



Remarks and Q&A at the Institute for International Economics

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Book Release for "China: The Balance Sheet: What the World Needs to Know About the Emerging Superpower"

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DEPUTY SECRETARY ZOELICK: Well, I want to open by thanking both Fred Bergsten and John Hamre of the Institute for International Economics and CSIS for inviting me and I very much appreciate their efforts and those of their sponsors in producing this new book about "China: The Balance Sheet." And I want to say a special word of thanks in that I understand Ben Heineman, formerly of GE and now at the Belfer Center at Harvard, played a key role in conceiving and launching this. One of the less known facts of my background was that when I was a starting lawyer, Ben was a young partner at Califano, Ross & Heineman, so I had a chance then to see his exceptional abilities, his skill, and I'm delighted that he's continuing to contribute to the country's service in the way that he is in his efforts with this project.



When I gave the speech on responsible stakeholder that Fred was kind enough to mention, last September, I made a point that in addition to my comments about the relationship, it was very important for Americans who are interested in the Sino-American relationship to play a more active role in getting out information and perspectives. So in that sense, I want to thank all of you who were involved with this for taking up that suggestion and producing what I think is a very fine project.

I know this is an independent report and that doesn't necessarily -- that means I may not necessarily concur with all recommendations, but I've had a chance to look at it at a couple different stages and I believe it's a very concise and useful framework for thinking about the relationship and describing things and indeed highlighting the key challenges that we'll be facing this week with the summit meeting.

Fred suggested that I offer the context for the book by saying a few words about the preparations for the meeting of the two presidents this week, and perhaps the starting reference point is that for many of you who have been involved with summits over the course of the Cold War, I'd suggest that one needs to view this session very differently. And it's different in part because the summitry has to operate at two different levels although of course they're interconnected. And I think it was one of the things that I liked about the book is I think the book recognizes this.

First, China and the U.S. have major issues of interest to discuss globally. We're two major powers. China, of course, is well recognized as a rising power, but what I think it's also important to recognize is that the United States, although it's the greatest power in the world, is not a status quo power. We're also a power that is promoting change in the international system. So you've got two very dynamic players in the global system meeting at the highest level.

But second, and I think this is equally important, is that both China and the United States have domestic considerations that affect how we interact with one another on these global and regional relations. And these conditions are reflected in the increasing degree of integration between our two countries.

Now, the speech that I gave before the National Council on U.S.-China Relations last September reflected this duality because I was trying to speak to both Chinese and U.S. audiences, and I'm pleased that some outside the two countries also took an interest. Because I was trying to point out that as we step back from a U.S. perspective and looked at this relationship, that one could recognize it had been the policy of some seven administrations over 30 years to try to integrate China into the international system. And I was one of the people that was proud to be a part of that, including playing the role picking up from the Clinton Administration and finishing the accession of China and Taiwan into the WTO.

But if you consider the world of today and you look at China's effect in the international marketplace, whether it be on capital markets or currency or commodity markets or counterfeiting, you have to recognize China has been integrated. That goal has been accomplished. So now the question is "integrate for what purpose?" And that's the context in which I suggested that it was important to try to work with China to become a responsible stakeholder in this international system of systems.

And I was trying to define the notion of stakeholder as being one that required an interaction that went beyond pure national interest but recognized how one develops a national interest in the strength of the international system. And since our Chinese friends often like to look at things in a historical perspective, one point that I've made is that if you look at the course of the 19th and 20th century for China, it wasn't really too good of a period except for the last 20 years, and over the course of the last 20 years China has benefited enormously. This is, in part, through its own hard work and the efforts of its own people, but it wouldn't have been able to do so if it weren't part of the international system that the United States and others created after World War II and sustained. So we have a common interest in that system. So the U.S.-China summit is not simply about bilateral issues but also it concerns U.S.-China in the world as a whole.

Now let me start perhaps from a slightly different perspective and offer a few words on how China might look at the context of this visit. As I know we have many China scholars in the room but some that are of a more generalist nature, it's important to recognize that China has just finished the National Party Congress, it's produced the 11th five-year what is now called Program, used to be five-year plan. That term in itself reflects a change in the Chinese approach. The Chinese leaders are very much focused on economic development, which is a huge challenge, as the book details, and they're seeking a benign external environment in which to pursue their internal development.

But of course they recognize that China's growth leads to greater influence and so part of China's goal is to convey the idea of a peaceful development, which of course is a slight editing of the earlier phrase of peaceful rise, which some in China thought was perhaps still too aggressive sounding and so instead they focused on the notion of development.

