eagerly stepped in to pick up the food markets the U.S. abandoned, and U.S. grain exports today are 20 percent lower in volume and one-third lower in market share than prior to the Soviet grain embargo.

The alternative is to think of food as a cornerstone for economic cooperation. The member economies of the Asia Pacific Economic Cooperation (APEC) forum, for example, have endorsed the concept of an APEC Food System (AFS). AFS is a regional food security strategy, centered on four principles endorsed last year by the heads of state of the member economies:

—*Renounce the use of food embargoes.*—To build more open access to markets, one must first assure open access to supplies.

—*Abolish export subsidies.*—Developing countries need assurances that their farmers will be permitted to explore their comparative advantage without fear of competition that is buttressed by national treasuries.

—*Identify impediments to expanded two-way food trade.*—Border protection for agricultural trade is ten times higher than industrial trade, but this is often driven by domestic farm policies. As well, apparent concerns about food quality or safety can be used to mask protectionist practices. So creating more open food markets requires not only drastic reforms of border measures but also of the internal policies that underpin them.

—*Involve development banks in accelerating rural diversification.* A constraint on agricultural reform is the fear that off-farm jobs won't be there for those people released from farming, leading to unemployment and a flight to overcrowded urban centers. Lifting this constraint requires more effective rural development strategies and the resources to implement them.

The APEC Food System has been endorsed by all regional leaders, including those from China and the United States. But it is up to those two countries to take the lead in implementing those recommendations.

They have the most to gain economically. They have the most to contribute in the way of policy adjustments needed to curb the disruptive practices that endanger a regional approach to food security. They have the ability to make it happen through their own collaboration. And, they have the ability to take the AFS global by supporting its concepts in the next WTO agricultural round.

Answers to Specific Questions

In effect, the first question is whether U.S. agricultural trade policy toward China serves U.S. national security interests. I would answer the question this way. Steps that the United States takes that encourage China to shift from defining food security as self-sufficiency to pursuing it through open regional trade serve U.S. national security interests in several ways. Such a policy shift:

—Promotes Chinese collaboration with its regional neighbors on one of the region's most vital issues—feeding its burgeoning, increasingly prosperous and urbanized population while reducing agriculture's environmental footprint and its stresses on Asia's land and water resources.

—Promotes more rapid emergence of a broad-based middle class in China, whose interests will be identified with closer economic integration and cooperation.

—Will strengthen all of the economies of the region; the U.S. Department of Agriculture estimates that three-fourths of the welfare gains to be achieved within APEC through trade liberalization come from liberalization in the agricultural sector.

—Will bring renewed export opportunities and economic growth to a U.S. agricultural sector that has been economically distressed and unsustainably dependent on taxpayer assistance for the last five years.

Your second question asks what accounts for China's large and growing trade surplus with the United Sates. No doubt there are many factors, but I would point to three:

—The strong U.S. dollar relative to the currencies of most other developed countries has made the United States an attractive market.

—The strong U.S. economy also has acted as a magnet for imports, which have helped to contain inflationary pressures and thereby prolonged our own strong economic performance.

—The United Sates has been relatively more open to China's principal comparative advantage—labor-intensive goods—than has China been open to land-intensive exports from the United States, particularly grains, oilseeds and beef products.

This last factor is related to the earlier discussion about food security. China is understandably reluctant to increase its dependence upon the United States for basic foodstuffs so long as there are questions about American willingness to be a reliable supplier. A clear U.S. renunciation of food embargoes for short supply or foreign policy reasons and a clear articulation of a narrow "national security reservation" on that commitment would go a long way to inducing in China the kinds of agricultural policy changes needed to replace self-sufficiency with a trade-based approach to food security.

Your final question asks whether these differences have national security implications for the United States. In the area of food and agricultural trade, they clearly do. The United States put partial and temporary restraints on soybean exports in the summer of 1973. It limited grain sales to Poland and the Soviet Union during the tight supply period of 1974–75. And it imposed ill-considered grain export sanctions on the Soviet Union in January 1980, which were not lifted until April 1981.

This unilateral approach to food sanctions has had three damaging consequences:

—As mentioned earlier, it triggered responses by competitors that have dramatically reduced U.S. agricultural export volumes and market shares.

—It made importers more reluctant to abandon costly self-sufficiency approaches to food security, which has restrained the growth in trade's share of global food consumption.

—It has perpetuated protectionist food regimes that, cumulatively, have had the effect of making global food markets more arbitrarily volatile, more economically depressed and less immediately responsive to changing global needs.

The United States remains the world's largest food exporter. It also has more potential to capture growth in global food markets than any other competitor. And as the residual supplier to global food trade, it shoulders a disproportionate share of the burden of distorted food trade. For all of these reasons, it has a compelling need to renounce its historical legacy of food trade sanctions and to lead the world toward commitments of reliable access to supplies as the foundation of more open bilateral, regional and global food trade.

Thank you.

PANEL IV DISCUSSION AND QUESTIONS AND ANSWERS

Chairman D'AMATO. Thank you very much. I'm going to open it to questions. Commissioner Wessel?

Commissioner WESSEL. I thank the panel for being here, and certainly you have good reason to be proud of what your industries have done. I think they are the envy of many around the world.

Without getting into the underlying debate about fast track, since that's subject to, I'm sure, many other forums, during the last major debate in '97, the number one concern showing up in polls was food safety and what impact the open trade would have on it. We've seen mad cow disease, we've seen foot and mouth, we've seen StarLink issues and many others over the last couple of years that have raised public attention here about the safety and security of our food supply and wondering what impact you see—Mr. Johnson, you indicated that you're beginning to import corn here, as well as your exports. How do you fare in China vis-a-vis the Europeans, for example, in beef? What issues are there around food safety and what should we be concerned with as we move forward with China?

Mr. JOHNSON. Well, first, to clarify one point, we're not importing corn from China into the United States. China has become a corn exporter.

Commissioner WESSEL. Exporting from, okay.

Mr. JOHNSON. I think that the sanitary and phytosanitary agreement that was negotiated in the Uruguay Round Agricultural Agreement lays out a very sound fundamental basis for dealing with food safety issues, and that is that regulations that countries wish to impose that are higher than the standards that might apply in other relevant international bodies are justified so long as they have a foundation in sound science.

That has been the approach that the United States has taken through the FDA and through APHIS and through other food regulatory bodies, and I think it has served us well. We haven't had foot and mouth disease in over 50 years. We didn't have an outbreak of BSE. We haven't had some of these other kinds of problems because, I think, our science is sound and industry is very careful to implement those recommendations.

I worry, when regions that I think for protectionist purposes raise non-scientific reasons for imposing food safety standards, that we are getting away from the best guarantee of food safety and letting politics creep back into the equation.

Commissioner WESSEL. Any of the other panelists?

Mr. FORD. If I might comment, about one year ago, APHIS and Under Secretary Dunn asked our director of our office in Beijing, the American Soybean office and myself to come to Alaska to meet with the Chinese on the phytothera issue and we were concerned at that time. We went up there and met with them, and our concern was they were stating that we as producers were putting soil into our soybeans and from there they were getting phytothera. We believe that they are using this as a trade barrier issue.

I explained to them—they did not understand the process of how the combine works and how we as producers here in the United States harvest our soybeans. I took the laptop and took the Internet and showed them what a combine looked like and the process and how clean our soybeans were when we came out after we harvest them and that we were not putting soil into our combines.

And we thought we had the issue resolved after about three days of negotiation. We came to an agreement that we would give them technical assistance. Our director from the Beijing office believes that from his own information—he has been out in their own fields out there where they have harvested their own soybeans—they do not have a process which they help themselves contain their own phytothera. We believe originally possibly that China had phytothera and then we got phytothera and then they're saying we're sending it back, but no less, we offered technical assistance to them to help alleviate the situation and we thought that's the way the process was going to work.

A letter was sent by APHIS to the Chinese government stating that we would offer assistance. As to date, they have not responded as though they have ever received the letter, and now the issue is now coming to the forefront again.

And we're very concerned about this, along with their new biotech regulations that they are starting to implement, and we do not want to do anything that's going to disrupt our trade with China, so we hope these issues will be resolved. As I stated in my testimony, how important the soybean market is in China to all U.S. soybean farmers, so this is an area that very much needs to be addressed and corrected.

Commissioner WESSEL. Mr. Lambert, any comments?

Mr. LAMBERT. We strongly support the sanitary/phytosanitary regulations. We have not had access problems in China to date. We have had in Europe and some other countries for a longstanding period. When the initial regulation to accept USDA inspection certificates was to go into place in China, there were some concerns. Our negotiators took it up with Chinese officials and those inspection certificates have been accepted. The notification of port authorities has taken place.

So to date, the Chinese have lived up to their agreement on the bilateral agricultural agreement and we are optimistic they will on the broader issues.

Commissioner WESSEL. With the problems the Europeans have been having in their beef supply, do they export or had they been exporting to China and are you seeing any benefit, unfortunately, from the concerns about their supply?

Mr. LAMBERT. Most of the European exports were into Egypt and Russia. We have picked up, or did pick up, at least short term, because of foot and mouth disease, some exports into those countries. But by and large, because of the BSE issue, the Europeans have not been large beef exporters to most countries, so the foot and mouth disease issue really did not open up additional markets for us because they were already not exporting.

Commissioner WESSEL. Does China engage in biotechnology? Do they have much of an industry there that they've been growing? Any of the panelists?

Mr. JOHNSON. China does have a substantial Chinese biotech industry. They also have investments by biotech or life sciences companies in China, both wholly owned and collaborative joint venture relationships. And they are beginning to come to terms with the regulatory issues that are developing around this industry.

I think all of us would feel that if China's biotech policies evolve within the context of WTO rules and regulations and deliberative processes, we will be better off than if they take place outside of that regime.

Commissioner WESSEL. In terms of the life science companies, those are our life science companies participating there, as well?

Mr. JOHNSON. They will be U.S. as well as European-based life science companies.

Commissioner WESSEL. Thank you.

Mr. VON TUNGELN. It's our understanding, too, that the Chinese are developing protocols for introducing more GMO products, whether they are domestically produced or imported, so that's a good sign. That's not happening all around the world.

Commissioner WESSEL. Thank you.

Chairman D'AMATO. Thank you. Commissioner Robinson?

Commissioner ROBINSON. Yes. Mr. Johnson, perhaps you could answer this. Does the Commodity Credit Corporation of the U.S. Department of Agriculture help support U.S. grain and other agricultural product exports to China in the form of credits or loan guarantees? Do you know?

Mr. JOHNSON. There has been a time in the past when that has been the case. I don't think there is much volume of business that is being done today under export credit guarantee programs, and I don't think there has ever been any food aid or food assistance exports to China.

Commissioner ROBINSON. So unlike places like the Soviet Union, Iraq, elsewhere, where we had such credits outstanding and in those particular cases, we did take some losses, as you can imagine, when things went south in both countries. In the case, I guess, of the Soviet Union, it was about $3 billion, and Iraq was about $5 billion. But to your knowledge, there's no U.S. Government financing in support of U.S. agricultural sales to China today of any significance?

Mr. JOHNSON. No. There's none on soybeans, never has been.

Commissioner ROBINSON. Right.

Mr. JOHNSON. There aren't much in the way of corn exports that go out under those kinds of programs, so it would only have been wheat, and I don't think there's much history of that.

Commissioner ROBINSON. What are the general payment terms, just out of curiosity, in your typical transactions by China?

Mr. JOHNSON. Most business with China is commercial terms, which is payment—cash on documents.

Commissioner ROBINSON. That's your experience, too? Thank you.

Chairman D'AMATO. Commissioner Mulloy?

Commissioner MULLOY. The issue that Mr. Robbin Johnson, you make, on page three of your testimony, you talk about that we have this bilateral with China governing agriculture, in part, and then they suddenly announced a new law restricting the export of genetically modified organisms to China and that this could result in a loss of $350 million per month in demand for just soybeans alone, right?

Mr. JOHNSON. That's not exactly what the statement says. It says that the ability of exporters who follow ethical business practices to participate in that $350 million a month demand is constricted by current China policy.

Commissioner MULLOY. Okay. So we——

Mr. JOHNSON. Sales are still occurring, but they're being handled by other companies.

Commissioner MULLOY. So, in other words, if you follow what the law says—is that what you're saying?

Mr. JOHNSON. May I take a minute to clarify the situation?

Commissioner MULLOY. Yes.

Mr. JOHNSON. China announced a new regulation for importation of genetically engineered commodities on the 6th of June. Included among the requirements were a certificate of healthfulness and certain other certifications. They did not at the time that they issued the regulation issue any implementing rules. So it's not clear today what you need to do in order to comply with that directive.

The Ministry of Agriculture in China is in the process of drafting those regulations, but the situation is confused right now. I think the United States has encouraged China to follow a practice which is typical in other countries of using a transition period while those regulations are put out for public comment so that you can understand their implications and all that rather than just dropping the curtain on a particular day. But because they did that, those of us who try to follow the letter of the law are essentially excluded from doing the business.

Commissioner MULLOY. Let me understand this. You referred to this WTO phytosanitary portion of the agricultural agreement in the WTO——

Mr. JOHNSON. Mm-hmm.

Commissioner MULLOY. —that permits people to look out for the safety of their public when they're looking at what's coming in and that helps keep mad cow and other things out of this country. Does that agreement, the multilateral, cover the issue of genetically modified organisms?

Mr. JOHNSON. That's an interesting question. At the time that the sanitary and phytosanitary agreement was negotiated, ag biotech was an infant industry. I think many people believe that the same rules and procedures and standards that have applied to other traditional food safety issues can be transferred wholesale and applied to the biotech industry.

For a while, the European Union took a different view of that issue, although I am told by some EU officials now that they've sort of backed away from that and are looking not so much to renegotiate the agreement as to make clear how certain aspects of it might be interpreted. One aspect, of course, is the famous precautionary principle debate.

But I think that it probably would be helpful if in the next WTO agricultural negotiation we clarified the degree to which it applies to biotech.

Commissioner MULLOY. Okay. So if China comes into the WTO and is part of the phytosanitary commitments—I presume they have to sign up to all of those—that doesn't necessarily solve your problem of genetically modified soybeans or other food like that that may get caught with that new law.

Mr. JOHNSON. Well, no. I think the way to solve a particular procedural issue—we don't have a substantive problem here, we have more of a procedural problem here—might be for prompt intergovernmental consultations between the United States and China, and I think if that happens, and I think it is beginning to happen right now, that this issue could be sorted out relatively easily. It's not an issue of a substantive difference.

Commissioner MULLOY. Thank you.

Chairman D'AMATO. Commissioner Lewis?

Commissioner LEWIS. Mr. Johnson, you mentioned on page two that you export from China cotton, steel, and corn. Can you tell us a little bit about the steel?

Mr. JOHNSON. I can tell you a very little bit about it. It's not a particular area of business that I work in, but China is a producer of relatively simple steel products, rebar, rod that goes into highway construction, things like that. Most of the exports are of those simple kinds of products and they go to a variety of destinations, including the United States.

Commissioner LEWIS. Are you in the steel business in America as well as the——

Mr. JOHNSON. Yes, we are. One of our subsidiaries, North Star Steel, is a mini-mill steel company, the second largest mini-mill steel company in the United States, and manufactures a number of those products.

Commissioner LEWIS. So the steel you bring in from China then competes with those products that are made here?

Mr. JOHNSON. They can, yes.

Commissioner LEWIS. I see. And the other thing I wanted to ask you about was you mentioned ethical business practices and following the letter of the law. Was this a different way of saying that you don't bribe people in China?

[Laughter.]

Mr. JOHNSON. No, actually—I mean, I wouldn't want your interpretation of that to be seen to be mine. The difficulty is that——

Commissioner LEWIS. What did you mean by those words?

Mr. JOHNSON. That when we do business, we make sure that all of the documents that accompany our transactions are accurate, and should anyone modify those documents and it comes to our attention, we would make that modification known and object to it. It's not clear that that's a practice that everybody is following.

Commissioner LEWIS. Could you please elaborate? I'm not quite sure what that means.

Mr. JOHNSON. Well, the law changed in China on the 6th of June. There's only so much business that was—and China made an explicit exception for business contracted prior to the change of law. Quite naturally, you wouldn't want the regulation to reach back into contracts that were made prior to that. There seems to be more business contracted prior to June 6 than is normal.

Commissioner LEWIS. And I'd like to ask each of you, do your companies have problems with the smut issue, and can you tell us something, whether that was protectionism or negotiations of the Chinese?

[Laughter.]

Mr. VON TUNGELN. I can give you an opinion.

Commissioner LEWIS. Yes.

Mr. VON TUNGELN. We've had issues in the case of wheat, and I don't have a company that sells or anything. We only promote. U.S. Wheat Associates, National Association of Wheat Growers, we maintain offices. We have three offices in that vicinity, in Beijing and Singapore and Hong Kong, and we promote the sale of wheat, particularly. Mr. Johnson and others make the sales after that. We try to work out technical difficulties such as sanitary and phytosanitary and things like that.

We have in the past had issues with the TCK and even had issues with Johnson grass seed. In the case of Johnson grass, and they may have found a little of it, but in hard wheat is where they were finding it, hard red winter wheat years ago when we were selling them a little bit of it, and Johnson grass is not even close to being mature when we harvest hard red winter wheat. There's no possibility that they could have gotten any Johnson grass out of the wheat that was harvested in the hard red winter area.

There could have been a little bit left in the hold of the ship or something from corn or soybean, when they harvest later in the year, you know, when Johnson grass is mature, but——

Commissioner DREYER. Excuse me. I'm from Brooklyn. What is Johnson grass?

Mr. VON TUNGELN. Well, it's a weed. It has a rhizome, a root that makes it spread very readily. It's just a nuisance weed. It has no harmful effect on—it's very good for grazing. In fact, in some areas of the United States, they plant it. Everywhere else, they fight it because it's a weed. It gets in your fields and it clogs up your machinery and all that sort of thing. It spreads very readily.

Commissioner DREYER. So it's kind of a pest?

Mr. VON TUNGELN. It's just a pest, and they contended that they didn't have it and they didn't want it. There was no harmful effect of it or anything, but they—and I don't blame them. If I didn't have it, I wouldn't want it, either.

[Laughter.]

Commissioner DREYER. Thank you.

Mr. VON TUNGELN. I work hard to keep from getting it. But my opinion is all I can give you on that, is that it was a bargaining tool, you know. Usually, those shipments that came in that were contaminated a little bit, we're able to negotiate a reduction in price where they——

Commissioner LEWIS. The same thing with TCK smut?

Mr. VON TUNGELN. Yeah, but we have worked that out now, you know, pretty much, come to an agreement on it. But I think that's one of the values of engaging China more fully in the WTO and all that. We can get together and work those things out.

Commissioner LEWIS. So that was really bargaining, also, the smut?

Mr. VON TUNGELN. It was. The smut could only live if you had snow cover for six weeks continuously, you know, which doesn't happen particularly in the hard wheat area, and in the spring wheat area, they haven't even planted it when the snow's on, you know, so——

Commissioner LEWIS. And it's my understanding that China was the only country or buyer that talked about the smut. Japan didn't and Korea didn't.

Mr. VON TUNGELN. Brazil did a little bit. They needed an issue, too.

[Laughter.]

Excuse me. I didn't say that.

Commissioner LEWIS. And then one last question for you. You said in the fifth paragraph there, policies have recently changed. What did you mean by that? The fifth paragraph of your first page. The Chinese wheat production levels increased sharply in the late '90s, but their policies have recently changed.

Mr. VON TUNGELN. Yeah, that they're shifting to—in the case of wheat, they're shifting to higher value crops, fruits and higher value crops. They have a tremendous amount—75 percent of their population is still in agriculture, you know, and the average size of a wheat farm in China is 1.5 acres. They handle it and till it very carefully. But it's our understanding that the policy of planting a lot of acres to wheat and being self-sufficient in small grains is changing. That policy is changing and they're going to more intensive crops, such as fruits and vegetables, where they can get a higher yield.