China wants to emphasize, very much in contrast with the experience of the Soviet Union, that it is not challenging the international system; indeed, it is trying to embrace it and it wants to work with the United States and others to try to calm anxieties. But at the same time, the Chinese want and expect respect. They are very sensitive to their own historical experience, including intrusions on sovereignty. So you have a country that at the same time it is moving at a very fast pace into the international system has the sensitivities that you even see in the United States or Western Europe or other economies about intrusions of this international system on its sovereignty.

And indeed, if you take a look at the new Five-Year Program, the 11th program, they reflect the elements of this balance. It's an effort to try to move from export-led growth increasingly to domestic consumption and demand to try to deal with the fast-rising set of imbalances. And as many of you know, China's current account surplus, its global current account surplus, has now risen over 7 percent. That's a relatively recent phenomenon. China is trying to adjust the balance of savings, consumption and investment, in part through domestic programs that should reduce the public's need to have a high savings rate because today, whether it's an issue of savings for education or healthcare or one's retirement, there really aren't programs to try to offer those services. So again, this is a process by which China's own internal development is connected to what it thinks is important for its international posture.

It's true in the area of energy development and also the environmental implications. It's true in the area of trying to develop higher value-added services connected to a knowledge economy which, of course, are connected to intellectual property rights. But one also needs to recognize that China is very cautious about these adjustments even though the society is changing at a fast pace. If you consider the challenges of development in China, those between the coastal and the internal provinces, those between the rural and the urban areas, those between Beijing and the provincial development and many others, you can understand that the Chinese leaders wake up in the morning with a pretty hefty set of problems to cope with and they're worried about missteps. They want us and the rest of the world to recognize that while they've increased income significantly, it's still a developing country, there are still hundreds and hundreds of millions of people that are very poor.

And there's a very strong sensitivity in China about the danger of upheavals, and this again is how the leadership has a strong sense of historical experience. And here I'm not only talking about the upheavals of the early 20th century, but I always find it useful to keep in mind that the people with whom I'm talking in China lived through the Cultural Revolution and this was not just a question of a slightly different experience for a few months. This was an upheaval in life and the leaders are very sensitive about anything that could return to any similar disruption because they saw what a tremendous effect it could have on their society. People are worried about rural unrest. You've seen the reports about the tens of thousands of incidents that have increased. Then of course how this is connected to the provincial-center relations.

And underneath all this, there's another fundamental challenge, which is that the legitimacy of the political system rests on economic performance and nationalism and the Communist Party itself is having to determine what role it will have in this new order.

Now let me turn to the U.S. domestic perspective. Now, part of our issue with China, of course, is part of our larger adjustment to globalization from what is a relatively open society. And so, unlike some, we're going to be more subject to these changes because it's been part of our success but it also requires our own adjustments. So understandably in our domestic look at China, there's a focus on economic concerns but also human rights and values of this new rising power. As I and my colleagues have told the Chinese, we need to demonstrate to the United States public that the economic relationship with China offers a fair two-way street, that there are mutual opportunities and benefits.

For many years, the effort of many of you and others who are involved with this issue was focused on the question of China and Taiwan's accession to the WTO. That was accomplished in 2001 and so part of what we're dealing with now is the next institutional phase that goes beyond China's accession. U.S. exports, as the book has talked about, have boomed, but so have our imports. If you look at the agricultural sector, some services, some value-added manufacturing, certainly investment, you see a boom in possibilities. And if you compare this with the growth of overall exports, there are great opportunities in China, although recognizing those percentage numbers come from a relatively small base.

But I think there's a larger issue here, which is our economic relationship with China reflects again the challenge that you see in global sourcing and investment. So as the book outlines, what you have, and you look at our overall import pattern from Asia and a lot of the imports that might have come from other Asian countries are now coming from China because China is playing the role of assembly and value-added and it's one of the reasons why, of course, you have large commodity increases as part of the Chinese development practice.

Now, there's another part of this WTO relationship and it's one that I took a first step when I was USTR and my colleague Rob Portman has just taken one recently, and that is how we can use the WTO's rules-based system to try to ensure a fair process. So recently you saw that the United States and the European Union brought a case against China dealing with auto parts regime. Similarly, during my tenure, we brought one dealing with the semiconductor industry and what we considered to be differential taxes that disadvantaged our exports.

Sometimes the Chinese react against these and think that they're hostile acts. I see them as basically a part of the international rules-based system and reflecting the fact that when you work with Chinese officials, often those who might be on the international trade side can handle an issue to a certain degree but as they work with the established bureaucracies they're going to run into resistance and sometimes it needs these cases to push them further. For example, in the case we brought against semiconductors, it never was brought to the WTO system because we were able to resolve it through negotiations.