Commissioner LEWIS. There may be a greater need for wheat from America, then.

Mr. VON TUNGELN. Yeah, the cereal grains and even feed grains.

Commissioner LEWIS. Thank you very much.

Chairman D'AMATO. Let me follow up with just one question on the wheat. The wheat consumption—maybe I have the wrong numbers, but I see we're at about five percent of our wheat exports compared to 1996 today? Is that true?

Mr. VON TUNGELN. To China?

Chairman D'AMATO. Yes.

Mr. VON TUNGELN. I'd say that number would probably be high.

Chairman D'AMATO. So even less than that?

Mr. VON TUNGELN. Yeah.

Chairman D'AMATO. What's the reason for why we've dropped off the table on wheat exports?

Mr. VON TUNGELN. They became self-sufficient in wheat. They had good weather, kind of like India.

Chairman D'AMATO. Is it a weather issue more than anything else?

Mr. VON TUNGELN. I think it is more a weather issue, but that's changing. Their stocks have declined somewhat. However, very recently, they did find a few million more bushels that they didn't know they had.

Mr. JOHNSON. May I expand on that answer a little bit?

Chairman D'AMATO. Yes.

Mr. JOHNSON. In the period 1994, '95, '96, there was a spike in grain prices that occurred at the same time that a book by Lester Brown entitled *Who Will Feed China?* came out, and at that time, the Chinese government was also combatting domestic inflationary pressures, and those three factors came together to produce a very unfortunate change in China agricultural policy that was, to some extent, rationalized by food security, self-sufficiency arguments.

What they did was dramatically increase support levels for domestic grain farmers in order to stimulate production and to discourage usage. It had its intended effect. The main impact was on trade flows initially. Wheat imports went down dramatically. Corn imports were replaced by corn exports.

But what is accumulating now are sthe domestic costs to China of that policy, which are not unlike the domestic costs of subsidizing agriculture in Europe or the United States. And so now there is another chance, another bite at this apple, another opportunity to influence the debate, and we're hopeful that the United States uses this as an opportunity to make them more oriented toward a trade-based food security strategy.

Chairman D'AMATO. Let me just pursue this a little bit. In other words, part of the reason that domestic Chinese wheat production increased was increased subsidies by the government as a purposeful attempt to become more self-sufficient?

Mr. JOHNSON. They raised price supports. They raised the acquisition price that was paid to farmers by the government.

Chairman D'AMATO. Do you know what that level of subsidy is?

Mr. JOHNSON. In the case of corn, it was about 30 percent above comparable prices in world markets. I don't know what it was for wheat.

Chairman D'AMATO. Because as I see it, you know, one of the alumni of this extended Commission is the current USTR negotiator, Mr. Zoellick. But we find that he has confronted the Chinese and they had averaged their subsidies at 3.3 percent. He was able to get them into supporting an 8.5 percent subsidy. Now, is that below the wheat subsidy, substantially below the wheat subsidy? Does that mean that they're going to get under pressure to increase more wheat, import more wheat?

Mr. VON TUNGELN. I can't say that for sure, but that was one of the major bones of contention, you know, in the agreement, getting a final agreement with China to go ahead with the WTO accession. They wanted to be classified as a developing country so that they could subsidize their farmers up to ten percent, and we said, no, you're pretty well developed now, or that's the way I understand it, and we want you to hold it to five percent. And they're currently, as you said, about three percent on wheat. So they kind of compromised. I understand it's up around eight percent now. But the people that I was with think there's very little likelihood that they'll do that again, you know, go beyond where they are now.

Chairman D'AMATO. The likelihood exists of substantially increased wheat exports to China, is that accurate?

Mr. VON TUNGELN. Well, I'm a farmer. I have to be optimistic, you know.

[Laughter.]

Chairman D'AMATO. But the obstacles are not—the subsidies or obstacles are not too high in terms of barriers to our exports.

Mr. JOHNSON. Once again, but for this aberration in policy that occurred in the mid-1990s, China was on a track to work its self-sufficiency ratio down toward 95 percent and there are some in the Chinese government who say that they would be comfortable with lower levels. Because of these policy changes, it's bumped up to 98, 99 percent, but we think a more rational set of economic policies and trends would suggest that, yes, they will come to be larger grain importers down the road.

Chairman D'AMATO. We're not sure of that at this point. I detect a certain amount of uncertainty about whether that's going to happen.

Mr. JOHNSON. Everything is influenced by policy.

Commissioner LEWIS. Can I just finish my question?

Chairman D'AMATO. Yes, go ahead.

Commissioner LEWIS. In selling to China, are your main competitors Canada, Argentina, France, or Australia? Which ones do you mainly compete with?

Mr. JOHNSON. It depends upon the commodity.

Commissioner LEWIS. Wheat.

Mr. JOHNSON. In the case of wheat, it would be Canada and Australia, predominately.

Commissioner LEWIS. And is the competition really based on price or are there policy issues that get involved in the purchases?

Mr. JOHNSON. China has had a longstanding trading relationship with Canada which they have, as their wheat imports have come down, I think they have tried to maintain Canada's share. Canada has suffered the adjustment, if you wish, less than the United States.

Commissioner LEWIS. Regardless of price?

Mr. JOHNSON. Mm-hmm, although I suspect the Canadian Wheat Board is——

Commissioner LEWIS. Will meet the price?

Mr. JOHNSON. —able to accommodate their price expectations.

Mr. VON TUNGELN. Certainly, that's true, but there's such a little amount of wheat being imported into China now that it really isn't a significant amount of trade compared to what we hope it might be in the near future.

I've had, in my position on U.S. Wheat Associates, I've had the opportunity to entertain in my home the ambassador to the United States from China just a year ago last December. I've had numerous trade teams from China, wheat buyers, millers, buyers, grain handlers, that have been here and been to my place a number of times and will have another group next month. They lead us to believe that they want to buy U.S. wheat, that when we get the whole deal worked out, you know, they want to buy U.S. wheat.

We have had an office in Beijing for I don't know how long, 20-some years or longer, and in the last five years, we've practically sold no wheat into China. We continue to maintain that office to keep in touch with the trade and everything, you know, to try to be ready. When they're ready, we want to be ready. So we're optimistic and hopeful and are putting our money where our mouth is.

Commissioner LEWIS. Thank you very much.

Mr. VON TUNGELN. But we may be wrong.

Commissioner LEWIS. Thank you.

Commissioner MULLOY. Just one follow-up question, Mr. Chairman. Is there anything in the bilateral or in the multilateral WTO agreement that prevents them from subsidizing agriculture so that—in other words, if we bargained to really open up these markets for agriculture but there's nothing in the agreement that prohibits them from subsidizing, all that bargaining doesn't get you a lot. So is there anything in the agreement or in the WTO agreement that restricts their ability to subsidize?

Mr. VON TUNGELN. Well, if I understand it right, and others can correct me, but in the case of wheat, my understanding is that they cannot subsidize more than eight percent, or is it 8.5.

Mr. JOHNSON. I'd answer the question this way. As part of the accession agreement that was negotiated with the United States, the Chinese have agreed not to provide export subsidies for agricultural commodities.

Commissioner MULLOY. Export subsidies.

Mr. JOHNSON. That's right. But that has a very important cascading effect on the policy decisions that they have to make because they will not have the opportunity if they produce surpluses to dump them on the world market through export subsidies. That internalizes the cost of policy errors, which has not been the case in the past.

The discussion about sort of the ceiling on the domestic subsidization is probably academic, because either the five percent or the eight percent ceilings, which were the two that were available, are well above China's resources or intentions to subsidize its own agriculture. They seem to be moving very much toward a market-oriented system.

Commissioner MULLOY. Thank you.

Chairman D'AMATO. Vice-Chairman Ledeen?

Commissioner LILLEY. I just wanted to raise a quick question with you and sound you out on this. Pieter Bottelier, who was the World Bank representative in China for about five years, I think, and did lots of work, when he saw the WTO agreement on agriculture, he made some very sweeping statements, and one of the things he said was that China has avoided the path that both Korea and Japan have taken to protect agriculture against foreign imports.

As you know, in Japan, this is very powerful, and in Korea, too. I mean, you grow a banana in Chengdu, it costs $7. You can import it for 25 cents. There are ridiculous aspects to this if you want to play with anecdotes.

But he said that China has taken Lester Brown perhaps more seriously than we do. Although they argue with him, they do have their agricultural land shrinking all the time and they've come to the conclusion that they can build up their industrial base, export, and buy food, and they are not going to subsidize an agricultural sector for political reasons, like they do in Japan or Korea, support the conservative movement, that sort of thing. They've moved away from that.

And one of the ironies we have today is that the most violent demonstrations against the Chinese government, many are in the rural area. Farmers are being taxed. They're being rooked by a corrupt cadre. All these things are happening and the farmers are very, very angry. We hear this quite a bit.

Do you think that—and if this goes into effect, the Chinese rural population is going to be hurt even more. The floating population is moving into the cities, estimated at 150 million, moving from the countryside where they can't be employed into the cities. It causes a great social dislocation in China, these potential policies that Bottelier says will revolutionize Chinese agriculture.

A country that came in its revolution by organizing the rural masses on land reform is now considering doing something that could really shake up China's rural base. I'd like your opinion of that. I'm quoting perhaps in an exaggerated way some of the comments that the World Bank man has made.

Mr. JOHNSON. I'll let my colleagues think while I respond.

[Laughter.]

In my testimony, I talked about the APEC Food System proposal and particularly the component in there about changing rural development strategies. We know that the process of industrialization of agriculture, the principal effect of that is two-fold, to drive up productivity and to drive people out of agriculture. This happens in every country and the challenge always is how to accommodate the social adjustment to that process.

The Japanese, and to a lesser extent the Koreans, chose to do so by trying to slow it down through propping prices up. There's every indication that the Chinese are prepared to take a different approach. They have invested more in developing rural infrastructure, rural industries, than—as part of their early economic development strategies that began in the late 1970s.

They unfortunately have had among the international development institutions, I think, a backing away from rural development strategies in the last ten years. I was pleased to see that Secretary of Treasury O'Neill in his op-ed in the *New York Times* of a couple of weeks ago saying that he thinks that policy has to change and that international lending institutions need to provide more support for rural economic diversification to China and other developing countries in Asia.

I think if that kind of a policy adjustment can occur with the kind of policies that you hear discussed in China, that we can accommodate that social adjustment without making the policy mistakes that Japan and, frankly, the United States and Europe have made.

Commissioner LILLEY. Yeah, because I had heard that the village and township enterprise, which was very successful ten years ago when I was there, and then after Tiananmen, they cut off credit for it. There were hard thinkers in the central leadership that didn't like the whole idea of this thing and they used it as an example both to cut credit to the village and township enterprises and to stop construction in the urban areas, which got them from both sides.

Mr. JOHNSON. I don't know the exact number, but World Bank lending to agriculture and rural economic activity over the last decade has probably fallen to 30 percent of what it was ten years ago, and that's been a serious——

Commissioner LILLEY. Well, the agricultural minister at that time said, if you think you had problems with Tiananmen having 200,000 or 300,000 people, you keep this up and you'll have ten million peasants in Tiananmen Square. They changed the policy, obviously. They started credit again.

But what I hear—I think you suggested this—that there's a real downturn in the efficiency and competitiveness of the village and township enterprises. They are not as successful as they were. They can't compete. I don't know. This is what I'm hearing.

Mr. JOHNSON. It's probably too blanket a statement to really know for sure what the truth is there. In agriculture, which I know better, we have seen, as Henry alluded to earlier, that the Chinese have been shifting toward more labor-intensive agricultural enterprises, aquaculture, fruits and vegetables, horticulture, things like that, employ five to ten times as many people per hectare, and are competing very successfully in global markets on a non-subsidized basis with those as well as satisfying rising domestic demands.

So I think there are opportunities that are long-term competitive. I've got to believe that with proper investment in human capital, that the same would be true in industrial areas and manufacturing areas as in agriculture.

Mr. FORD. The American Soybean Association has also been seeing this trend, and we are working very closely in some of those, such as aquaculture and the poultry industry in showing them how to use high-pro U.S. meal and those rations to make them more efficient and be able to feed those people.

And also, one advantage we have in China, as well as all of Asia, they have been eating soy in their diets for a number of years. They understand the nutritional value of soy, so it's not like we have to teach them how to eat a complete new diet. So this is very beneficial and makes it much easier for us in the soy industry to do so.

But we're working very closely and providing them technical assistance, how to use high-pro U.S. meal in those diets of that type of livestock, as well as those people move into the urban areas, then if the economy does decrease somewhat, we can provide a very high quality protein diet at a very low cost that those people can afford, of which we're doing around the world with other countries that are developing.

Commissioner LILLEY. Archer Daniels Midland was trying to use soy to convert to meat substitute.

Mr. FORD. I'm sorry?

Commissioner LILLEY. I say, Archer Daniels Midland was trying at one time to take their soy and convert it to meat substitute.

Mr. FORD. Yes.

Commissioner LILLEY. Has that gone anywhere?

Mr. FORD. Yes. In the food industry, with soy foods, there's been great strides. I know that some of you probably ate a soy burger a few years ago and thought you'd probably never eat soy again or if you didn't like tofu. But they've made great strides in soy foods now, and even so more around the world than even here in the United States. You can go into other countries and you can eat soy foods that you don't know that are any different than anything else, and they're putting lots of money into the soy food industry, especially since the new FDA health claims came out supporting soy and saying it is helping lower heart disease, possibility of heart disease, cholesterol levels, osteoporosis. So it's been very beneficial.

Mr. VON TUNGELN. In the bilateral agreements for agricultural cooperation and WTO membership, there are clauses relating to U.S. technical assistance, various programs of technical assistance. Now, I don't know what they are, but apparently they recognize the problem in that area and they recognize that it's beyond the scope of individual industries to provide this kind of technical assistance. So there is something in the works on that.

Commissioner LILLEY. One of the things, and Terry Cooke can comment on this, is one of the major transfers from Taiwan to China is in the aquaculture, all this kind of thing. Sugar, apples, all that kind of thing is moving from Taiwan over to China, also training Chinese agricultural economists. It's a big program and I imagine this could have a beneficial effect on Chinese agriculture, too.

Mr. VON TUNGELN. I think horticulture is another big area, too. They are very good at flowers and things like that, learn to use the system to market their products.

Chairman D'AMATO. Thank you. Mr. Chang, I was wondering, we've been discussing Chinese agricultural policies as to whether the Chinese government is encouraging self-sufficiency or moving toward a more market-based agricultural system. Do you have any comments and perspective on that?

Mr. CHANG. I think they are moving to a more market-based system. I think the central leadership has very good ideas about what to do with the problems in Chinese agriculture, which are actually quite serious because many people think out of all the sectors of the Chinese economy, agriculture will be the hardest hit after accession to the World Trade Organization, and so they're trying to modernize agriculture and have a number of initiatives, especially modified types of crops, hybrid crops.

The problem is that the central leadership has not been able to effectively implement its policies at the local levels, which has really been quite serious. But it's not just in terms of agricultural policy but many other aspects of life in the countryside, and so that's caused quite an amount of unrest.

It is said that after WTO accession, that about 18 percent of Chinese land currently under cultivation will be taken out of cultivation, and some of the things that people have said about the ability of Chinese agriculture to compete are actually quite gruesome.

It's said, for instance, and this is something that's said many times, that Australian rice will become much more competitive in

China than Chinese rice in the domestic markets, largely because it could be cheaper and also because of China's internal distribution system, where it makes it very difficult to take products from point A in China to point B. So, essentially, when foreign producers come into China after accession, they will have much better methods of distribution in the country so that their products will actually penetrate much further and much faster than most people expect. The example given was Australian rice, and I imagine it would be true for many of the other products represented at this table.

Of course, there are some other problems with the Chinese policies. They've got too much grain right now. They've stockpiled, some people say, 500 million tons, some people say 1.3 billion tons of grain, much of it inedible, a lot of it unsalable because it's not the high-end grain which is really salable these days. And so there is a big market opportunity for foreigners with better types of grain to come in and actually penetrate the market.

You do have, as someone here mentioned, 400 million consumers in the middle class and they're demanding better products. Of course, this has a social stability aspect to it which the central government has to deal with and which is not the subject of today's or this afternoon's panel.

But certainly, there is—I imagine of all the foreign segments, agriculture probably has the best prospects to penetrate the Chinese market.

Chairman D'AMATO. Thank you.

Commissioner LILLEY. Can I just ask him one question? But why does Jilin province, right on the border of North Korea, have bumper harvests and then North Korea is starving to death? If it's basically the same climate zone, I mean, are there other reasons? I can think of many other reasons why this is happening, but the normal excuse is drought.

Vice Chairman LEDEEN. You know the answer. The North Korean regime wants the North Korean people to starve.

Commissioner LILLEY. Thank you. Is there any other explanation?

[Laughter.]

Chairman D'AMATO. Write that down.

Mr. CHANG. I'm not really an expert.

Commissioner LILLEY. We've looked at Manchurian agriculture. It's where they have their largest, wheat, state farms in the north there. They grow a lot of wheat. Apparently, they have been growing it for years.

Mr. VON TUNGELN. For one thing, North Korea has a million man army, or a million person army, and that's where most of their resources are directed. There's very little infrastructure today, certainly in North Korea, that's conducive to production. That may be one partial explanation for it.

Commissioner LILLEY. There's other reasons, too.

Mr. VON TUNGELN. Certainly.

Commissioner LILLEY. It's a terribly screwed up system.

Mr. VON TUNGELN. Absolutely.

Mr. JOHNSON. The transportation links between North Korea and China along that border are not very well developed and I think it would take some time to be able to really redirect resources to create modern transportation between the two countries, really to permit substantial amounts of Chinese grain to go into North Korea. Obviously, that's a political issue, but there are underlying infrastructure issues that I imagine are as important.

Commissioner DREYER. According to CIA, there are seven railway bridges, and this came up a few years ago when people were deciding, should we levy sanctions against North Korea, and John Culver, the CIA's guy in charge of this, said that as long as China didn't participate, and China made it clear it wouldn't participate, they wouldn't work.

Chairman D'AMATO. Commissioner Ledeen?

Vice Chairman LEDEEN. Mr. Lambert, as I understand it, the EU refuses to permit American hormone-fed beef into Europe, is that still true?

Mr. LAMBERT. That's correct. We've been basically shut out of the European market since the mid-1980s, U.S., Canada, several of the countries that use these approved technologies have been shut out of the European Union. We have won a case at the WTO. We are currently retaliating on $116.8 million worth of European goods as retaliation for their failure to live up to their obligation under the WTO.

Vice Chairman LEDEEN. There was a court case which you won, also, wasn't there, in Europe? The Europeans were given a year or something to introduce evidence that the stuff was dangerous?

Mr. LAMBERT. Yes. As part of the appeals process——

Vice Chairman LEDEEN. Was that part of the WTO process?

Mr. LAMBERT. Yeah. They've expended all of their options and we're at that retaliation stage.

Vice Chairman LEDEEN. Is there any similar problem with China? Is China worried about hormones in meat?

Mr. LAMBERT. China has been a very willing acceptor of U.S. technologies. The agreement that was reached, the agricultural agreement that was reached before the overall agreement, basically, they agreed to accept U.S. inspection systems, USDA's inspection certificates, and they have been willing to do that, so we've not had that non-tariff trade barrier imposed on us.

Vice Chairman LEDEEN. And could I just make sure I understand the grain situation. China still seems to be committed to a program of autarky in wheat, but in other grains, not so, is that correct? Is that a correct summary? China is still trying to be self-reliant in grain, in wheat, but not so in soybeans and other such products, is that right?

Mr. VON TUNGELN. I'd say that's basically right.

Vice Chairman LEDEEN. Although you hope they're going to get off their independence kick on wheat, obviously.

Mr. VON TUNGELN. Yeah.

Mr. JOHNSON. I would maybe amend it a little bit. Oilseeds, they have clearly been the most willing to open up and to let economics dictate. Corn has sort of gone both ways, but I think there's an indication now that they recognize the costs of autarchy, to use your terminology, and are more inclined to let markets guide that.

Wheat and rice, the staples of their diet, are the most politically sensitive. I wouldn't say that they're committed to autarchy or self-sufficiency in them, but they are the ones that they are the least willing to look at opening a significant dependence on imports on.

Vice Chairman LEDEEN. But didn't you say that at one time they had a policy after this book came out and the other two factors that you mentioned, that the Chinese decided they were going to produce all their own wheat so that this thing couldn't happen to them and they wouldn't be vulnerable again and so on? That was a deliberate policy, right?

Mr. JOHNSON. It was a deliberate policy.

Vice Chairman LEDEEN. It's not just a reluctance to open to the market, it was a policy designed to make sure that they avoided certain kinds of crises.

Mr. JOHNSON. It was a deliberate policy change, I think driven in part by domestic inflationary concerns and in part by this analysis that Lester Brown had done about where their agriculture was headed. I think they didn't appreciate the cost of that, nor did they fully appreciate how inaccurate the underlying analysis was. Both, I think, are now better understood, and we have a better day ahead of us.

Vice Chairman LEDEEN. Okay. Thank you.

Mr. VON TUNGELN. There's a lot of feeling also that the reason the Chinese delayed the agreement for so long a period, haggling over this, whether it was going to be five percent or ten percent and finally wound up at 8.5 percent is because they are not fully committed to accepting suppliers outside their own borders, you know, for their food supply.

Vice Chairman LEDEEN. Right.

Mr. VON TUNGELN. They're not fully committed to that yet, so they insisted on the 8.5 percent subsidy level for their farmers in case they decide—as a safety valve in case they decide to go back to self-sufficiency and then they could encourage their farmers by subsidies to produce sufficient grain to feed their own people.

Chairman D'AMATO. As a hedge.

Mr. VON TUNGELN. Yes, hedge.

Chairman D'AMATO. Mr. Bryen?

Mr. BRYEN. I have no questions.

Chairman D'AMATO. Commissioner Becker? We're out of questions?

Commissioner DREYER. No, I was supposed to be on your list. Did you forget about me?

[Laughter.]

First of all, I may say, I really enjoyed the testimony. This is very, very interesting to me and now I know what Johnson grass is.

[Laughter.]

Mr. VON TUNGELN. Come to Oklahoma. I'll show you a lot.

Commissioner DREYER. I would have thought it was named after the gentleman here.

Mr. JOHNSON. I was worried about that interpretation.

Mr. VON TUNGELN. I think it was named after Lyndon.

[Laughter.]

Commissioner DREYER. Ambassador Lilley really asked the question I wanted to ask, but I'd like to expand on it a little. What I heard Mr. Johnson say is, assuming rational policies here, and I think the problem that Chinese agriculture runs athwart, which is actually mostly good for U.S. agriculture, is that policies that seem rational come athwart problems from another sector of the economy. That is if you move people from raising wheat into raising fruit, you have to run up against the problem there isn't any water out there to spare. Something I have learned since moving to Florida is that agriculture is extremely—irrigation is extremely important when you're raising fruit, and so that's a concern.

Finding other jobs for these people who are displaced from agriculture—it's very easy to say agriculture is a very inefficient sector, which it definitely is in China, but finding these other jobs for them and what happens when they go to them is a problem.

One of the reasons for cutting the subsidies to the TVEs is that—township and village enterprises—is because you were getting local economic power centers which are able to buck the power of the central government, so you don't want those. So that slows down your engine of growth.

And the other part is something one of you mentioned, which is this floating population, the people who are displaced from agriculture who go into the cities and the agricultural base can't—I mean, the industrial base cannot support them. The earlier panel mentioned overcapacity in a lot of these industries already. This is social dynamite. And as Ambassador Lilley mentioned, the farmers are extremely unhappy. They've been taught for years under textbooks compiled under Mao that the Chinese revolution was carried out on behalf of the peasants and now they find themselves being screwed in every possible way.

So I think if any of you discover what those rational agricultural policies are that would satisfy all these considerations, you can make yourself an awful lot of money by selling them to the Chinese government.

Mr. VON TUNGELN. Well, in the case of water, that's one of the resources that's very limited there, as it is everywhere, but it also, you can take a bucket of water and put it on a wheat field and maybe get ten cents worth of grain from it. If you put it in a flower bed and produce roses or something for the world market, it might yield $10 or something. So it's also——

Commissioner DREYER. If you have it at all.

Mr. VON TUNGELN. Yeah. Yeah. Well, they have some. A lot of their crops are irrigated, of course, and rice and wheat are some of those.

Mr. JOHNSON. I would simply echo what Henry said, that if you shift from not just land-intensive crops to labor-intensive crops but also higher value added and more capital-intensive crops, you change the use of water and you increase the value added for the water that's applied.

Absolutely one of China's largest constraint is not limited land, although the land resource is limited, but it's the water constraint and the growing demand from alternative uses for that. So they're going to have to move in their own best interest to higher value agricultural applications of water.

With respect to rural development strategy, I actually think that there are a lot of people who have the essential rational policies pretty well understood. The challenge is implementation. And one of the things that I had wanted to say and forgot to say in response to Ambassador Lilley's comments was that we're not thinking about village enterprises so much as investing in more Omahas in China, regional centers that can be commercial and manufacturing centers and support surrounding rural economies.

We are involved, in fact, Cargill is involved with some others in a demonstration project in Jiangmen City, where we're sort of playing some of this out in collaboration with the mayor of that city and the governor of that province, which is my last comment. I saw the red light go on.

As was said at the other end of the table, governance is oftentimes the largest constraint here, not understanding what the right policies are but getting them implemented. We will no doubt have to be patient across all of the issues that have been raised. They won't change as quickly as we would like.

Chairman D'AMATO. Thank you very much. We have another panel coming on. We'd like to thank you for your testimony and we'd like to reserve the right to be able to give you some questions for the record as we go along, if that's okay with you all. I appreciate the testimony and thank you for coming today.

We are going to get started again. One of our panelists has got an appointment at five o'clock and we want to take full advantage of his appearance here.

Co-Chairman BECKER. Could we get the panel up to the table, and any Commissioners that are back there, get them up front, too.

This is the last panel of the day. We're running a little bit late. We apologize for that, but to be quite frank about it, from our other hearings that we've been involved in, this is not too bad. We're doing pretty good for the end of a very long day, starting at eight o'clock in the morning.

This last panel is on computer electronics/telecom issues. We have three panelists, Ed Fire, who is the President, the International President of the IUE, recently merged with the Communication Workers; David McCurdy, President of the Electronics Industry Alliance; and Merritt Todd Cooke, Junior, Chief, Commercial Section, American Institute in Taiwan.

We'll go from left to right, and Ed, you're up at bat first.

PANEL V: COMPUTER ELECTRONICS/TELECOM ISSUES

STATEMENT OF EDWARD FIRE, PRESIDENT, INTERNATIONAL UNION OF ELECTRONIC, ELECTRICAL, SALARIED, AND FURNITURE WORKERS DIVISION OF THE COMMUNICATIONS WORKERS OF AMERICA (IUE–CWA)

Mr. FIRE. Thank you very much. Mr. Chairman and distinguished members of the Commission, especially my good friend and colleague President Becker, my name is Ed Fire. I am President of the IUE Division of the Communication Workers of America. On behalf of the more than 750,000 workers represented by CWA, I thank you for this opportunity to present our views regarding current U.S. trade policy toward China and their national security implications.

IUE/CWA represents production and skilled trades workers in a broad spectrum of industries, including consumer electronics, automotive electrical equipment, telecommunications, and household electrical goods and appliances. Our members are employed by some of the largest multinational corporations in the world, including General Electric, General Motors, Delphi Automotive Systems, and numerous other companies with significant economic interests in China.

The corporations where our members work already have relationships and investments in China and they'll continue to do so regardless of U.S. policy. We believe, however, it is the responsibility of our government to deal with that engagement so that it occurs in ways that strengthen, rather than weaken, our nation.

Trade policies should not sacrifice the viability of key manufacturing sectors to narrow foreign policy objectives. Instead, they should serve the interests of U.S. citizens who live, work, pay taxes, and serve in our country's armed forces. Our policies should be designed to make sure that trade does not result in downward pressure on American wages and living standards. Investment in China should also act to promote human and labor rights for Chinese workers.

In the absence of such regulations in international trade agreements and in the WTO, multinational corporations are given incentives to exploit the human rights environment in China rather than act to improve it. Indeed, labor rights can be abrogated at will with no accountability or financial repercussion. China has clearly shown that it will continue to repress human rights and democracy.

Unfortunately, the United States has failed to insist that China establish a policy of responsible engagement. In fact, the Bush administration and many in Congress reject any linkage between rights abuses and economic policy. Once China's accession to the WTO is complete, our nation will have even fewer tools available to address violations of human rights and other unfair trade practices.

IUE/CWA has opposed permanent normal trade relations between the U.S. and China precisely because the United States has not required the terms of trade to include standards on human and labor rights, nor do WTO rules provide protection of labor rights in the global trading system. Thus, the Chinese government continues to promote an economic environment in which universal human rights, defined in the ILO declaration of fundamental principles and rights at work, such as the freedom of association, the right to organize and bargain collectively, the right to reject child labor, refuse forced labor, and to be free from discrimination in the workplace are all systematically denied.

Our GE members have heard reports over the years of labor rights violations and the existence of horrendous working conditions within the company's Chinese production facilities. But when our union tried to arrange a delegation to China in 1998 to meet with GE workers and local management to discuss our concerns about the company's operations and labor practices, we were denied access to the plants.

Current U.S. trade and investment policies with China are having a profound impact on our own economy and on our national security. The U.S. trade deficit has grown even larger in recent years. Employment and real wages for production workers in many electrical and electronics industries are lower today than they were at the beginning of the 1990s.

Today, when non-represented workers in our country attempt to organize, they are routinely threatened with plant closings and job loss to China. When unionized workers try to bargain for better wages and benefits, they're often threatened with plant closures and job losses to China. When unions lobby the U.S. Congress and the executive branch for increases in the minimum wage and other social benefits, we are denied as a price for keeping plants in the U.S.

American companies are moving out of the U.S. to manufacture advanced electrical and electronic products in China and importing them back into our country. Electronics and electrical goods now make up the largest single category of imported goods from China. The U.S.-China trade deficit in the electrical machinery, sound equipment, TV equipment, and parts sector increased 915 percent, or by more than $10 billion to $16.9 billion, from 1990 to 2000.

From their perspective, this trade balance makes the Chinese heavily dependent on the U.S. economy and its consumers. The question is, how can the U.S. Government use the leverage created by this bilateral trade imbalance to promote basic labor rights and democracy in China rather than simply opening up the Chinese labor market for further exploitation?

In the electronic and electrical equipment industry, total employment of production workers fell from January 1990 to January 2001. This employment shift resulted in a significant decline in union density in the overall industry throughout the 1990s. The effect on U.S. wages from globalization and trade has been even more pronounced than the employment effect.

For U.S. production workers in the industry, real wages grew just 1.9 percent, to $14.07 per hour, from January 1990 to January 2001. Because this inflation-adjusted increase is far less than increases in labor productivity over this period, there has been a worsening in the distribution of income and wealth between labor and stockholders.

These statistics reflect the fact that globalization and trade with countries such as China have led to a disproportionate loss of well-paying jobs in our economy. A complete examination of the effects of unrestricted trade with China on workers in the industry requires an analysis at the company level. This is not simply because we bargain and interact directly with individual employers, but because these firms exert a great influence over the global economy, including our economic relationship with China.

GE and its globalization strategy illustrates the detrimental effects of free trade and investment policies. The global revenue of this single multinational company is more than one-eighth of the entire gross domestic product of China. GE has moved production and employment out of the United States to China from each of its major business segments, including lighting, power systems, electrical controls, medical equipment, and financial services. Its globalization strategy is to move its capital, advanced technology, and employment continually around the world to exploit workers. China's entry into the WTO will make it easier to do just that.

In the absence of meaningful labor rights standards in the rules of the WTO and regional free trade agreements, unions have tried to bargain international codes of conduct that would apply to all of the global operations of a company, including those in China. In the case of General Electric, management has outright refused to discuss this proposal, claiming that it is not a "mandatory subject of bargaining."

GE workers have also submitted stockholder resolutions at GE's annual meetings seeking a similar code of conduct. The GE board of directors has opposed these proposals, which would restrict GE's ability to use child labor, prison labor, or to discriminate on the basis of race, sex, age, religion, political opinion, or nationality. Our experience with smaller corporations in the industry has been similar to that of GE.

Hundreds of IUE members recently lost their jobs when General Cable moved work out of its Williamstown, Massachusetts, and Montoursville, Pennsylvania, locations to China. In 1996, Rotorex-Fedders forced 500 IUE members in Walkersville, Maryland, out on strike and then moved most of the existing work to China. We learned just a month ago this plant will be closed permanently, with the last 50 jobs gone.

We believe that it is in the interest of the United States to promote a stable economic relationship with China. However, the promotion of free trade and investment policies with China without meaningful and enforceable labor and environmental protections will not lead to equitable, sustainable, or democratic development in China. We urge this Commission to develop and recommend new policy tools directed at fostering an engagement with China based on the respect for fundamental democratic and labor rights. Thank you.

[The statement follows:]

PREPARED STATEMENT OF EDWARD FIRE

Mr. Chairman and distinguished members of the Commission, my name is Edward Fire, and I am the President of the IUE Industrial Division of the Communication Workers of America (IUE–CWA), AFL–CIO. On behalf of the more than 125,000 electronics workers represented by our union, I would like to thank you for this opportunity to present our views regarding current U.S. trade policies toward the People's Republic of China and their national security implications. IUE–CWA represents production workers from a broad spectrum of industries, including consumer electronics, automotive electrical equipment, power generating equipment, telecommunications, aircraft engines, electrical motors, lighting, and household appliances. Our members are employed by some of the largest multinational in the world including General Electric, GM/Delphi Automotive Systems, Philips Electronics, and numerous other companies with significant business interests and investment in China.

As Richard Trumka, Secretary-Treasurer of the AFL–CIO, testified before this Commission in June, our economic relationship with China in one of the most controversial and complicated relationships we have with any country in the world. The corporations for which our members work already have trading relationships and investments in China and they will continue to do so regardless of U.S. policy. We recognize that in today's global economy our employers will continue to be economically engaged with China. We believe, however, it is the responsibility of U.S. foreign policy to manage that engagement so that it occurs in ways that strengthen rather than weaken our nation.

The trade policies of the United States should not sacrifice the viability of our domestic electrical and electronics sectors to narrow foreign policy objectives that may or may not undermine the long-term interests of America. First and foremost, American trade policies should serve the interests of Americans—not just corporations chartered in America, but American citizens who live, work, pay taxes, and serve in our country's armed forces. Our trade policies should be designed to make sure that trade with other nations will not result in downward pressure on American wages and living standards. Yet, that is precisely the impact U.S. trade with China has created, and will continue to create if the terms of trade with China are not changed radically.

Another crucial issue is how the U.S. should regulate the investment in China by U.S.-based companies. American investment in China should promote human and labor rights for Chinese employees. Unfortunately, in the absence of such regulations imposed by the U.S. in international trade agreements and in the WTO, these U.S.-based multinational corporations are given incentives to exploit the abysmal human and labor rights environment in China, rather than act to improve it. Indeed, some would say that the primary motivation behind investment in China is the knowledge that human and labor rights standards can be abrogated at will, without any accountability or any financial repercussions.

Last week, on the eve of U.S. Secretary of State Colin L. Powell's visit to Beijing, China convicted another American scholar of espionage and sentenced her to ten years in prison. At least six U.S. citizens and permanent residents have been detained by Chinese police in the past year alone. China has clearly shown us that it will continue to repress human rights and democracy with an arrogance that is staggering. But the U.S. has responded to this arrogance with acquiescence. The U.S. has not insisted that China establish a policy of responsible engagement. Indeed, the Bush Administration and many in Congress reject any linkage between human rights abuses and economic relationships with China. China is emboldened by their views.

Once China's accession to the World Trade Organization (WTO) is complete, our nation will have even fewer tools available to address violations of human rights and unfair trade practices in China. Nor is there any reason to believe the claims of the Administration that unfettered free trade with China will lead to an improvement in the situation. On the contrary, a China free to act without international pressure will act as it has in the past.

Secretary Powell's visit to China has brought to mind the 1994 U.S. delegation to China led by Secretary of State Warren Christopher. Secretary Christopher's effort to promote the Clinton Administration's human rights agenda was rejected by the Chinese and in fact led to the suppression of political dissidents on the eve of his visit. What is worse, and even more damning is that fact that the Chief Executive Officer of General Electric, Jack Welch, helped undermine our government by publicly criticizing Mr. Christopher's efforts, and arguing that linking U.S. policy on democracy and labor rights interfered with the free-market. An unrestricted investment environment for American companies came first for Mr. Welch, and democracy and U.S. foreign policy be damned.

As Members of the Commission know, the IUE–CWA has joined with other international unions and the AFL–CIO in opposition to permanent normal trade relations between the United States and China precisely because the U.S. has not required the terms of trade to include standards on human and labor rights. Similarly, the rules of the World Trade Organization (WTO) provide no protection of labor rights in the global trading system. The Chinese government continues to promote an economic environment in which universal human rights, defined in the ILO Declaration of Fundamental Principles and Rights at Work as including freedom of association, the right to organize and bargain collectively, the right to reject child labor, refuse forced labor, and to be free from discrimination in the workplace, are systematically denied.

The AFL–CIO has received reports from China over the past year of increased labor protests, arrests, and violence, which indicate that the human rights situation is worsening, rather than improving for the vast majority of Chinese workers. Our GE members have also heard reports over the years of labor rights violations and the existence of horrendous working conditions within the Company's Chinese production facilities. But when the IUE attempted to arrange a delegation to China in 1998 to meet with GE workers and local management to discuss our concerns about the Company's Asian business operations and labor practices, we were denied access to the plants. What does GE have to hide in China?

Current U.S. trade and investment policies and relationships with China are having a profound impact on our own economy and on our national security. Despite the long period of economic expansion in the United States over the past decade, the U.S. trade deficit has grown larger. Employment and real wages for production workers in many electrical and electronics industries are lower today than they were at the beginning of the 1990's. Today, when non-represented workers attempt to organize, they are routinely threatened with plant closure and job loss to China and elsewhere. When unionized workers attempt to bargain for better wages and benefits, they are threatened with plant closure and job loss to China and elsewhere. When unions lobby the U.S. Congress and the Executive branch for increases in the minimum wage and other social benefits, we are denied as a price for keeping companies in the United States.

The overall 2000 U.S. trade deficit with China increased by 20 percent over 1999, to more than $80 billion. In fact, the largest single bilateral U.S. trade deficit is now with the PRC. The most immediate effect of this trade imbalance is the loss of U.S. manufacturing jobs. Our experience shows that American companies are moving out of the U.S. to manufacture advanced electrical and electronic products in China and export them back into the U.S. Electronics and electrical goods make up the largest single category imported goods from China. While the U.S. global trade deficit in the "Electrical Machinery, Sound Equipment, TV Equipment and Parts" sector increased 267% to $19.1 billion from 1990 to 2000, the deficit has actually declined by more than $3 billion since 1995. Over the same time period, however, the U.S. trade deficit with China in this industrial sector grew 915% to $16.9 billion. The deficit with China increased by more than $10 billion over the past five years. The U.S. imported more than $19 billion worth of goods from this category in 2000.