Of course, there are still many concerns in our economic relationship with China. There's the notion of fair market access and I would suggest that what you'll see in this nature of the relationship is a transformation from some of the traditional topics like tariffs or particular rules that are part of the traditional WTO system to questions of the government's intervention in the economy, the role of subsidies. And again, part of this most recent meetings we've had to get the Chinese to finally put forward their subsidies in the system, which you're supposed to do as a WTO member, but I think this will go beyond. I think we're now going to be entering an era of how do we deal with Chinese industrial policy.

There's also the issues of intellectual property rights protection and of course currency and exchange rate.

So as part of the buildup to this summit, the focus was on, in part, the meeting of the JCCT, the meeting of Vice Premier Wu Yi on the Chinese side and Secretary Gutierrez of Commerce Department, Ambassador Portman of USTR. And as you've probably seen the results, there was an effort to try to open up additional access, particularly in the software area, beef, medical devices, express delivery, telecommunications, moving the Chinese to accept a position as a member of the government procurement code as part of the WTO and an important step in transparency, getting the Chinese to agree that all measures will be reported in a single journal, the equivalent of our Federal Register, if you will.

And of course to complement the JCCT, the Chinese announced some \$16.2 billion of purchases. This involved a rather significant business tour led by Vice Premier Wu Yi to some 14 cities. And what I think they tried to emphasize, and we certainly encouraged them to do this, was that this should be seen as part of developing ongoing business relations as opposed to a series of one-off purchases. Of particular note, the Chinese visited the Haier plant in South Carolina, which was some recognition that as you build up the Chinese role in the international economy there are going to become international investors. And of course this was an opportunity to try to demonstrate that foreign investment, including from China, can help create jobs in the United States.

In the currency area, the policy of China is to move to a flexible exchange rate, a convertible currency and open capital accounts, and so the big question is the implementation and the pace. And all of you are probably well aware of the discussion that Governor Zhou of the People's Bank of China had with our Senate delegation trying to emphasize their plan and timing, but again I think there will be great attention and this will be a part of the discussion about when and how China will proceed.

If you connect their stated policy with the Five-Year Program, you can again see that the Chinese policy framework seems to be designed to move towards these goals, and as I mentioned, since they're going to be sensitive about their internal development, there will be forces in China that will be cautious about the pace but there will be external pressures that will urge them to move faster and further.

Now, part of President Hu's challenge is also to speak to the U.S. public, not just to officials. It's part of this duality of the domestic as well as the global issues. And so his first stop, as many of you know, will be to Seattle, where part of the message will be to Boeing and part of the message will be to Microsoft and our software industries, and so also focus on the intellectual property rights development. Then Washington, then also to Yale, which of course has long ties with China. And again, it was striking to see how Vice Premier Wu Yi combined her negotiating role with this business visit where she brought some 114 Chinese companies and over 200 people as part of this mission.

But second, as I noted in the start, the summit and our relationship clearly looks beyond economics, in particular to human rights and the nature of China's system. This is a point that President Bush emphasized extensively in his conversations with President Hu last year. He's had a particular focus on our interest in terms of opening up possibilities for greater religious freedom. We discuss individual cases and press the Chinese on those.

But I think equally important, we're trying to develop an institutional dialogue on these topics. As some of you who've worked on the economic side know, the Chinese have had an interest in rule of law development on the economic side and I think one of the big questions will be how Chinese interest in rule of law for their own interests can help create a more rights-based society, more procedural protections. But in my mind, the big open question is how that will interact with the role of the Communist

Party. This also raises the question that you've seen in the papers about internet censorship, how you can open a society to information and maximize information flow but also the restrictions that China has tried to impose.

Third, beyond economics and human rights, of course we need to discuss the foreign and security policy topics at the highest level. This is the effort to try to put the building blocks in place to fill out this concept of being a responsible stakeholder at the foreign policy level.

And just to give you a couple examples, I have been pleased that in my discussions with the Chinese we try to find areas where I believe we have common interest, for example Afghanistan's development. And Afghanistan -- or China was one of the participants in the recent London conference to try to focus on an action plan for Afghanistan and China has committed some \$230 million to the development of Afghanistan but also it's tried to supply some people and equipment, including non-lethal military equipment for the Afghan army.

This is true with Iraq, where the Chinese have proposed some assistance. Equally important, they have made it clear that when the Iraqis put together a new government, that that government would be welcome to come to Beijing.