When U.S. consumer demand for these electronic commodities is met by Chinese imports instead of domestic production, existing U.S. jobs are lost and new manufacturing jobs are not created. From the Chinese perspective, this trade balance makes them heavily dependent on the U.S. economy and its consumers. The question before this Commission is how the U.S. government can use the leverage created by this bilateral trade imbalance to promote basic labor rights and democracy in China, rather than simply opening up the Chinese labor market for further exploitation.

Since the beginning of 1990, total employment in the United States grew by more than 21 percent to 132.4 million (Appendix I). Net U.S. employment in manufacturing, however, fell by 883,000. Over the past twelve months alone, manufacturing job losses have totaled more than 500,000. In April 2001, manufacturing employment fell below 18 million for the first time since 1965.

The overall expansion in the U.S. economy has masked the adverse trends occurring in key manufacturing sectors in the United States. In the Electronic and Other Electrical Equipment Industry (SIC 36), total employment of production workers fell from 1,077,000 in January 1990 to 1,063,000 in January 2001. If the Electronic Components and Accessories sub-sector (SIC 367) is removed, employment in the rest of the industry fell by 93,500, or 12.6%, over this eleven-year period. Because the Electronic Components sector, which includes the production of semiconductors, is essentially non-union, these employment shifts resulted in a significant decline in union density in the overall electronic and electrical equipment industry in the 1990s.

The effect on U.S. wages from globalization has been even more pronounced than the employment effect (Appendix II). For U.S. production workers in manufacturing, *real* average hourly wages increased by just 0.7 percent to $14.54 from January 1990 to 2001. Because this inflation-adjustment increase is far less than increases in labor productivity over this period, there has been a worsening in the distribution of income and wealth between labor and stockholders. For production workers in the Electronic and Electrical Equipment Industry (SIC 36), real wages grew 1.9 percent to $14.07 per hour over this same period. Real wage changes in individual sub-sectors of the industry have varied widely. Wages in Household Appliances (SIC 363), Motors and Generators (SIC 3621), Communications Equipment (SIC 366), Electron Tubes (SIC 3671), Storage Batteries (SIC 3691), and Engine Electrical Equipment (SIC 3694), for example, have fallen over the past 11 years. These statistics reflect the fact that globalization and our trading relations with countries such as China have led to a disproportionate loss of well-paying jobs in our economy. Our experience with individual employers within the electronics industry confirms that it is not just low-paying jobs that are threatened by unrestricted trade.

Given the intrinsic diversity of the electronics and telecommunications industry, assessing the economic impact of the bilateral trade and economic relationship between the United States and China on the electrical and electronics sector is difficult. The effect on consumer electronics and household appliances, for example, is quite different than on power generating equipment. Even with CWA-represented firms such as General Electric, Delphi, and Lucent Technologies, changes in our trade relationship with China will vary in their effects depending on the current location of production facilities and on the relative importance of domestic versus Chinese markets for these goods and services. In the case of GE, the analysis is further complicated by the fact that it is the world's largest non-bank financial institution and changes in the rules for financial services and insurance are likely to have a significant impact on the corporation's investment and acquisition strategies. It is our understanding that negotiations over the treatment of existing insurance holdings by foreign corporations is one of the few remaining open issues in the discussions over China's entry into the WTO.

Thus, the complete examination of the effects of unrestricted trade with China on electrical and electronics workers requires an analysis at the company level. This is not simply because we generally bargain and interact directly with individual employers in the industry, but because these firms exert a great influence over the global economy, including the economic relationship with China. GE and its globalization strategy illustrates the detrimental effects of free-trade and investment policies. Indeed, for the IUE–CWA, GE is the corporate face of globalization. Global revenues of this one multinational electrical corporation are more than one-eighth of the entire gross domestic product of China.

Over the past decade, GE has moved production and employment out of the United States to China from each of its major business segments, including lighting, power systems, electrical distribution and controls, medical equipment, and financial services. Jack Welch was quoted a few years ago as saying: "Ideally, you would have every plant you own on a barge." The implication of this statement is clear: One of America's largest and perhaps its most powerful corporation is not loyal, economically, to any one country or workforce. Its globalization strategy is to move its capital, advance technology, and employment continually around the world to exploit workers. China's entry into the WTO will make it easier to do just that. Over the past decade, GE has shut down dozens of plants in the United States, including those doing U.S. government work, not because they were unprofitable, but because they were not profitable enough for GE. GE closed them so it could make even higher profits by operating in China and elsewhere, where wages are low and unions virtually non-existent. Although GE made more than $12 billion in net profits last year, it wants to continue the "race to the bottom" game of global exportation of jobs and global exploitation of workers. It is looking toward China to help it achieve that goal.

In the absence of meaningful labor rights standards in the rules of the WTO and regional free-trade agreements, unions in the United States have attempted to collectively bargain international codes of conduct that would apply to all of the global operations of a company, including those in China. In the case of GE, management has refused to discuss this type of proposal claiming that it is not a "mandatory subject of bargaining." Over the past three years, GE workers have also submitted stockholder resolutions at the GE annual meetings seeking a similar code of conduct. This past year in Atlanta, GA, the GE Board of Directors argued that it "does not believe that the code of conduct suggested in the proposal is necessary and recommends a vote against the proposal." The proposal would have restricted GE's ability to use child labor, prison labor, or to discriminate on the basis of race, color, sex, religion, political opinion, age, nationality, or social origin. GE management claims such provisions aren't needed because it already meets the labor standards in affect everywhere it does business. But even if this were true, this policy relieves the company of meeting these minimal standards in countries such as China that lack internationally-recognized labor rights and protections.

Unfortunately, our experience with smaller corporations in the industry has been similar to that of General Electric. Hundreds of IUE members, for example, recently lost their jobs when General Cable Corporation moved work out of its Williamstown, MA (IUE–CWA Local 299) and Montoursville, PA (IUE–CWA Local 123) locations to China. In 1996, Rotorex-Fedders forced the 500 members of IUE Local 133 in Walkersville, MD out on strike, and then moved most of the existing production to China. While we prevailed in the ensuing legal battles and forced the company to pay damages to our members, the majority of the lost jobs have not returned to the United States from China.

In conclusion, we believe that it is in the interest of the United States to promote a stable economic relationship with China. However, the promotion of free-trade and investment policies with China without meaningful and enforceable labor and environmental protections will not lead to equitable, sustainable, or democratic development in China. We urge this Commission to develop and recommend new policy tools directed at fostering a engagement with China based on the respect for fundamental democratic and labor rights. Thank you.

APPENDIX I.—U.S. EMPLOYMENT OF PRODUCTION WORKERS IN SELECTED INDUSTRIES

[In thousands]

	1990	2001	Change	Percent Change
All Workers	108,946	132,428	23,482	21.55
All Manufacturing Workers	19,140	18,257	−883 0	−4.61
Electronic and Electrical Equipment (36)	1,077	1,063	−14	−1.30
Electronic Distribution Eauipment (361)	69.6	57.7	−11.9	−17.10
Transformers (3612)	35.9	25.8	−10.1	−28.13
Switchgear and Apparatus (3613)	33.7	31.9	−1.8	−5.34
Electrical Industrial Apparatus (362)	122.1	98.8	−23.3	−19.08
Motors and Generators (3621)	68.0	50.5	−17.5	−25.74
Relays and Industrial Controls (3625)	40.4	31.1	−9.3	−23.02
Household Appliances (363)	102.1	88.7	−13.4	−13.12
Household Refridgerators & Freezers (3632)	21.7	20.0	−1.7	−7.83
Household Laundry Equipment (3633)	17.4	13.7	−3.7	−21.26
Electric Housewares and Fans (3634)	25.6	16.0	−9.6	−37.50
Electric Lighting & Wiring Equipment (364)	138.5	131.8	−6.7	−4.84
Electric Lamps (3641)	21.0	14.5	−6.5	−30.95
Current-Carrying Wiring Devices (3643)	48.2	43.3	−4.9	−10.17
Non-current-Carrying Wiring Devices (3644)	13.1	14.6	1.5	11.45
Residential Lighting Fixtures (3645)	18.3	14.0	−4.3	−23.50
Household Audio and Video Equipment (365)	58.2	47.5	−10.7	−18.38
Household Audio and Video Equipment (3651)	42.1	30.5	−11.6	−27.55
Communications Equipment (366)	137.0	124.4	−12.4	−9.20
Telephone and Telegraph Apparatus (3661)	74.5	60.8	−13.7	−18.39
Electronic Components and Accessories (367)	333.3	412.8	79.5	23.85
Electron Tubes (3671)	21.8	13.6	−8.2	−37.61
Semiconductors and Related Devices (3674)	92.7	131.4	38.7	41.75
Electronic Components (3679)	91.8	109.2	17.4	18.95
Storage Batteries (3691)	24.3	20.1	−4.2	−17.28
Engine Electrical Equipment (3694)	51.3	50.8	−0.5	0.97
Aircraft Engines and Parts (3724)	77.5	49.2	−28.3	−36.52

Source: U.S. Department of Labor (BLS).

APPENDIX II.—AVERAGE HOURLY EARNINGS OF PRODUCTION WORKERS BY SELECTED INDUSTRIES: JANUARY 1994–JANUARY 2001

	1990	2001	Percent Change	Percent Real Change
Manufacturing	$10.59	$14.54	37.3	0.7
Electronic and Electrical Equipment (36)	$10.12	$14.07	39.0	1.9
Electronic Distribution Eauipment (361)	$9.90	$14.33	44.7	6.1
Transformers (3612)	$9.63	$13.02	35.2	−0.9
Switchgear and Apparatus (3613)	$10.19	$15.35	50.6	10.5
Electrical Industrial Apparatus (362)	$9.99	$13.67	36.8	0.3
Motors and Generators (3621)	$10.07	$12.76	26.7	−7.1
Relays and Industrial Controls (3625)	$9.89	$15.49	56.6	14.8
Household Appliances (363)	$10.31	$13.22	28.2	−6.0
Household Refridgerators & Freezers (3632)	$11.81	$15.59	32.0	−3.2
Household Laundry Equipment (3633)	$12.01	$12.67	5.5	−22.6
Electric Housewares and Fans (3634)	$7.79	$12.77	63.9	20.2
Electric Lighting & Wiring Equipment (364)	$9.93	$13.80	39.0	1.9
Electric Lamps (3641)	$11.43	$18.46	61.5	18.4
Current-Carrying Wiring Devices (3643)	$9.90	$14.28	44.2	5.8
Non-current-Carrying Wiring Devices (3644)	$9.47	$12.53	32.3	−3.0
Residential Lighting Fixtures (3645)	$7.42	$12.09	62.9	19.5
Household Audio and Video Equipment (365)	$9.09	$13.19	45.1	6.4
Household Audio and Video Equipment (3651)	$9.41	$12.81	36.1	−0.2
Communications Equipment (366)	$10.96	$14.30	30.5	−4.3
Telephone and Telegraph Apparatus (3661)	$11.39	$14.43	26.7	−7.1
Electronic Components and Accessories (367)	$9.81	$14.63	49.1	9.4

APPENDIX II.—AVERAGE HOURLY EARNINGS OF PRODUCTION WORKERS BY SELECTED INDUSTRIES: JANUARY 1994–JANUARY 2001—Continued

	1990	2001	Percent Change	Percent Real Change
Electron Tubes (3671)	$11.58	$15.31	32.2	−3.1
Semiconductors and Related Devices (3674)	$12.07	$19.75	63.6	20.0
Electronic Components (3679)	$9.17	$12.21	33.2	−2.4
Storage Batteries (3691)	$11.94	$15.27	27.9	−6.2
Engine Electrical Equipment (3694)	$11.33	$12.51	10.4	−19.0
Aircraft Engines and Parts (3724)	$14.65	$20.12	37.3	0.7

Source: U.S. Department of Labor (BLS).

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

STATEMENT OF DAVE McCURDY, PRESIDENT, ELECTRONIC INDUSTRIES ALLIANCE

Mr. McCURDY. Thank you, Mr. Chairman. Ladies and gentlemen, I want to commend you for your service. Having sat on the other side of those podiums in eight-hour-long hearings, I appreciate your patience and continued interest.

I appreciate the opportunity to appear before you today, and I think you'll like the fact that I went through my oral statement and started deleting some sections there, and if I can, Mr. Chairman, I ask unanimous consent that my full statement be admitted into your record and I'll try to summarize as best I can, because I know that you'd like to get to questions.

Chairman D'AMATO. It will be.

Mr. McCURDY. I represent the Electronics Industry Alliance, a partnership of electronic and high-tech associations with over 2,300 member companies accounting for roughly 80 percent of the $550 billion U.S. electronics industry.

China is the most promising emerging market in the world today, and this fact is especially true for the U.S. electronics industry. In the year 2000, total U.S. electronics exports to China were an estimated $4.2 billion. This figure represents a 43 percent increase over just the year before and a more than 300 percent increase since 1994.

A significant factor driving these impressive gains is China's exponential growth in Internet usage. The number of people with Internet access exceeded 22 million last year, up from four million at this time in 1999. Worldwide, Chinese is now the second most used language on the Internet, after English. Furthermore, we anticipate that a reduction of personal computer prices and the rollout of information appliances specifically tailored for the Chinese market will spur even greater Internet diffusion throughout the country.

China is also just beginning to embrace e-commerce. A government-sponsored nationwide survey found that China had more than 1,100 consumer-related e-commerce websites in early 2000.

Nevertheless, our companies do face considerable obstacles to penetrating the Chinese market and this is reflected in the lopsided bilateral trade deficit. Even in the electronics sector, where in most cases U.S. manufactured products are superior in both terms of quality and price competitiveness, the electronics trade deficit in 2000 totaled over $22 billion. This is due in part to the high tariffs China imposes on our products.

But of even greater significance to our trade deficit with China are the costly and burdensome non-tariff barriers which confront our companies. These barriers take many forms, from a distribution system which discriminates against our companies to the discriminatory buying practices of state-owned enterprises, to the arbitrary customs procedures we face at the ports of entry. Bringing China into WTO's system of rules and procedures will go a long way towards making China a more attractive and easier place to do business.

The electronics industry has much to gain from China's accession to WTO in the areas of trade and non-tariff barriers, distribution rights, trading rights, transparency, state-owned enterprises, and national treatment, and I refer you again, Mr. Chairman, to my written testimony, which outlines what we see as the major commercial benefits of China accession.

We are very pleased that China's accession now appears imminent and that China will soon begin implementing its commitments. While China is already making progress in liberalizing certain sectors of its economy to prepare for WTO accession, it is also lagging in key areas.

For example, in the latest national trade estimates publication from the USTR, it reported that China is making important progress in deregulating its telecommunications sector. Earlier this year, China passed new regulations that allow for interconnection, cost-based pricing, and foreign investment, as well as set out regulatory jurisdictions and procedures. However, these regulations are vague in many important areas and require refinement to be WTO compliant. Similarly, more progress needs to be made with regard to advanced services, like Internet, where regulations hinder foreign companies from owning China-based websites.

Clearly, our industry has much to gain from China's commitment to open its economy. However, the potential benefits may be undermined if our own government imposes outdated and burdensome export controls on U.S. electronics companies dealing with China.

We are very pleased and encouraged by Secretary Powell's recent trip to China and we look forward to further progress in the bilateral relationship when President Bush visits Beijing in October. We believe that the Chinese leadership generally wishes to minimize conflict and desires a mutually constructive relationship with the United States, particularly in areas of economics.

Nevertheless, when incidents occur like the recent spy plane shoot-down or our accidental bombing of the Chinese embassy in Belgrade, we can expect China to lash out with nationalist rhetoric and unreasonable demands. Similarly, on issues like human rights, Taiwan, and others, our two countries have very fundamental disagreements which are certain to be continuing points of contention.

These dramatic highs and lows in the U.S.-China relationship have become a predictable, if unnerving, cycle which has persisted for over a decade, and unfortunately, may continue indefinitely. The best way for the United States to deal with these highs and lows is with patient but firm diplomacy, as we saw in the spy plane incident this year.

One largely ineffective and counterproductive strategy to affect China's behavior, in my opinion, is to use our technology industry as a bargaining chip through the imposition of unilateral export controls. With the collapse of the Soviet bloc, the multilateral consensus on export control policy collapsed with it. Hence, many of our allies do not impose comparable restrictions on their export activities. China is perhaps the best example of the lack of international consensus on export control policy, and from the electronics industry's perspective, the most important.

While the U.S.-China relationship may be controversial in this country, there is no such dilemma for our allies. For them, China is a partner to cooperate with on a range of issues. It is also a major market for their products. This is the reality we are faced with when we consider unilateral export controls.

Now, managing the U.S.-China relationship is among the most challenging and important tasks facing the new administration. Among the most challenging aspects of this relationship is managing our own expectations of China's emerging role in the post-Cold War world. We should not expect the rule of law to take hold immediately upon China's accession to WTO. Similarly, we should not expect WTO implementation to proceed without problems. We must remember that China remains a developing country which is undergoing a wrenching transformation of its society.

But accepting this reality certainly does not mean we should overlook or downplay the excesses of the Chinese regime, whether they be human rights abuses or weapons proliferation or saber rattling towards Taiwan. Considering the intense spotlight that the U.S. media, Congress, this Commission, and interest groups put on China, there's little chance of overlooking these, anyway.

Rather, we must hold China to the high standards of a mature global power as it wishes to become. We must insist that China implement its WTO commitments and other treaty commitments as it has pledged to do, and we must object clearly and forcefully when it fails.

But we must take care not to overreact ourselves when China fails to live up to international standards, as expected. This Commission would provide a great service to the nation if it helps point the way toward a thoughtful and reasoned approach to this particular challenge.

Again, Mr. Chairman, I appreciate the opportunity to present these views and would welcome your questions.

[The statement follows:]

PREPARED STATEMENT OF DAVE MCCURDY

I. Introduction

Thank you, Mr. Chairman, for the opportunity to testify today on Bilateral Trade Policies and Issues between the U.S. and China. I represent the Electronic Industries Alliance (EIA), a partnership of electronic and high tech associations and companies whose mission is to promote the market development and competitiveness of the industry. EIA includes the Consumer Electronics Association (CEA); Electronic Components, Assemblies, and Materials Association (ECA); Electronic Industries Foundation (EIF); Government Information Technology Association (GEIA); JEDEC—Solid State Technology Association; and Telecommunications Industry Association (TIA). Simply put, we connect the industries that define the Digital Age.

I am also a former Member of Congress from Oklahoma. During my 14 year tenure, I served as Chairman of the House Intelligence Committee, as well as subcommittee chairman on the Armed Services Committee and the Science Committee. In addition, I have served as a member of the Commission to Assess the Organization of the Federal Government to Combat the Proliferation of Weapons of Mass Destruction (WMD Commission). This experience gives me valuable insight into the complex interplay of technological, economic, and political issues which surround the U.S.-China relationship.

II. China and the Electronics Industry

With over 2,300 member companies, accounting for 80 percent of the $550 billion electronics industry, EIA represents the most dynamic and competitive industry in the U.S. economy today. The companies we represent operate globally, they think and plan in global terms, and they face intense international competition. The fact is, the days when the domestic U.S. market could sustain the industry are also over. In 2000, more than one-third of what the U.S. electronics industry produced was exported overseas, over $200 billion in goods. That means more than a third of the 1.8 million employees who work for U.S. electronics companies depend on exports for their jobs, and the percentage goes up every year. It has become almost cliche, but the global economy is a fact of doing business for us, and is a critically important concept to keep in mind as we formulate public policy in this area.

It is from this perspective that we approach China. China is the single most promising emerging market in the world today, and this fact is especially true for the U.S. electronics industry. In 2000, total U.S. electronics exports to China were an estimated $4.2 billion. This figure represents a 43% increase over just the year before, and a more than 300% increase since 1994. To break these numbers down further, telecommunications equipment exports experienced a 37% increase last year over 1999; consumer electronics experienced a 64% increase in exports; computers and peripherals experienced a 72% increase; and our passive components sector saw its exports to China increase by 108% in 2000.

A significant factor driving these impressive export gains is China's exponential growth in Internet usage. The number of people with Internet access exceeded 22 million last year, up from four million at this time in 1999. Worldwide, Chinese is now the second most used language on the Internet after English. Furthermore, we anticipate that a reduction of personal computer prices and the roll-out of information appliances specifically tailored for the Chinese market will spur even greater Internet diffusion through that country. China is also just beginning to embrace e-commerce. A government-sponsored nationwide survey found that China had more than 1,100 consumer related e-commerce websites in early 2000. More than 800 of these are shopping websites; 100 are auction websites; 180 are distance education websites; and 20 are distance medical and health-related websites.

Nevertheless, our companies do face considerable obstacles to penetrating the Chinese market, and this is reflected in the lopsided bilateral trade deficit. Even in the electronics sector, where in many cases U.S. manufactured products are superior in terms of both quality and price competitiveness, the electronics trade deficit in 2000 totaled over $22 billion. This is due, in part, to the high tariffs China imposes on our products. These tariffs average about 17 percent, and in some sectors tariffs may be much higher. But of even greater significance to our trade deficit with China are the costly and burdensome non-tariff barriers which confront our companies. These barriers take many forms, from a distribution system which discriminates against our companies, to the discriminatory buying practices of state-owned enterprises, to the arbitrary customs procedures we face at the ports-of-entry.

In addition to exports, our industry utilizes China as a vital source for components that are then incorporated into larger, more advanced products. The availability of these components, which often are not produced domestically, are essential to the competitiveness of our industry. Without access to the inputs produced in China, these firms would not be able to be competitive domestically or internationally.

III. China's WTO Accession

Bringing China into the multilateral system of rules and procedures which the World Trade Organization oversees will go a long way towards making China a more attractive, and easier, place to do business. The electronics industry has much to gain from China's accession in the areas of tariff and non-tariff barriers, distribution rights, trading rights, transparency, state-owned enterprises and national treatment. As part of the WTO accession agreement, China agreed to:

—Implement the Information Technology Agreement by 2005, which will eliminate tariffs on a wide range of high-tech products.

—Provide U.S. firms significant market access rights that include the ability to import, export and distribute their goods throughout China. State-owned enter-

prises would be prohibited from discriminating against U.S. firms in their buying decisions.
—Enforce laws protecting intellectual property, and preventing local content requirements and forced technology transfers.
—Open the telecommunications market to foreign competition and investment:
  —China has agreed to implement the pro-competitive regulatory principles embodied in the Basic Telecommunications Agreement (including cost-based pricing, interconnection rights and independent regulatory authority), and agreed that foreign suppliers can use any technology they choose to provide telecom services.
  —China will allow 49% foreign investment in all services immediately upon accession, and will allow 50% foreign ownership for value added in 2 years and paging services in 3 years. This is a change from the April 8 deal, in that China had indicated it would allow 35% foreign ownership for value-added and paging services two years after accession and 51% four years after accession.
  —China will phase out all geographic restrictions for paging in 3 years, value added, and closed user groups in 3 years, mobile/cellular in 5 years and domestic wireline services in 6 years. China's key telecommunications services corridor in Beijing, Shanghai and Guangzhou, which represents approximately 75% of all domestic traffic, will open immediately on accession in all telecommunications services.
  —Internet services will be liberalized at the same rate as the other key telecommunications services, and China will permit provision of telecom services via satellite.
—Regarding antidumping, the U.S. will continue to treat China as a non-market economy. Moreover, in applying countervailing duty law, the U.S. will be able to take the special characteristics of China's economy into account when we identify and measure any subsidy benefit that may exist. This provision will remain in force for 15 years after China's accession to the WTO.
—Should China fail to abide by these commitments, China is subject to the WTO's Dispute Settlement Mechanism, including the possibility of multilateral trade sanctions.

In addition to the substantial economic opportunities the accession agreement creates, China's membership in the WTO also advances our broader foreign policy goals by promoting economic and political reform. The practical effect of adhering to WTO principles and commitments makes China's economic reforms of the last two decades irreversible, and sets China on a course for further free-market reforms. It commits China to abide by the same multilateral trading rules—like national treatment, Most-Favored-Nation, and impartial dispute resolution—that we and our other major trading partners already abide by. WTO membership will require greater transparency from China's legal system and bureaucracies, creating unprecedented accountability for the country's decision makers. Furthermore, it creates the foundation for China's prosperity and improving the quality of life for 1.3 billion people. Finally, it promotes the free flow of ideas and information through enabling greater Internet penetration, music and movies, financial information and other news, and increased exposure to U.S. companies and citizens.

Thirty-three emerging market countries have applied for membership in the 135-member World Trade Organization (WTO). The United States has seized the opportunity of potential WTO membership, to negotiate bilateral agreements with countries, such as China, to press them to open and modernize their economies and markets. China, not the U.S., had to make significant concessions to secure membership in the WTO. China must reduce tariffs, open markets for competition and investment from U.S. firms and abide by international rules of commercial behavior and monitoring of its compliance. As a result, U.S. telecommunication and high tech companies have a tremendous opportunity to gain from China's accession to the WTO and concurrent implementation of the WTO deal. It is a commercially viable agreement that is a huge win for the United States and the cause of free trade.

We are very pleased that China's accession now appears imminent and that China will soon begin implementing its commitments. While China is already making progress in liberalizing certain sectors of its economy to prepare for WTO accession, it is also lagging in key areas. For example, in the latest "National Trade Estimates" publication, the Office of the U.S. Trade Representative reports that China is making important progress in deregulating its telecommunications sector. Earlier this year, China passed new regulations that allow for interconnection, cost-based pricing, and foreign investment, as well as set out regulatory jurisdictions and procedures. However, these regulations are vague in important areas and require refinement to be WTO compliant. Similarly, more progress needs to be made with regard to advanced services like Internet services, where regulations hinder foreign companies from owning China-based websites.

Another example of an issue that needs resolution is the Ministry of Information Industry's continuing policy of discouraging the use of imported components in favor of domestic sources. Similarly, "safety inspections" of electronic products are often more rigorous and expensive for imports than for domestic products. There are many other discriminatory practices which require attention and which the WTO can help address.

IV. U.S.–China Relations and Unilateral Export Controls

Clearly, our industry has much to gain from China's commitment to open its economy. However, the potential benefits may be undermined if our own government imposes outdated and burdensome export controls on U.S. electronics companies' dealings with China.

We are very pleased and encouraged by Secretary of State Powell's recent trip to China, and we look forward to further progress in the bilateral relationship when President Bush visits Beijing in October. We believe that the Chinese leadership generally wishes to minimize conflict and desires a mutually constructive relationship with the United States, particularly in areas of economics. Nevertheless, when incidents occur like the recent spy plane shoot-down or our accidental bombing of the Chinese embassy in Belgrade, we can expect China to lash out with nationalistic rhetoric and unreasonable demands. Similarly, on issues like human rights, Taiwan, and others, our two countries have very fundamental disagreements which are certain to be continuing points of contention. These dramatic highs and lows in the U.S.-China relationship have become a predictable, if unnerving, cycle which has persisted for over a decade, and may continue indefinitely.

The best way for the United States to deal with these highs and lows is with patient but firm diplomacy, as the spy plane incident clearly demonstrated. One largely ineffective and counterproductive strategy to affect China's behavior is to use our technology industry as a bargaining chip through the imposition of unilateral export controls.

Whereas U.S. industry once had a virtual monopoly over the development and production of many technology products, today many countries produce comparable or even superior technologies. Furthermore, with the collapse of the Soviet bloc, the multilateral consensus on export control policy collapsed with it. Hence, many of our allies do not impose the same restrictions on their export activities. Despite extraordinary efforts by the U.S. government to strengthen the binding aspects of the Wassenaar Arrangement, our allies agreed only to limited information sharing. This is the reality we are faced with as we consider unilateral export controls.

China is perhaps the best example of the lack of international consensus on export control policy, and from the electronics industry's perspective, the most important. While the U.S.-China relationship may be controversial in this country, there is no such dilemma for our allies. For them, China is a partner to cooperate with on a range of issues, and is also the single largest emerging market.

The impact of export controls on how this industry competes in the global economy is substantial. They hold us back from competing. Unilateral export controls essentially force us to cede the playing field to our overseas competitors, or burden us to the point that we cannot compete effectively. When export controls are used properly, they can be a useful tool in combating the development and proliferation of weapons of mass destruction. However, they are a tool to be used carefully and sparingly because of their negative impact on our industry and their limited impact on the target country.

Much of the rhetoric over export controls always boils down to national security versus economics and exports. But more than ever before, protecting U.S. national security depends on a dynamic and innovative high-technology sector. Whether we are talking about weapon systems, intelligence gathering capabilities, or command and control networks, our industry is constantly improving the technologies that keep us a step ahead of our adversaries. An effective export control policy would recognize the reality that our national security is improved by enabling our high-tech industries to thrive. U.S. national security should be based on maintaining our technological edge through innovation, not on a doomed effort to hoard as much technology as possible.

Another key point to keep in mind is that export controls can severely disrupt the business models which sustain our competitive advantage. The U.S. technological advantage is based, to a large extent, on speed-to-market and mass-marketing through electronic commerce and the World Wide Web. But the administrative costs of trying to determine what products may go to what end user for what purpose can easily wreak havoc with these models. Our industry operates in terms of global

R&D collaboration, Web-based, instantaneous order processing, and just-in-time manufacturing. In contrast, our export control system operates in terms of General Prohibitions, notification periods, and interagency dispute escalation procedures.

The system in place encourages regulatory complexity. It emphasizes bureaucratic processes and paperwork over coordination with our allies to prevent the bad end-users from acquiring truly sensitive technologies. Effective export control policy would be based on multilateral cooperation and facilitating effective corporate compliance. But the hundreds of pages of regulations we now operate under have the effect of penalizing those U.S. companies that try to obey the law. Our small companies, which are often the most innovative but which also need the most assistance, are the hardest hit by these policies. A small company can be overwhelmed by the costs, delays and confusion which plague our export licensing system. Faced with the prospect of hiring a team of attorneys to ensure compliance, a small company may simply export only to "safe" destinations like Canada, Western Europe, or Japan, thereby excluding the emerging markets we need to develop most. Sometimes, the potential liabilities loom so large that a company may shun the export market altogether as not worth the risk.

V. Conclusion

Managing the U.S.-China relationship is among the most challenging and important tasks facing the new Administration. Among the most challenging aspects of this relationship is managing our own expectations of China's emerging role in the post-Cold War world. We should not expect the rule of law to take hold immediately upon China's accession to the WTO. Similarly, we should not expect WTO implementation to proceed without problems. We must remember that China remains a developing country which is undergoing a wrenching transformation of its society. Many domestic constituencies, including factions of the ruling elite and military establishment, have much to lose in this transformation and will not retire quietly. In this environment, inconsistency of policies and nationalistic rhetoric must be expected.

But accepting this reality certainly does not mean we should overlook or downplay the excesses of the Chinese regime, whether they be human rights abuses or weapons proliferation or saber rattling towards Taiwan. Considering the intense spotlight that the U.S. media, Congress, and interest groups put on China, there is little chance of overlooking these anyway. Rather, we must hold China to the high standards of a mature global power, as it wishes to become. We must insist that China implement its WTO commitments, and other treaty commitments, as it has pledged to do. And we must object clearly and forcefully when it fails. But we must take care not to overreact ourselves when China fails to live up to international standards as expected. This Commission would provide a great service to the nation if it helps point the way toward a thoughtful and reasoned approach to this challenge.

I appreciate the opportunity to present these views and welcome your questions.

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

STATEMENT OF MERRITT TODD COOKE, JR., CHIEF, COMMERCIAL SECTION, AMERICAN INSTITUTE IN TAIWAN

Mr. COOKE. Mr. Chairman, thank you. I hope the Commission will feel free to overlook the confusion that my parents introduced with my legal name and call me by the name that I most often respond to, Terry.

[Laughter.]

I will also request that, with the consent of the Commission, some paragraphs that I delete in the interest of brevity do be entered into the record. I will spare the Commission a recap of Taiwan's ten-year structural transformation in the 1990s.

It is an honor to be asked to testify in front of this distinguished panel of Commissioners. In the following brief statement, I will bring to bear my perspective as current Chief of the Commercial Section at the American Institute in Taiwan to address the issues identified by the Commission in its July 24 invitation letter, specifically the growing interdependence of the U.S., Taiwan, and Chinese high-tech economies.

The strategic interdependence of the U.S. and Taiwan economies has grown steadily throughout the 1990s as Taiwan's economy has shifted from its traditional structure as a labor-intensive export-oriented economy towards a more service-oriented investment and technology-intensive economy. While Taiwan's industrial sector has shrunk in relative terms over this period, capital and technology-intensive industries have expanded dramatically. These industries accounted for approximately 75 percent of total manufacturing in 2000, compared to 48 percent in 1986.

Taiwan now supplies 60 percent of the world's motherboards and is the world's leading supplier of notebook computers, monitors, mice, keyboards, video cards, sound cards, on/off switches, LAN cards, graphic cards, scanners, and laser disk drives. Through the strength of its foundry model, Taiwan has emerged as a pre-eminent semiconductor supplier to the world.

This transition from the production of labor-intensive goods to high-tech goods has to date proceeded relatively smoothly, even against the background turbulence of the Asian financial crisis in 1997–98 and a major earthquake occurring on September 21, 1999.

Against the broad backdrop of its structural transformation, two major dynamics have emerged: First, the growing regional partnership and global interdependence of the U.S. and Taiwan high-tech industries, and secondly, the accelerating shift of the lower end of Taiwan's high-tech production offshore, particularly to mainland China.

One clear indicator of the degree of evolving interdependence with the U.S. was the fact that following the 9/21 earthquake in Taiwan, the tech markets in New York dropped more in percentage terms than in Taipei.

The scale of this interdependence is likewise highlighted in other ways. For example, four of the top U.S. suppliers of PCs alone procured $20 billion of components from Taiwan to support their 1999 global sales. Additionally, Taiwan will soon have more state-of-the-art 300-millimeter chip wafer fabs in operation than the U.S., Germany, Japan, or any other world market.

The accelerating shift of high-tech production from Taiwan to mainland China has been equally pronounced over this period. The Taiwan government's Office of Budget, Accounting, and Statistics reported in February that government approved Taiwan investments in China for 2000 more than doubled from the 1999 levels. The Taipei Computer Association reported in the same month that 30 percent of Taiwan's 411 high-technology companies had established major investments in mainland China and that fully 90 percent of those 411 companies planned to be invested in China by the end of 2001.

Lastly, China edged out Taiwan in 2000 for the first time for the number three slot in world IT production value. China came in behind the U.S. and Japan, with $25.5 billion of production value, against Taiwan in fourth place with $23 billion. The key point to note, however, is that Taiwanese companies generated fully 70 percent of that $25.5 production value in mainland China.

The impending accessions of China and Taiwan to the WTO will likely further accelerate this process of growing cross-straits commercial interdependence in high-tech, with consequent implications for the already highly interdependent U.S. and Taiwan high-tech economies. Although Taiwan's relatively late liberalization and privatization of its fixed-line monopoly regime will limit somewhat the impact of this development in the telecom sector, the likely effect will be continued fast accelerating cross-straits interdependence in sectors such as PC and notebook assembly, motherboard and other PC component manufacture, production of chip sets for mobile telephony and other applications, scanner and computer peripheral production, and lower end IC production.

A number of important trends will reinforce WTO financial linkages and commercial disciplines and tend to produce this outcome. First, the network of business relationships which Taiwan firms have established in China represents largely an extension into China of preexisting product and service supply chain relationships originally established in Taiwan. This greater Taiwan phenomenon in China, localized in growth centers such as Donguan in Guangdong, Xianen in Fujian, and increasingly in the greater Shanghai area, has now reached a critical mass sufficient for greater efficiency in the global supply chain.

Second, the commoditization of IT production worldwide is increasingly pressuring production costs, forcing manufacturers to distribute a growing number of lower end steps in their production processes to the world's lowest-cost production centers. Under more than a decade of the KMT or Guangdong's "Go South" policy, Taiwan manufacturers have quite fully exploited the advantages of relatively low-cost production centers in the Philippines, Thailand, and elsewhere in Southeast Asia, the one exception to that probably being an expected spurt of Taiwan investment in Vietnam following the ratification and implementation of the U.S.-Vietnam bilateral trade agreement.

At the same time, the KMTs, and now the new administration, the DPP's "go slow" policy vis-a-vis investment in the mainland has tended to limit the degree to which Taiwan firms could take advantage of the even lower costs of production in China. However, since cost pressure started mounting sharply in March 2000, Taiwan high-tech firms have found themselves no longer able to maintain global competitiveness without relocating a greater share of their production to China, the lowest cost major production center in the Asian production platform.

A third trend really represents a number of technology trends that underlie an emerging division of labor in high-tech production between Taiwan and the PRC. Without trying to go into any of these, I would just note the increasing specialization of national economies in the globalized IT industry segments. For instance, fully half of Finland's GDP is dedicated to wireless telephony.

Secondly, the migration of value away from hardware assembly and towards embedded software technologies in scanners, in peripherals, in Internet appliances, and so on.

And a third technology trend being the steep rise in investment costs and shorter product cycles in the IC semiconductor sector.

A fourth and final trend, the Taiwan and China markets are largely complementary, creating unique opportunities for commercial cooperation between these political rivals. For instance, Taiwan firms have generally failed to establish global brand and to capture the higher valuations that accrue to brand-name products. However, the large size of the China market, the skill and cultural familiarity of Taiwan business managers, and the high regard which China's consumers have for Taiwan's products are now giving Taiwan firms a chance to establish brand names on a large-scale regional basis as opposed to global basis.

Each one of these trends holds important implications for U.S. interests. The establishment of Taiwan regional brands might, for instance, tend to weaken the existing cooperative bonds between U.S. and Taiwan alliance partners and foster more direct competition in the region. Conversely, the combination of U.S. innovation, Taiwan regional management skill, and the largely untapped potential of the developing China market is already creating a set of opportunities for enhanced commercial cooperation among traditional U.S. and Taiwan partners.

The rapid proliferation of commercial ties between Taiwan and China is of major importance to U.S. interests. There are the narrower set of commercial implications for the U.S. competitive posture in regional and global markets, to which I have just alluded. Also, as Rupert Hammond Chambers, President of the U.S. ROC Business Council suggested in his June 14 testimony to this Commission, there are equally important implications which fast-growing commercial interdependence between Taiwan and China have for traditional U.S. military and security interests in the Straits of Taiwan.

I commend the Commission for focusing attention on the extent to which commercial dynamics in the computer electronics and telecommunications sectors are affecting these interests. It is my personal observation that these market and technology-driven dynamics are not always fully captured in the dialogue regarding our key interests in this potential flash point region of the world. Thank you very much.

[The statement follows:]

PREPARED STATEMENT OF MERRITT TODD COOKE, JR.

It is an honor to be asked to testify in front of this distinguished panel of Commissioners. It is also, personally, a distinct pleasure to see again a number of former Departmental and Embassy colleagues as well as others with whom I have had the past pleasure of working on various overseas and stateside activities. In the following brief statement, I will bring to bear my perspective as current Chief of the Commercial Section at the American Institute in Taiwan to address the issues identified by the Commission in its July 24th invitation letter.