As many of you know, I've spent a lot of time working with the issues of Sudan and Darfur. This is another topic where I've engaged with the Chinese and I believe if we can bring along the other parties in the African Union that China, as a member of the UN Security Council, will at least not stand in the way of the process and maybe even be more cooperative. China has actually committed to provide some of the forces in the UN peacekeeping force in the North-South arrangement that is part of the Comprehensive Peace Accord in Sudan.

When Premier Wen Jiabao was in Burma recently, he emphasized the importance of a national reconciliation effort.

And some of you may have noticed that when one of the Hamas officials recently invited himself to China, China said, no, you're not invited.

I don't want to overemphasize these, but I do think that they are the foundations of the type of discussion with China about the types of mutual interest that we can have and work together.

Now, the two biggest ones that are going to be on the table for this discussion are Iran and North Korea's nuclear program. I think it's extremely valuable since both these are going to have ongoing diplomatic aspects for the two leaders to be able to discuss that face to face.

Similarly, on the issues of terrorism. And as many of you know, in the area of security and military affairs, we've encouraged the Chinese to expand their transparency.

And as part of this visit we encouraged three steps that the Chinese seem to be amenable to: One is taking the idea of military exchanges and expanding it from the top level to driving it further down into sort of mid level of officer corps; a discussion about strategic nuclear forces; and also cooperation on disaster relief, like the United States was involved in with Indonesia.

Now, China, in turn, is also looking for some things and I think the primary one is the recognition of its strategy of peaceful development. And as part of that connection to its development plan, China does not want to be seen as a threat. It's seeking respect. But there will always be a very strong sensitivity to the Chinese sense of interest, Chinese sense of sovereignty and internal stability. And of course, the Chinese will always repeat, as many of you have been familiar with this, Taiwan over and over again.

As for President Hu, and I think this is another important aspect, he, of course, is looking at how this projects his leadership at home so he is looking at how he comes across within China in comparison with his predecessors.

And fourth and finally, we have an expanding set of mutual interests, each of which could -- or requires some much fuller discussion, that we need to operationalize to become more effective. These include topics like energy security or energy and environment issues or avian influenza or the education and scientific exchanges. Or even Secretary Chertoff was in China recently because we are trying to send back people who come to the United States illegally. We've been working with a number of countries to do this and we have a large number of illegal Chinese immigrants and China has started a process with the Department of Homeland Security to implement that.

So, in sum, I think the summit reflects two balances. One is the short and the long term. There are things on this agenda that are very immediate and there are things that are trying to set up the longer term relationship. And then the other balance is between the domestic support in both countries and the global agenda. Now, of course, in general, when you have an agenda that is so broad and has different time periods, part of your goal is to achieve some results -- that's partly what the JCCT meeting was about -- but also to lay the groundwork for future cooperation; try to draw out a better sense at the top level about these points of mutual interest; and where we disagree, and of course, we will, to point out those disagreements, discuss them, and try to set a stage for further effort.

So I don't know if this was the intention of the authors of the book, but as I was reflecting on this last night, I was thinking that the title of "balance sheet" may have unintentionally captured the duality, because at least as I saw it, you were first trying to use the term, balance sheet, as a notion of an accounting about the relationship. But the balance also reflects the balance between the domestic and the global relationship and balancing cooperation and points of differences that we need to try to manage and I hope overcome.

So thank you very much for the project. I'm happy to take some questions.

MODERATOR: Okay, great.

(Applause.)

MR. BERGSTEN: Bob, thank you very, very much. You've laid out a brilliant panorama and a huge agenda. Let me abuse my privilege as chairman to ask you the first question.

You're absolutely right about the intention of the balance sheet project and how it did attempt, as you have outlined today, to link the international and the domestic concerns. Let me ask you a somewhat hypothetical about the upcoming visit of President Hu. In the context of carrying the message from this book out, I recently testified to several congressional committees, briefed a number of congressmen and their staff, as well as, of course, talked to people in the Administration and elsewhere.

And I must admit that I've been struck, somewhat surprised, by the growing degree of frustration and impatience on the part of some of our more thoughtful and leading members of the Congress, in particular, about the lack of deliverables from China. The Chinese will often set out a laudable goal, and you've mentioned several of them, but have been slow to deliver a realization of those objectives.

So what happens if President Hu comes and goes and nothing very significant is done on the exchange rate issue, getting the North Koreans back into the six-party talks, et cetera, et cetera? Suppose the outcome is more indication of objectives, but little follow-through in terms of practical results. Does that worry you about China's acceptance of a responsible stakeholder role and/or a possible pushback and serious reaction, even backlash to China within our domestic politics, particularly the Congress?