The strategic interdependence of the U.S. and Taiwan economies has grown steadily throughout the 1990s as Taiwan's economy has shifted from its traditional structure as a labor-intensive, export-oriented economy towards a more services-oriented, investment- and technology-intensive economy. While Taiwan's industrial sector has shrunk in relative terms over this period, capital- and technology-intensive industries have expanded dramatically. These industries accounted for approximately 75 percent of total manufacturing in 2000, compared to 48 percent in 1986. During this structural transition, labor-intensive industries, such as toys, footwear, umbrellas, and garments, relocated offshore. Their place was taken by petrochemicals, metal products, machinery, and "most dramatically during the 1990s" by technology-oriented industries, such as electronic, electric, and information products.

By 2000, more than half of the top ten manufacturing firms in Taiwan were electronic and computer manufacturing firms, compared with only two in 1993. More than half of the top ten manufactured products were in the areas of integrated circuits (ICs), personal computers, and computer peripherals, whereas in 1993, only ICs had been among the top ten. Taiwan now supplies 60% of the world's motherboards and is the world's leading supplier of notebook computers, monitors, mice, keyboards, video cards, sound cards, on-off switches, LAN cards, graphics cards, scanners, and laser disk drives. Through the strength of its foundry model, Taiwan has emerged as a preeminent semiconductor supplier to the world. This transition from the production of labor-intensive goods to high-tech goods has, to date, proceeded relatively smoothly, even against the background turbulence of the Asian Financial Crisis in 1997–98 and a major earthquake occurring on September 21, 1999.

Against the broad backdrop of this structural transformation, two major dynamics have emerged: (1) the growing regional partnership and global interdependence of the U.S. and Taiwan high-tech industries and (2) the accelerating shift of the lower-end of Taiwan's high-tech production offshore, particularly to mainland China. One clear indicator of the degree of evolving interdependence with the U.S. was the fact that, following the 9–21(–99) earthquake in Taiwan, the tech markets in New York dropped more in percentage terms than in Taipei. The scale of this interdependence is likewise highlighted in other ways. For example, four of the top U.S. suppliers of PCs alone procured $20 billion (USD) of components from Taiwan to support their 1999 global sales. Additionally, Taiwan will soon have more state-of-the-art 300mm chip-wafer fabs in operation than the U.S., Germany, Japan or any other world market.

The accelerating shift of high-tech production from Taiwan to mainland China has been equally pronounced over this period. The Taiwan Government's Office of Budget, Accounting, and Statistics reported in February that government-approved Taiwan investments in China for 2000 more than doubled from the 1999 levels. The Taipei Computer Association reported in the same month that 30 percent of Taiwan's 411 high technology companies had established major investments in mainland China and that fully 90 percent of those 411 companies planned to be invested in China by the end of 2001. Lastly, China edged out Taiwan in 2000 for the first time for the number three slot in world IT production value. China came in behind the U.S. and Japan with $25.5 billion of production value against Taiwan in fourth place with $23 billion. The key point to note, however, is that Taiwanese companies generated fully 70% of that $25.5 production value in Mainland China.

The impending accessions of China and Taiwan to the WTO will likely further accelerate this process of growing cross-straits commercial interdependence in high-tech, with consequent implications for the already highly interdependent U.S. and Taiwan high-tech economies. Although Taiwan's relatively late liberalization and privatization of its fixed-line monopoly regime will limit somewhat the impact of this development in the telecoms sector, the likely effect will be continued fast-accelerating cross-straits interdependence in sectors such as PC and notebook assembly, motherboard and other PC component manufacture, production of chipsets for mobile telephony and other applications, scanner and computer peripheral production, and lower-end IC production. A number of important trends will reinforce WTO financial linkages and commercial disciplines and tend to produce this outcome:

—First, the network of business relationships which Taiwan firms have established in China represents largely an extension into China of pre-existing product and service supply-chain relationships originally established in Taiwan. This "Greater Taiwan" phenomenon in China, localized in growth centers such as Dongguan (Guangdong), Xiamen (Fujian) and, increasingly, the Greater Shanghai area, has now reached a critical mass sufficient for greater efficiency in the global supply chain;

—Second, the commoditization of IT production worldwide is increasingly pressuring production costs, forcing manufacturers to distribute a growing number of lower-end steps in their production processes to the world's lowest-cost production centers. Under more than a decade of the KMT's "Go South" policy, Taiwan manufacturers have quite fully exploited the advantages of relatively low-cost production centers in the Philippines, Thailand and elsewhere in Southeast Asia. (The exception to this being an expected spurt of Taiwan investment in Vietnam following the ratification and implementation of the U.S.-Vietnam Bilateral Trade Agreement). At the same time, the KMT's (and now the DPP's) "Go Slow" policy vis-à-vis investment in the mainland tended to limit the degree to which Taiwan firms could take advantage of the even lower costs-of-production in China. However, since cost pressures started mounting sharply in March 2000, Taiwan high-tech firms have found themselves no longer able to maintain global competitiveness without relocating a greater share of their production to China, the lowest-cost major production center in the Asian production platform;

—Third, a number of technology trends underlie an emerging division of labor in high-tech production between Taiwan and the PRC. Among these, are (a) the increasing specialization of national economies in globalized IT industry-segments (e.g., fully half of Finland's GDP is now generated from wireless related technologies); (b) the migration of value away from hardware assembly and towards imbedded software (e.g., scanners and other peripherals, Internet Appliances, etc.); and (c) the steep rise in investment cost and shorter product cycles in the IC/semiconductor sector; and

—Fourth, the Taiwan and China markets are largely complementary, creating unique opportunities for commercial cooperation between these political rivals. For instance, Taiwan firms have generally failed to establish global brands and to capture the higher market valuations that accrue to brand-name products. However, the large size of the China market, the skill and cultural familiarity of Taiwan business managers with that market, and the high regard which Chinese consumers have for Taiwan products, are now giving Taiwan firms the chance to establish brand-names on a large-scale regional basis. Further, Taiwan's proven skills in development and service-oriented management of global IT technologies, coupled with the breadth and potential of China's basic research capabilities, create distinct opportunities for partnership in regional innovation.

Each one of these trends holds important implications for U.S. interests. The establishment of Taiwan regional brands might, for instance, tend to weaken the existing cooperative bonds between U.S. and Taiwan alliance partners and foster more direct competition in the region. Conversely, the combination of U.S. innovation, Taiwan regional management skill, and the largely-untapped potential of the developing China market is already creating a set of opportunities for enhanced commercial cooperation among traditional U.S. and Taiwan partners.

The rapid proliferation of commercial ties between Taiwan and China is of major importance to U.S. interests. There are the narrower set of commercial implications for the U.S. competitive posture in regional and global markets, to which I have just alluded. Also, as Rupert Hammond-Chambers, President of the U.S.-R.O.C. (Taiwan) Business Council, suggested in his June 14 testimony to this Commission, there are equally important implications which fast-growing commercial interdependence between Taiwan and China have for traditional U.S. military and security interests in the Straits of Taiwan. I commend the Commission for focusing attention on the extent to which commercial dynamics in the computer electronics and telecommunications sectors are affecting these interests. It is my personal observation that these market- and technology-driven dynamics are not always fully captured in the dialogue regarding our key interests in this potential flashpoint region of the world.

PANEL V DISCUSSION AND QUESTIONS AND ANSWERS

Co-Chairman BECKER. I thank all three of you. Those were very interesting presentations.

We'll go forward with Commissioner Wessel.

Commissioner WESSEL. Thank you for being here this afternoon. Let me ask a question, if I can, about compliance, which we've heard a good bit about today, and the coming, I presume, coming of China into the WTO.

President Clinton was fond of talking about the 300-plus trade agreements that he signed or were reached under his administration. We've reached the China WTO agreement, which someone said is one of the largest trade agreements in history. We now seem ready to rush ahead with new trade negotiations when some are questioning whether China and others actually have the infrastructure, legal and otherwise, to actually implement their existing commitments, yet we'll then move forward and reach new ones before we've even ensured that the current rules are adhered to.

Mr. Fire, what are your concerns about that, if you have any, as well as the other panelists?

Mr. FIRE. Well, obviously, our concern is that we just don't have a level playing field with China, and as a matter of fact, with many other countries, in terms of our ability to compete. That's the fundamental problem. And the net result always is, with whatever kind of trade agreements we bargain, is that it ends up with a loss of the very best paying American jobs that there are.

When we negotiate agreements that provide for no labor standards and no concern about the environment, particularly from the labor standards aspect of it, I mean, we saw what happened to American jobs as a result of NAFTA. And now, how can we objectively or reasonably expect that based on the deal as we know it with China, that anything is going to happen except causing more and more loss of jobs?

If I can just personalize this a little bit, I come from the Mahoning Valley of Ohio, the Youngstown/Cleveland area. As my good friend George Becker will tell you, it is an economic wasteland. There were 50,000 steel jobs wiped out as a result of these so-called wonderful agreements that Mr. Clinton and others have negotiated.

The plant that I came out of myself, a General Motors plant, when I was president of the local union, we had 13,000 members, the very best job you could find as a working person in that particular area. They're down to 4,000 jobs today. In the meantime, this very same company, Packard Electric Division, now of Delphi, has 35,000 jobs in Mexico.

Now, we are obviously facing that same situation as far as China is concerned. So it's just, as you can, I'm sure, detect, the frustration that we have. We try to be responsible and reasonable and cooperative and do all the things the companies say we need to do to remain competitive, and what do we find out? More and more and more jobs. I don't understand.

Quite candidly, I have no expertise with regard to all the technicalities of these trade agreements. All I do know is that every time we sign one of these deals, it's fewer of the very best working class jobs in this country.

Not everybody's going to become a computer expert of some kind. Not everybody has the opportunities. A lot of working people to this point in time that can't afford to send their kids to college. When I got out of high school, I had all kinds of great opportunities—go to work in a steel mill, go to work in a car factory in Lourdestown, Ohio. I chose to go to work at the Packard Electric Division. I defy anybody to go to the Mahoning Valley today and find any kind of a job unless you have some skill, if you're an attorney or something like that, that's going to pay you more than $7 or $8 an hour with absolutely no benefits.

That's my long-winded answer. I'm sorry it's not more appropriate, perhaps, to the question, but that's how I feel in my heart about these things.

Commissioner WESSEL. The other panelists?

Mr. MCCURDY. Mike, I'm trying to make sure I answer your question. I think with regard to implementation that it's important that this Commission and policy makers and the administration look to the facts and they'll have to continue to determine what the facts are. As difficult as a global economy is, and there are transitions, there are also incredible upsides in this country.

Over the last decade, you see an industry that I happen to represent that account for ten percent of the workforce but accounted for over 45 percent of the increases in the GDP. And you also see on a regular basis there's no other industry that can abide by the model, which is it's generally better, smaller, faster, and cheaper every year. And in that, the consumer derives incredible benefits.

I have three college-age children. You should have seen the truck I had to rent to bring my daughter home from college this last summer after graduation, the computer equipment and the stereos and stuff that probably cost cheaper than the one I took to college back in the '70s.

So I think there's—I certainly appreciate and understand the frustrations that Mr. Fire experiences. My parents both worked and were members of the union. But the fact is, we don't stop globalization. The question is, can we work with it, can we help channel it, and how do we affect it in a positive way. I believe that effective treaties, well thought out treaties with enforcement are the best way to go.

Commissioner WESSEL. Let me ask a question, if I could, as well, Mr. McCurdy, since you have the unique background of not only having been on Armed Services, Intelligence, but now in the electronic industry, we've seen in recent days, I guess it's the Code Red worm which some have questioned whether its genesis is in China. We've seen a lot of cyber warfare. What is your industry doing? What concerns do you have about, as we expand the Internet, that, in fact, we're opening ourselves up to potentially devastating impact long term?

Mr. MCCURDY. Well, Mike, I spent a great deal of time and actually some shorter nights over the past few weeks monitoring the Code Red worm. This afternoon, I attended a board meeting. I'm on the board of the Software Engineering Institute of Carnegie Mellon University that runs the CERT, and the CERT is the global leader in identifying and addressing many of the computer viruses and threats to the Internet. In fact, it's too early. There's not enough forensic evidence to point to the source, if, in fact, we will be able to point to that.

But you'll recall there are incredible benefits to the use of the Internet. It's opening opportunities. It's a borderless technology. It's not U.S.-centric. There are no borders. And with regard to the Internet, consumers have to be aware, and as do businessmen, there's no such thing as Internet security. It's risk management. And you have to weigh the benefits versus the risk.

There will have to be increased best practices. There will have to be improved tools and an education effort. What you saw over the past few days was an unprecedented partnership between the government, whether it was law enforcement, intelligence, national security, and the private sector trying to alert consumers of a potential threat. It was not catastrophic, and it actually turned out to be less of a problem because of the effective downloading of patches and actions by consumers.

But unlike other appliances, it's not plug in and forget. It's not like your hair dryer or your toaster. You have to maintain some vigilance, and so as we get these benefits, it increases productivity, increases the quality of life, there are increased threats.

China, any country other than our own—there are 30 countries today developing the info war capability. I was involved in computer security issues with the Armed Services and Intelligence

Committee long before there was an Internet and I can assure you that it's only going to increase as a potential. But that doesn't mean we don't take advantage of it and continue to move forward.

Co-Chairman BECKER. Commissioner Mulloy?

Commissioner MULLOY. Thank you. Mr. McCurdy, on page two of your prepared testimony, you noted that we had $200 billion in exports of electronics in the year 2000. Do you know what amount we imported of electronics in the year 2000?

Mr. MCCURDY. Well, there was a trade deficit, and I can actually get the actual number for you if you——

Commissioner MULLOY. The total, worldwide? I'm not referring to China. I'm talking——

Mr. MCCURDY. Oh, I'm sorry.

Commissioner MULLOY. See, you first talk about worldwide. You say we're running $200 billion worth of exports. To China, we're running $4.2 billion worth of exports——

Mr. MCCURDY. Right.

Commissioner MULLOY. —which is quite different. Do you know what we're importing electronically, I mean, of those goods around the world?

Mr. MCCURDY. I can get you the details of that. But, in fact, there is a——

Commissioner MULLOY. No, worldwide.

Mr. MCCURDY. Yes, worldwide, and I'll get that number for the Commission. There is, I think as Mr. Cooke indicated, as well, there is an interesting relationship in the trade in electronics. There's a large number of component parts that are produced by U.S. firms on a global basis that are reimported to the United States for production assembly, and in many cases exported again, but I'll get you those numbers.

Commissioner MULLOY. All right. So we've got a $200 billion surplus worldwide. With China, we've got about $4 billion of exports. We've got $22 billion of imports. So in China, we're running an $18 billion deficit in higher value added goods made in——

Mr. MCCURDY. Right.

Commissioner MULLOY. —but this is supposedly an area that we're supposed to be a winner worldwide. We're losing out in textiles. We lose out in shoes. We say, okay, we can get—because we're going to be the winners in these other areas. But here, your testimony suggests, at least with China, we're not a winner.

Mr. MCCURDY. We've not been a winner from the standpoint of trade surplus, and the reason has been that China itself has not developed as the market. But over the past few years, you're seeing a transition there as their economy develops, as their economy matures. And again, I think Ambassador Lilley and Asian experts will tell you, any of us with experience in that region will tell you that you can't speak to China as a monolithic or single picture.

If you look at the urban areas and the coastal development, it's rather remarkable and the market is there developing for consumers, both U.S. produced, internal, imported to China, but also internal that will remain there with U.S. corporate interests.

Commissioner MULLOY. Let me, Mr. Fire, you noted that—and you left it out of your testimony but it's in your prepared testimony—that Mr. Welch said that the ideal plant would be on a barge so you can move it around the world wherever your costs of production were cheapest.

Mr. FIRE. Yes.

Commissioner MULLOY. Do you know, of the goods we're importing electronically, these goods that we're importing that are electronic from China, the $22 billion, what percentage of those are made by American plants that have relocated to ship back to this market?

Mr. FIRE. I don't have that, but we'll certainly try to.

Commissioner MULLOY. I think that would be helpful, to get that type of information.

Mr. FIRE. Okay. I'll do that.

Commissioner MULLOY. Now, Mr. McCurdy, on page two at the bottom of your testimony, you note that our industry utilizes China as a vital source of components that are then incorporated into larger, more advanced products.

Mr. MCCURDY. That's correct.

Commissioner MULLOY. You say, the availability of these components, which are often not produced domestically, are essential to the competitiveness of our industry. It seems to me there's a national security implication of what you're saying there, and I think Mr. Cooke, with regard to we're very dependent upon the Taiwan components, which you imply and Mr. Rupert Chambers said were migrating into China.

Is there a national security issue there with getting so dependent upon things that we don't make that are very important to our advanced electronics systems?

Mr. MCCURDY. Well, my testimony there, sir, refers a lot in the consumer electronics field where there are no national security implications. Primarily for weapons systems, there is not a dependence on foreign sources of componentry at the high end. These are more of less value added components. And again, the reason you're able to afford personal computers today that have higher speeds is because of the advancement in many of the technologies and the fact that these components are cheaper. But there is not a dependence and the United States military will testify here, as well, that they've been careful not to develop that.

There are some areas, quite frankly, that maybe are troubling, and it's not a question of traditional manufacturing but it's in areas of software engineering and others. Today, many—most of the software engineering is outsourced to different countries, including India. If you look at the capability maturity model, which is the highest quality of software development, 15 level ten facilities around the world, institutions, eight of them are in India. Now, it's not because there's a lack of job opportunities here. Quite frankly, we're not educating our own population in these areas and training them to provide this kind of expertise. That, to me, sir, is a greater national security interest that everyone should be focused on.

Commissioner MULLOY. Mr. McCurdy, you make the point that the dependence doesn't deal with national security because you're dealing with consumer electronics. Mr. Cooke, you're talking about information technology, which I think is a little different. Do you have any feel for whether we're getting ourselves into a difficulty with regard to being so dependent upon things that are now migrating into China?

Mr. COOKE. Although I have served in Shanghai back in 1988–90, that market knowledge is fairly stale, so I'm in the slightly awkward position of having current information only for Taiwan and less so for China.

The one security implication that I would offer in response to your question is I think the 9/21 earthquake in Taiwan did throw into relief implications for the United States for having that degree of high technology development in the IC area concentrated in what is both a geologically and somewhat politically unstable part of the world.

Commissioner MULLOY. Thank you, Mr. Chairman.

Co-Chairman BECKER. Yes. Let me exercise a chair privilege here before we move onto the next person.

When you say that's consumer electronics and that doesn't pose a national security threat because of the military application, are you really thinking that through well when you think that all of our industry, our stock market, our whole network of electricity, all operates on consumer electronics? Wouldn't that in many ways pose a greater national security threat in the United States, and even military application?

Mr. MCCURDY. Commissioner, there are a number of ways of defining national security. I was responding in the traditional sense. I mean, you can talk about economic security and economic dependence. There's clearly co-dependence. With all respect to Mr. Cooke's analogy, there are concentrations of production in many areas that could be subject to climatic change or earthquakes or whatever, and Taiwan's an ally and so there is some co-dependency.

The fact of the matter is, in a global economy, there is co-dependency and that can work to our benefit. We don't have to be held hostage. Not too many years ago in the Cold War, when we had co-com restrictions, we lost opportunities for expanding jobs and technology in this country and this industry has only grown.

If you look at the current recession in telecom today, it's not because of agreements with China. It's because of some regulatory rules in this country, in an old infrastructure, in a regulated structure that has caused some blockage in broadband deployment and other areas. Those are things that we ought to be focusing on.

In the future, it's important for us to increase the markets that we can sell our products to. Ninety-five percent of the markets reside outside the United States. This is a borderless world today with regard to the economy and it's only going to increase and I think we have to be smart about how we address it.

And just trade agreements that are blindly enacted are not going to help, but they have to be negotiated with a view as to how we continue to provide leadership to promote effective opening of markets.

Co-Chairman BECKER. I was interpreting the question and your response to the transfer of the computer technology and electronics technology from Taiwan into mainland China. There's a question in a lot of people's mind as to whether or not we really have an adversarial relationship with China or if this in of itself doesn't pose some risk in the future as far as our stability in this country, to put all of our computer technology into mainland China, out of our control?

Mr. MCCURDY. First of all, Commissioner, the facts would not bear out that China has a disproportionate share of computer technology. There are a number of facilities there. They are increasing their production of components. But you go throughout Asia, you go throughout other parts of the world, in Latin America, Malaysia today, some of the biggest chip manufacturers are there, in Korea. Again, Asia is a very vital region and it is an area—Japan—where we have strong relationships and ties. I think that will increase over time.

With regard to the China-Taiwan situation, those of us who had some experience—and that's why I have gray hair now—is with regard to China and Taiwan is that there really wasn't a clear cut—we had a policy of designed ambiguity because we didn't have any clear choices there. What you're seeing in the increased investment from Taiwan into China, many would view as a positive sign that they may, in fact, have an advantage to influence that government over the long term over others, and I think it's going to come from within.

If you recall in my statement, when you have 22 million Internet users in China today, that's far more effective in bringing democracy and openness and change than were the hundreds or 1,000 faxes that we had in Russia when we were dealing with a communist regime there. And those of us who fought diligently to help bring down the Soviet empire and to change that actually believe this is the kind of technology that we should promote, because they're not going to be able to regulate that. Just as we can't prevent all the viruses, guess what, they can't clamp down on all the information flow.

And information, if there's a battle between information, I'll tell you what, we in the United States and we in the West in promoting democracy have a far better argument and are going to win every time over the closed communist regime in China, and they know it and they fear it, but guess what, they can't control it.

Commissioner WESSEL. Can I ask just a very quick follow-up? Two weeks ago, I believe, China closed down its 2,000 Internet cafes. Is that something we should be concerned with, based on what you were talking about in terms of the flow of information?

Mr. MCCURDY. Obviously, any time there is an act of censorship, we should speak out against it, but it's short term. The Chinese mindset looks at a time line much different than ours, and we often get focused on one or two years or even quarters or balance sheets or quarterly returns. You have to look at the longer term.

The trend lines are clear in China. I think they recognize it. I think the leadership that grew up in the Shanghai area of China recognize it and they're trying to hold on as best they can against that tide.

I would actually think a longer term concern, and you didn't ask me here to give this advice, but I think Ambassador Lilley raises a very interesting strategic question, and that is what happens—because this is a global issue, and that is it's important in our industries, and I know it goes against traditional kind of protectionist thinking, but in our industries, there is a real concern that we share technology with developing countries because there is a growing have/have not discrepancy, and it's technological haves. And it's no longer just capital and resources and technology. As Peter Drucker said, we won't have rich and poor nations, we'll have informed, knowledgeable, and ignorant nations, and we can't afford to have that discrepancy.

What I would be concerned about in the long term is in the emergence of potential instabilities within China between their intellectual information haves, and financially empowered haves, and the larger population of have nots. If we had 1.3 billion people in this country, that would keep a lot of policy makers up at night, and that's their challenge.

Co-Chairman BECKER. Commissioner Dreyer?

Commissioner DREYER. Yes. I must admit, you struck a responsive note there with your story of the truck coming home from college. We've just done that ourselves, the refrigerators and all.

Mr. MCCURDY. Oh, yeah.

Commissioner DREYER. I was interested in your statement about patient but firm diplomacy. What would you say to somebody who's a skeptic about this, meaning me, of course. Patient but firm diplomacy is fine, but the Chinese are very patient and they're very firm, so we get nowhere. There are a lot of people who wouldn't agree that the end result of the reconnaissance plane incident—we don't say spy plane incident—is not really to our benefit, but let's get away from that particular instance.

The Chinese have shown themselves to be far more patient and far more firm than we are. Suppose dialogue doesn't end up getting the results we want. You know, nobody's industry wants to be punished. Where do we go from there?

Mr. MCCURDY. Well, my view, and I have to back off a little bit because our questions are becoming a little more philosophical than maybe industry-specific, so I want to make sure that I'm not speaking for an entire industry if I make this particular comment, but with regard to the reconnaissance aircraft, and having chaired the Intelligence Committee and being a patriot who believes that there are national security interests and national interests in making sure that we have opportunities to acquire information and to provide stability throughout that region, that was a very unfortunate incident. I believe it was a provocation by the Chinese.

But I also believe that sometimes you have to look from their perspective, and if we had Soviet bears, as we used to, patrolling the West Coast of the United States, as an Air Force reservist, I can tell you, there were a few times that we probably got a little close on those.

But the fact of the matter is, it's how we reacted to it that proved right. And there were those within this administration, perhaps, and even within the Republican Party that might have hoped that Colin Powell failed. But I think he and Secretary Armitage handled it extremely well.

Commissioner DREYER. Okay, but getting away from that——

Mr. MCCURDY. And that was patient and firm, and whether it was boxed up and sent back, you know, we can debate that all you want. But the fact of the matter is, cooler heads prevailed on both sides. In that instance, what we learned from the Chinese experience there, I believe, and I'll defer to better experts, is that that was an unusual incident where the military had the upper hand. We gave them an opportunity to exert pressure on their own leadership and that's not what we want. We don't want the military to be calling shots in China. We want the civilian leadership that's going to be motivated by economic interests and other interests to eventually provide the direction for that country.

I'm sorry. I probably didn't answer your question all the way, but I didn't want to——

Commissioner DREYER. The real question was, what if patient diplomacy doesn't work?

Mr. MCCURDY. Well, you can't just talk.

Commissioner DREYER. You just keep talking?

Mr. MCCURDY. No. Obviously, you don't just keep talking, and again, you base things on fact. I supported—with regard to Taiwan Straits, I think Secretary Perry at the time and President Clinton were absolutely right to deploy carriers into that region to demonstrate forcefully that we had commitments and we were going to live up to those commitments, and that wasn't just talk. And I think this administration would not hesitate in that kind of situation, either. So it's not a partisan issue. It's not an ideological issue. It's a clear demonstration that there are lines that are drawn and will be drawn and it has to be in the economic realm as well as military.

However, you have to look at the success rate of sanctions over the years. Ma'am, I tell you, when I was chairman of the Intelligence Committee, all my years on the Intelligence Committee, I lost bets every year because I bet this was Castro's last year, and I lost. And the fact of the matter, those sanctions really—you know, when we look at those, we have to question. Look at what Congress did the other day. I think it's time we reevaluate our positions.

Commissioner DREYER. Look at the EU sanctions on Austria.

Mr. MCCURDY. Certainly. Yes, absolutely. Sanctions are not terribly effective, especially in the global economy. So we have to look at other methods.

Commissioner LILLEY. Can I weigh in on this, Mr. Chairman?

Co-Chairman BECKER. Yes.

Commissioner LILLEY. But anyway, I think you've hit on something really very important. I think it's at the guts of this whole Commission, what we're all about, is the relationship between security and economy, and it's lying in there in this report. You can draw certain conclusions out of it that this is going to take us down a path of dependency and all this sort of thing.

On the other hand, I think the possibility is you've just broken the rice bowl of 100 China experts that watch the security aspect, because all they want to do is count missiles on the Taiwan-China coast and missile defense and one China, three systems, sovereignty, unity, independence, and all that. That goes on and on and on.

If you start talking money, commerce, trade, dynamism, their eyes glaze over. I mean, you make that point that it's underemphasized here. I can tell you, that is very true. That is very true.

And the argument that's made by even your most so-called expert China hands is that security situations will always trump economic dynamism.

Next question. Having been around China for a while, I'm not sure that applies. Something is in process here that I think is a very fundamental question that this panel needs to deal with and it would take—I would think we could have our hearings on this one question. Does the economic dynamism between Taiwan and China diffuse the so-called flash point in the Taiwan Straits?

This is the key question. You've got these Cassandras running around here saying the sky is falling because China will lose a million men to take Taiwan and on it goes. You've heard it ad nauseam.

The Chinese don't think that way. They never have. It's very calculating. They've got a tremendous dependence on Taiwan for growth, which in turn leads to social stability, which in turn leads to the perpetuation of the regime.

The regime now, at least if you follow the Tiananmen papers and on through to what we're hearing now from Willie Lam and a few other columns that have come out recently, have come out and said—and it's in this book, too—that the leadership in China is split and Taiwan plays a role in this, in Chinese domestic politics, because the people that make the argument, going back to your EP-3 incident off Hainan, yes, the military was in the beginning, but they lied to their leadership. They lied to Jiang Zemin and he goes off and demands an apology. All of a sudden, he gets the facts, and when he went to Latin America, I understand he gave two instructions. One, I want this thing cleaned up by the time I get back, and two, I want civilians in control.

If you look back at the WTO arguments, Zhu Rongji in April '99 getting the deal six months later despite the accidental bombing, Zhu Rongji's called everything from a running dog of the Americans to a traitor to the Chinese race. They got a deal six months later.

Bob Zoellick goes over there in May with Jeff Bader—thank God he had Jeff with him—and they got another deal.

There are forces in China, which we can track if we spend the time doing it, that are making an argument in there for the expansion of the trade economic leverage because they think they can take us on. As you hear today, in many ways, they're getting the better of us. Certainly our labor union people are suffering. They've got this huge trade surplus. They've built up foreign exchange reserves. They buy Russian weaponry. It looks like a pretty good deal.

But this is fragile. It depends on their ability to keep their economy running and they're dependent on the United States and Taiwan. That's what I call leverage.

It seems to me we should be spending a great deal more time on what Terry's talked about in his paper, the economic leverage we get over China, sort of the chain of globalization from Taipei to Shanghai to Silicon Valley. That is the crux of what I think we deal with, because that can trump the military card.

The EP–3 thing did one thing for us, and you can argue about George W. Bush's statement on Taiwan. I think he said exactly the right thing. You got the strategic ambiguity out of the way. You made it clear. You made an arms sale. You've got the Chen Shuibian going through and treating him like a civilized human being. You saw the Dalai Lama and you said, okay, we put this behind us and we get on with trade.

But we're not going to get into this long-winded watering contest with you about military matters, and that ties us in knots and the people love it. They just want to talk about it endlessly, write books about it, this military confrontation, and we miss the point.

I hope as we develop this in terms of our own charter here that we look very carefully with the economic dynamism, with all of its downsides in terms of our labor unions and places like this and see how we can use it to bring about a more stable atmosphere.

And I do think that the one thing you want to do is to take the military option off the table for China, and I think that's been done. I think there are people that are arguing in China—we know there are people arguing in China saying, you're in no position to take on the United States militarily. Back off. You can have your tri-service exercises on islands, but don't take it seriously. The serious business is investment from Taiwan.

Commissioner DREYER. And don't try to outspend them militarily.

Commissioner LILLEY. But you're going to have a lot of people running around China pushing this line, and they write some perfectly awful stuff about us and we'll hear it from Pillsbury tomorrow.

Co-Chairman BECKER. We have three more. Chairman D'Amato, followed by Ken Lewis and Roger Robinson and Bill.

Chairman D'AMATO. And before I ask a question, well said. Hear, hear. Bravo on those comments.

Along those lines, I also want to congratulate you on your testimony. I thought that was very interesting. I want to follow up with a question. I'm not sure how to handle this trend, if it's a trend, but I want to ask you about it.

You talk about equally important implications which fast growing commercial interdependence between Taiwan and China have for traditional U.S. military security interests in the Straits of Taiwan. Here we have a report last Saturday in the New York Times, the first I've seen such a thing about the leadership of Dell Computer going to the leadership of Taiwan, direct pressure to establish "direct trade and transportation ties with the Chinese mainland."

I thought that was a function of the United States Government, not the Dell Computer leadership, but this indicates to me that this tri-part—this relationship—Dell is doing the business of the Beijing regime in terms of what it wants to happen in terms of the Taiwan-Beijing relationship here, it would appear to me. Maybe you can comment on that.

My question is, how much of this is going on below the waterline? Are other major companies—I mean, is this a strategy that is being used by more and more companies at the request of the Beijing regime to change this relationship in this way, and do you see that over there? Do you see this kind of behavior more and more?

Mr. COOKE. There are a couple of elements to that question, and first of all, thanks to both you and Ambassador Lilley for the kind words.

First of all, there clearly is a conscious strategy by Beijing to not talk to the current government in power in Taiwan and to talk to everybody else. That includes local and city mayors, it includes the opposition parties, it includes the business community in Taiwan. So Beijing will talk to everybody except the current leadership.

The viewpoints that were expressed in that article about Dell are most commonly heard by the Taiwan—heard from the Taiwan high-tech community, and virtually unanimously from the high-tech community. And in my personal view, the fact that a Dell says it or an Acer Computer says it reflects primarily a reality in global business, which is that in recent years, in order to compete with North America and Europe globally, any global company has to take advantage of the complete Asian production platform.

If you are in complex IT manufacturing, if you're trying to do the whole thing from soup to nuts in one country, you're not going to be able to compete. And in every single segment of the high-tech industry, you see this. You see the design for a chip fab coming from one place, the investment in the fab being somewhere else, the wafer cut in a third country, and then the back end assembly in a fourth country.

From the point of view of the Asian production platform, there's an artificial political constraint in doing business across the Strait of Taiwan, and I think what you are really hearing is not, in my personal view is not any Taiwan companies doing Beijing's business. What you hear is that they—or any foreign company that is a Taiwan partner and a Taiwan alliance partner, so much doing Beijing's business as it is the pressures that they're under since the fall of the NASDAQ and the absolute pressure on them to wring costs out of a regional production platform.

Chairman D'AMATO. Well, let me pursue that question. On your first page of your testimony, you talk about the growing regional partnership and the accelerated shift of the lower end of Taiwan's high-tech production offshore, mainly—particularly to China. Now, it sounds to me like what this involves then is moving above the lower end, the pressure being to move to a higher end into Beijing from the mainland—into the mainland.

Mr. COOKE. My understanding actually of Dell's business model is that they need the sourcing of some of the lower-end componentry from Beijing, not the top end. And, in fact, this goes back to the point I made before. I think it illustrate how great the interdependence is in this region of the world.

When I mentioned the security implications of a concentration of fabs in Taiwan, the Taiwan government itself appears to share exactly the perspective of the U.S. that it is problematic to have so much clustered in one part of the world, because all of the fabs in Taiwan were in the north, which is where the fault lines are, and they have since done two things since September of 1999. They've moved their most sophisticated fabs down south, farther away from the fault lines, and they're starting to take and even give policy backing to taking the lowest end of chip production, which was always barred from China, the six-inch, and on a case-by-case basis, the eight-inch fab production, and allowing that to go to China.

And that's the general trend, whether you look at it in the IC sector or in notebook computers. There is a differentiated farming out of steps of the production process to the places where it's cheapest, and especially now under the cost pressures of a difficult IT business environment.

Chairman D'AMATO. Well, it would seem to me that it validates what the Ambassador just said about the growing interdependence, economic interdependence. If this pressure is occurring at various levels to go across the strait, it has to affect the strategic equation, without any doubt, and be perhaps the single most important effect on that equation, and how we evaluate that is important.

I have one other question I want to ask Mr. Fire, and that is the trade in computer electronics and telecommunications demonstrates that technological leadership does not ensure a trade surplus for the United States, in part because of increasing subcontracting, a product manufactured in lower-cost countries.

Do you think that the U.S. trade deficit in these important industries will continue to rise, particularly given this kind of behavior? Regardless of China's WTO accession, do you think that we need to start taking steps to evaluate whether or not that's in our fundamental national interest for that——

Mr. FIRE. I think that is the question. I think the entire issue of trade with China, number one, is whether it is in the best interest of the United States and the people of the United States, obviously from an economic standpoint, and secondly, while I don't claim to have the knowledge or the expertise of Mr. McCurdy with regard to these issues, one of the things that I often think about, as I'm sure most other people do, is by exporting all of this sophisticated technology to countries like China, which I think it's reasonable to say, does not have the most sterling human rights record, for example, which has demonstrated historically that their concerns first, last, and always is what's happening to their county and to their people, whether there is, in fact, or there is developing a national security interest.

If I may just add to that, on the whole question of, well, traditional manufacturing maybe doesn't have the significance in this country that it once did, I wonder about that, too. I wonder whether it is in the interest of the United States not to have a thriving steel industry, for example, and I've heard George Becker say this. It is—and you probably heard it from Leo Gerard this morning.

Chairman D'AMATO. And from the President of U.S. Steel.

Mr. FIRE. Yeah. Eighteen steel companies in bankruptcy in this country. I mean, if this doesn't raise at least a question in your mind about is there a national security issue or not, I don't know.

Lee Iacocca, of all people, said, you know, the definition of an institution, of a country that exports raw materials and imports finished goods, you know what that definition is?

Commissioner MULLOY. A colony.

Mr. FIRE. It's a colony, that's exactly right. And so I think as we go forward with all these things, aside from the profound impact on the jobs of people that we represent, I think we have to be concerned about these other issues, as well, and I think that is a tremendous challenge for this Commission, to get to the point you just raised, Mr. Chairman, about are there really legitimate national security interests involved. I think that there are, very frankly.

Chairman D'AMATO. And just to follow up, one quick point is that it seems to me there are certain thresholds you start reaching when the level and volume and sophistication of that trend reaches certain thresholds, certain changes occur in the relationships between countries, which are still sovereign nations in this world.

Mr. FIRE. That's exactly right.

Co-Chairman BECKER. Before I pass it on again, and since I'm not signing up to ask questions, I just want to shoot something in every once in a while that bothers me a little bit.

I think there's a difference, and Ed, I would ask you if you concur on this, I think there's a difference between trading with another nation and shutting down industry in your nation and shipping it to another nation in order to import back. That's not—I've never viewed that as trade.

A CEO of a large corporation that decides that he's going to dismantle all the manufacturing in a certain industry in the United States and put it in another country, I think that should be dealt with maybe within the framework of these trade agreements. But I think it can be dealt with different than free trade. I don't consider that free trade.

Mr. FIRE. I agree with you, too, and I think—George, obviously, I agree with you, but I think, also, you have to put the entire question of trade into perspective in terms of what's happened to this country over the last 20 to 30 years.

I know this much. I know that in the past 20 to 25 years, four million union manufacturing jobs have been lost in this country, replaced by what? Replaced by jobs that pay $7 or $8 an hour. In a typical working class family now, it's not one person, it's not one person being the breadwinner because they can't make enough money. That's all there is. It's two and it's sometimes three.

And the question becomes on all of these issues, is that in the interest of the United States of America to create this kind of a society where some of us are doing extremely well and moving up higher and higher and the working class of people are going down lower and lower? We are, in fact, it seems to me, in some respects, developing a two-tier society, and it is all tied to the economy and globalization.

I would make this point, as well. When you see what happened in Seattle and when you see what happened in Quebec and when you see what happened in Genoa, and by no stretch of the imagination am I going to defend these people who put masks over their face and do the kinds of things, but there's a whole lot of other people that are saying something there about the impact of globalization on ordinary people in this country, and I would hope that this Commission addresses that issue.

Co-Chairman BECKER. Thank you. Commissioner Lewis?

Commissioner LEWIS. I've got three questions that I'd like to ask you. Is there any kind of conduct in a country that you would say is so heinous that we shouldn't participate in investing and buying goods from that country?

Mr. MCCURDY. Absolutely.

Commissioner LEWIS. Where do you draw the line?

Mr. MCCURDY. I supported the sanctions against South Africa, and it's one of the one instances where, in fact, it made a huge difference and it was right. And there, we, on a bipartisan basis, decried apartheid and we worked effectively, because it was a very clear threat and it was wrong. It was morally wrong. It was against the best interest of our country and the world. And there was consensus around the world for that and that was a very clear case. So, yes, absolutely.

Commissioner LEWIS. If a country doesn't allow free speech and if a country doesn't allow free religion, if a country doesn't allow free association for unions, what more do they need—and they start throwing in jail people who start protesting because they're not being paid, what more does a country have to do before you finally say, we shouldn't really be buying their goods?

Mr. MCCURDY. In those instances, again, and you have to look at it case-by-case and country, and there are some countries where we have actual influence, but unilateral action often does not work. Even though we're the economic leader of the world, because of the interdependencies, when we have allies, and I don't care, we take other examples, whether it's Iraq or Iran or other parts of the world where human rights are abused, then it's incumbent upon a world leader to try to rally forces together and get consensus. We had——

Commissioner LEWIS. But it's tough when business is chasing the buck, as we know from Nazi Germany and from Japan before World War II.

Mr. MCCURDY. Commissioner, and that's true and we can look at those examples, but I'll also say that I've walked in facilities in plants around the world, both as a member of Congress and the private sector, where, in fact, they have raised the standard of living, and people, again, regardless of the wage offered, it was far better than anything else offered in that region. And there are very positive lessons learned.

I don't think any of us would dispute the fact that free market liberal democracy is a far better system and a model that will win out in the long term. There are abuses within it and there are excesses in some areas and we should as society and human beings work to improve those.

But I also believe in my experience that we as a nation have to be very careful not to impose in some ways our values and beliefs on others. In many developing countries, as much as I believe in strong environmental policies, some people don't have the luxury to make those options and choices. There are going to have to be alternatives developed, and quite frankly, I'm not sure that I've seen a clear model of administrations in the last four that I've worked with that have solved that problem, and I think it's going to take some unique leadership to have to look at those.

Commissioner LEWIS. Let me go on to question number two. This morning, we heard that a steel industry is really essential for a functioning society, and perhaps an electronics industry is essential for a functioning society. Is there any industry in America that is really safe if a country with low-cost labor targets that industry and says, we can capture that industry, whether it's TV sets or whether it's the steel industry or whether it's electronics, making telephones, computer chips, whatever it is? Is there any industry in America that's ultimately safe?

Mr. MCCURDY. Our industry that I deal with is one of the most price competitive of any around the world. It's also one that has the highest potential return for a country as far as improving the quality of life. That's why so many countries would love to be in our position.

And as dire as some of the statistics are and the personal stories, I'd beseech you to look at the country as a whole. I've not been in many countries that are—you can go across the spectrum and see the improved quality of life that's occurred in just our lifetimes——

Commissioner LEWIS. Except we know that——

Mr. MCCURDY. In this country.

Commissioner LEWIS. —until three years ago, the standard of living for 80 percent of Americans decreased over the last 20 years. We know that.

Mr. MCCURDY. If you look at—I'll be glad to look at statistics with you and comparisons, but if you look at the questions across America today, whether people believe they are better off today, that they have higher choices and better choices and that they believe with confidence that their future is going to be better and that their children will have better lives than their parents did, I believe it shows that this country is the strongest.

Commissioner LEWIS. And then finally, my last question.

Mr. MCCURDY. I hate to be so philosophical, but those are kind of broad questions.

Commissioner LEWIS. We're dealing with very philosophical questions.

The last question is, if American companies like General Motors couldn't invest in Russia or in China and if the foreign governments didn't allow American companies to invest there but they allowed the French and the British to invest there and the British and the French invested in these foreign countries and started shipping goods back to America, competing with General Motors and U.S. Steel and so on, what would be the reaction of U.S. companies?

Mr. MCCURDY. Well, I think that's one of the reasons we've argued for WTO and changing non-tariff barriers and being careful about unilateral export controls when we don't have consensus, and China is the perfect example, because, quite frankly, the French, not necessarily the British, but other of our so-called allies are investing in those areas and have invested for years and, in fact, have a competitive advantage, not necessarily price advantage, but they do have political advantage because they've maintained relationships. And at some point there becomes a price, because we are looking at long-term potential markets.

When you look at 1.3 billion people that are industrious, that have potential to be educated, that want to be free, that want to have choices, I think that is a very dynamic market that, quite frankly, I believe as Americans we'd like to take advantage of.

Commissioner LEWIS. Except we're running an $85 billion deficit with them.

Mr. MCCURDY. Because it's not developed as a market yet because they haven't had the opportunities. But you look at the trend lines. Go to Shanghai.

Commissioner LEWIS. I have.

Mr. MCCURDY. I know. I mean, it's pretty impressive. It used to be the crane was one of the symbolic—the animal. The crane was one of the symbolisms of China. Now, it's the construction crane.

Commissioner LEWIS. Don't you find it——

Co-Chairman BECKER. Do you have reason to believe that that deficit will go down?

Mr. MCCURDY. I'm sorry?

Co-Chairman BECKER. Do you have reason to believe, anything of substance that would indicate that the deficit goes down? Everything I've read with their accession into the WTO is that the deficit is going to increase.

Mr. MCCURDY. Well, I can't predict what the deficit will be. You may think this is heresy, but I'm not sure that deficits are the single most important economic indicator when it comes to economic relations with countries. It's troubling and I don't like it, but we can't have constructive trade and relations and have totally lopsided, one-sided positions. Then you don't have trade. There are compromises and changes in a dynamic system and that's what competition is about.

Commissioner LEWIS. But everybody says this deficit is unsustainable on our side. Greenspan says it. Rubin says it. I mean, Volker says it. Everybody says——

Commissioner MULLOY. You mean the total?

Commissioner LEWIS. Yeah, the total.

Mr. MCCURDY. The total, yeah. I think the total is true. But let's also look—this is not the jurisdiction of this Commission, but let's also look at the U.S. savings rate. I don't think that can be sustained over time, and I think there are many other indicators and facts that we have to focus on. I don't think the education level can be sustained and the lack of education, and I don't think the declining institutions can be sustained in this country, and I don't believe that the skills gap can be sustained, and that's areas that the government should, in fact, focus and make investments and try to provide leadership.

If you went to rural parts of——

Commissioner LEWIS. Our higher ed must be doing something right, because the world's sending their students here.

Co-Chairman BECKER. Let's get two more, very quickly. Commissioner Robinson?

Commissioner ROBINSON. Well, as usual, Commissioner Lewis has covered the important landscape, so in an effort to earn the gratitude of my fellow Commissioners and perhaps that of the panelists, as well, I'm going to waive my opportunity, Mr. Chairman.

Co-Chairman BECKER. The last one, then, is Commissioner Reinsch, and he won't waive his.

Commissioner REINSCH. No, actually, Mr. Fire in his own way responded to the question I was going to ask, so I think I'll just say that I think this has been an exceptionally thoughtful panel. Each of you have made your points, I thought, very articulately and very thoughtfully, not that you all agree, and shouldn't, but it's been, I think, a wonderful disquisition for us.

The thought I'd leave you with is, to go back to something that Mr. McCurdy mentioned, which I think he mentioned several times, is the word "globalization," which is really what we're talking about here, and that's not China's fault. It's a global trend. In fact, some of the other panels we had left on the table the suggestion that to the extent some industries, the steel industry being a good example, had a lot of problems, China was only a small part of them. They may be a bigger part later, but right now, they're a small part and we're dealing with a global phenomenon.

I don't think we're going to go backwards, and I suspect what you're going to see is a lot more of the kinds of platform development, if you will, that Mr. Cooke talked about, not just between Taiwan and China, but everything is going to be made everywhere in pieces and the question is, how do you cope with that, how do you, Mr. Fire, cope with that, in particular.

Ken's comment was, are any of our industries going to survive, and I think the answer to that is yes, clearly. Mr. McCurdy's industry is going to survive. They are going to survive because they run faster than everybody else and because they're smarter than everybody else and because they maintain market share by capturing the high end.

Now, one of the dirty little secrets of that, though, is that in order to do that, they have to generate profits in order to continue to invest, and in order to do that, they have to export. That's particularly true with the computer industry, which is what we've been going around and around about in another context. If they don't export, they're not going to make any money. If they don't make any money, they're not going to stay ahead of the pack.

So you need to think about how do we encourage them to do what they want to do? There's nothing wrong with them making money. It actually is good that they're making money and plowing it back in. And how do we, at the same time, deal with the consequences of the accelerated economic change that globalization provides?

Mr. Fire's in the worst position of all because a lot of the workers he's talking about, I suspect, are my age or a little bit younger, don't have a lot of skills, live in communities where there are not a lot of other alternatives, and are not at a point in their lives emotionally or financially where they're prepared to explore other alternatives.

I mean, I lived through, when I worked for Senator Heinz, the steel industry losing two-thirds of its workforce then in the 1980s. And when you asked somebody to find a new job, what you were actually asking a third or fourth generation steelworker to do is, in effect, leave Pittsburgh or leave the Mon Valley, leave his parents, leave his grandparents, and go somewhere out in the Midwest where the unemployment rate was four percent and do something completely different for one-third the wage. That's very difficult, and one of the things that's outside our purview is things you can do about that that are remedial.

But I'd also just commend Mr. McCurdy on making what I thought was one of the most important observations, which is we also ought to be thinking not just about those people but about the next generation and are we preparing them, because if we're not, they're going to go through the same cycle.

And the answer is, we're not, because he's right. Our education system, I think, is deficient, and that's one of the biggest problems we have to deal with.

Why did we used to have, until chunks of the high-tech sector imploded, why did we have a big H1B crisis? Well, we had an H1B crisis because there weren't enough Americans with good enough educations to take these jobs, and now that they're not hiring anybody, that doesn't matter quite as much, but it says something about our system.

So I guess I don't have a question and it's late and everybody wants to go home, so I'll stop talking.

Co-Chairman BECKER. We have one more—wait one second, Pat, and then I'll turn it over to you. I just want to make an observation.

This has been a very good day. It's been a long day. We started at eight o'clock this morning. Each panel that we've had, I think, I've felt that that's the best panel that we've had so far today, and we've worked up to the end and you're the end——

Mr. MCCURDY. We're the best.

[Laughter.]

Co-Chairman BECKER. I mean, it was just delightful. I disagree strenuously on a few points that you made there, and I would love to carry those on someplace with a bottle of beer.

Mr. MCCURDY. Maybe we'll have to go to dinner sometime. We'd be glad to do that.

Co-Chairman BECKER. Yes, we could do that. Pat had a comment he wanted to make.

Commissioner MULLOY. I think Ambassador Lilley hit a key point. The investment from Taiwan into China, and I think that diffuses a flash point in terms of our national security interest. I think that's good.

But the worry for me is the larger economic issue that Mr. Fire has talked about and that has been talked about by other people today, the downgrading of skills of people that once had good jobs and that are driven out as these jobs migrate abroad.

Now, we had at our first hearing Bill Wolman, who's the chief economist of Business Week magazine, and he said what is going on here is that there is a proportion of our population that's doing well off this globalization, but the problem is we're not taking care through other public policies of the people who aren't doing as well in terms of providing education and in terms of providing other types of economic assistance. Something needs to be done.

Otherwise, my view, Mr. McCurdy, is you made the point about the difference between the rich and the poor in China, being unstable. I don't want the United States, as we pursue this course, to get into that type of situation, and that's what worries me because I think that is a national security issue writ large.

Mr. MCCURDY. And I would agree with you and I endorse what you say. I tried to make the point on several occasions, that is an unsustainable gap that is occurring. I mentioned the decline of institutions, I mentioned the skills gap, and I think a third factor is that the melting pot in this country needs to continue to melt and that people, regardless of race or background or ethnicity, need opportunities to improve the quality of life.

In immigration, and I know there are some who like to throw up the walls, but, in fact, immigration has made this country. My ancestors, and it hasn't been that long ago, homesteaded in Indian territory in Oklahoma, and my family, my dad and mom both worked on the shop floor. And the skills they had, they got good wages for probably not the highest skills level, with high school education. But all four of their sons have college educations and continue to improve, and you see the successive generations. That is an American dream that we want everyone in this country to have an opportunity.

Also, likewise, in countries around the world, I believe we have an obligation as the richest country in the world to try to help those countries address some of those plights.

Co-Chairman BECKER. We have an obligation. That's the part that's hard to define, "we." The decisions are being made, those that affect Ed and those that affect the steel industry, the textile industry, those are being made by manufacturers. Those are being made by somebody that is not under any direction of government.

We have no trade policy. They are doing this on themselves. If they decide to shut down an industry, they can do it, and they do do it. We've had industries just completely wiped out because one person decided—Ed mentioned Jack Welch, a very powerful man, the largest corporation in the world, moved the engine division to Mexico and then held a conference and pulled in all the suppliers here in the United States and told them they were going to relocate into Mexico or they would be wiped out. And there's communities and families that depended on that. They didn't want to go. They could make a profit. But he made that decision. But under our trading agreements, he can do that, and this brings about the heartache and the problems that the Ed Fires of this world have to deal with.

Mr. FIRE. Can I make just one comment? Then the tragedy, compounding the tragedy is that we collectively, we, the union, management, and the government, we are unable to find a way to deal with these issues. As we have gone through this revolution of globalization and the profound impact that that has had, as George just said, on so many lives, we can't get our act together.

When we've got a Democratic President, people like George and I and Mike rub our hands and say, oh, boy, we've got a friend. Now we're going to get something done. Okay, now we lost—well, we didn't lose it, but that's a whole other story.

Commissioner DREYER. Hey, wait a minute.

[Laughter.]

Mr. FIRE. Now we have a Republican President and I know that there's a whole bunch of my friends on the corporation side of the table who say, oh boy, now it's our turn to clean up.

And the point is that we just can't get it together in this country and sit down together and say, what the hell can we do to see to it that these companies do remain profitable so that they do have the money to invest to create additional jobs, but at the same time take care of the people who get left behind so that we don't have the devastation of a Youngstown, Ohio, for example.

If there's a challenge to this panel, go beyond what you're supposed to and come out with something like that.

Co-Chairman BECKER. That's why I admire so much your patience to sit here all day, because there is a vehicle. It may not be the most perfect vehicle, but we do have a voice and this Commission is looking at this as well as it possibly can and we're hearing a lot of testimony from a lot of people. We have a very broad charter in which to deal with and it gives us a lot of latitude. That's why I appreciated so much your comments on this.

Our permanent Chairman here wants to——

Chairman D'AMATO. I just have one question.

Co-Chairman BECKER. He wants to open up a whole new line of questioning.

[Laughter.]

Chairman D'AMATO. Oh, no, no. I just want to get your—just a quick thought from each of you on this one particular question because it's in our mandate, and it does have to do with this whole, I would say, confusion between what you call us, the melting pot, as we are, and this uniquely American stew that we have and this globalization thing. There is a certain contradiction in this which we're all wrestling with.

But part of our mandate is to take a look and see whether or not certain industries—steel, telecommunications, electronics, whatever it might be—is there a certain point where you have to take it out of the WTO framework because it's an industry that is profoundly central to our national security? In the GATT treaty, of course, there is a provision, which is a national security waiver, which carries over to the WTO. It hasn't been triggered. One of the things we want to look at is to see whether or not there is a technique to trigger a national security exception to the obligations under the WTO, because if you were to go all the way down that path, that industry goes away from us and we lose the national security aspect.

I just ask this question. Is it legitimate to look at that optic in terms of certain industries?

Mr. MCCURDY. Mr. Chairman——

Chairman D'AMATO. It's a tough question.

Mr. MCCURDY. No, it's a tough answer. I would just caution the Commission only from the standpoint that that becomes a slippery slope, because the concept of multilateral agreements is that you want other countries to exhibit the same behavior. And if, in fact, we start creating big exceptions for national security, we can start defining those in very, very broad context and, in fact, we may say, well, wait a minute, the Chinese may say it's agriculture is in their national security. They may say it's steel. We may say it's computer chips. That is a very, very difficult thing to adhere to.

So from my perspective, I think it's better that we as a nation try to understand what drives the economy. In those areas where we do have clear national security concerns, that we define those narrowly.

And I would also suggest that Secretary Rumsfeld is having a very difficult time today in looking at the culture and perhaps a

Cold War legacy culture in the Department of Defense to redefine what is national security and what is not and that there has to be a revolution in this.

So my only suggestion is that we have to be cautious.

Chairman D'AMATO. Use a scalpel.

Mr. MCCURDY. Yeah. And just for the Commission, I beg your indulgence for one minute. There's been a lot of statements about corporate leadership and I think there's a perception that all the corporate leadership in this country is driven by greed and, even though self-interest is the one human quality that we find around the world.

The fact of the matter is, I think most industry—and we urge in our industry and our leadership to stress responsibility, not just to talk—Steve Forbes gave a speech to one of our groups recently and I went up to him afterwards, and we worked together on the Radio Free Europe in the '80s and he asked me how he did and I said, you gave a good speech, better than I used to hear from you. But the fact that you talked a lot about rights, but one area that you didn't mention is responsibility, and I think that's what we as Americans need to remember. We have a lot of rights, but we also have responsibilities to give something back.

We gave an award to an industry leader earlier in the year. His name is Dr. Zandman. He's the CEO of a company called Vishay, V-i-s-h-a-y. He's in his 70s, late 70s. He's Polish by heritage. He's Jewish. And in his home town and village in the '40s when the Germans occupied, invaded and occupied that particular area, there were 30,000 Jews that lived in this one area and only 300 survived and he was one.

And he did it by running through the forest one afternoon and he went to a house in the woods and he knocked on the door and he asked for refuge just for that night, or for that day. He actually was fleeing at night. And the woman said, "You're the Zandman boy." And he said, "Yes." She said, "You know, I'm Catholic, but I will shelter you with my life." And they dug a hole in the floor boards of this cabin, and it was a yard, you know, a meter by a meter, and eventually seven people stayed in that hole during the day for 17 months.

The story is that his uncle, who was a young man, as well, in order to keep their sanity, taught him math and physics. So after they talked math and physics, which you have to be—that's a unique mindset, I must admit.

After liberation, he got a scholarship. He went to the Sorbonne in Paris, got his Ph.D. And he gives this remarkable story and then he said, of course, I came to the United States, got 39 patents, created a $3 billion a year company, and goes through it.

But he said, the model of my company and the things that drive me are not profit. You have to have good technology, you have to be bright, you have to treat your workforce well, but he said the overriding concern is clean hands, and he talked about the ethics and the responsibility of being a businessman and giving something back and talked about his grandmother's philosophy. And the reason this woman sheltered him is because his grandmother, who was Jewish, was kind to her and actually had given them aid during a particular time. That's the human quality that we need to highlight and represent.

So I just want to make it clear that we have to be careful about stereotypes, whether it's in industry or other parts of the world, because there are people like that who provide real inspiration for all of us.

Co-Chairman BECKER. I have spent much time identifying and bringing companies, corporate executives in to speak with us at different times. They're victims just like us. It's the multinationals, those that really, to be frank about it, hold allegiance to no country. They have plants all over the world and they can shift product lines, they shift products, they shift taxes. It's a whole different world out there and they're the ones that push, I believe, these world trade agreements.

But be that as it may, most corporations, most companies, small companies particularly, want to stay put. They have close community ties. They have a lot of loyalty to their workforce. And these are the ones that are getting wiped out, incidentally, in the whole process. No, I agree with you.

Mr. MCCURDY. Thank you.

Mr. FIRE. Thanks.

Chairman D'AMATO. Tomorrow morning at nine o'clock.

[Whereupon, at 5:58 p.m., the proceedings were adjourned, to reconvene on Friday, August 3, 2001, at 9:00 a.m.]