DEPUTY SECRETARY ZOELLICK: Okay. Well, after working all those years for Secretary Baker, as soon as I hear a hypothetical question, I automatically say I don't answer hypotheticals. (Laughter.)

But let me try to address your question nevertheless. I think the point that you are making is a point that some of us have tried to stress to the Chinese, which is that, as the book sets forward, there are many aspects of potential mutual benefit and mutual benefit today in the relationship. But for those of us who, just to take one example, want to keep America's markets open, we need help from the other side to be able to demonstrate that it's a fair two-way street.

And so if you take, for example, an area that I know you have particular interest in, Chinese currency policies, China seems to be saying the right things, seems to be embedded in its program. The head of the People's Bank talks about this in a way that would suggest they're going to move in the right direction, but the process of change seems agonizingly slow.

Now to come back to my remarks, I think that this reflects the fact that you have this duality operating in China. You have certain people -- and I would think those that are associated with the People's Bank of China are very interconnected with this international system we've described. But as Governor Zhou will freely tell you, he reports up to the State Council and the people up in the State Council are probably more focused on the aspects of internal instability that I've described.

And so it's important for us and for others who want to work with China in different dimensions, private sector, to keep emphasizing how we have to try to get them to play this responsible role as a stakeholder on trade issues or currency issues. And the same is true, obviously, across the foreign policy agenda. Having said that, and I think the book also highlights this, for America's own future, I always find it unfortunate when we blame others for our own problems. So we also have to focus on things that we need to do and we also, at least, need to have some sense of the facts about what is happening. So, you know, if you look at the trade balance with China, you can see that it's partly been an adjustment of flows from other countries, but it leads to a very large bilateral trade deficit.

For those of us, you know, that were involved in this at earlier points, you know, we tried to make the point, don't look at the bilateral, look at the whole global account. But that, in a sense, gives us, I think, an opportunity to point to the Chinese. This is a relatively recent development that the very large current account surplus is a global current account surplus. And frankly, it doesn't make sense for a developing economy to have that large of a global current account surplus.

Now, there are many reasons for this and this comes back to the dialogue that we have as officials and many of you have, either as scholars or businesspeople or NGOs or others. You know, I think some of this, not only for the Chinese, but others, reflects the 1997 experience. You know, people -- while your institute and others did studies of IMF reform, people in East Asia said, "The way we're going to deal with the uncertainties of the IMF is by building very, very large stockpiles of capital to deal with the uncertainties in international capital markets."

But this is all the more reason why I think it's important with China or, frankly, with other players, to put the cards on the table and explain how we see the situation, how we want to try to work with them and how I believe there are many points of common objectives. But we both have to try to contribute to make this effective together.

Another good example is the WTO and the world trading system. China was actually very constructive in the launch of the Doha round in 2001, even before it became a member, and this was because there were a number of APEC meetings held in China, as China was the APEC host that year.

China is now playing a tactical game; as a recently acceded member, we don't really want to contribute much to the process. What country is likely to benefit most from a successful international trading system over the next 10 or 15 years beyond China and India? But are they really stepping up to the process? Not enough, I think. And so, of course, there's an ongoing role for the major economies -- U.S., EU, Japan -- but one of the stories of this WTO round will be will the mid-level developing countries sort of contribute.

So you know, in a sense, I could just reprise the remarks, which I won't do, but that is the exact purpose of what I try to do with them and I hope others try to do with them and get them to recognize that for us to be able, in the United States, to sustain the system, we're going to need their cooperation and support, too.

MR. BERGSTEN: Okay. The floor is open. Yes, right here. Please identify yourself. There are microphones over here, over there. You need to go to it, I think.

QUESTION: Daphne (inaudible). President Bush, (inaudible) last month (inaudible) said that, you know, this is in addition to free trade and human rights, Taiwan will be another key issue on the top of agenda. How will President Bush address this issue with President Hu?

DEPUTY SECRETARY ZOELLICK: I think the Chinese will raise it. (Laughter) If my experience is any guide. (Laughter.) And President Bush has been very straightforward and direct about his policy to Taiwan and we have been very proud to have our association with Taiwan over the years. I have found myself in the unusual position of having brought the negotiations forward to bring China, Taiwan and Hong Kong into APEC and then had the delight of doing it again with China and Taiwan coming into the WTO. But we have also made very clear our overall policy on Taiwan, which I'm not going to restate all the fine points, and it's important that there not be any unilateral change in the status quo from either side.

MR. BERGSTEN: President Zedillo of Mexico.

QUESTION: Mr. Secretary, on the issue of Doha what can China bring to the table that will move the negotiations forward, considering that the big bottleneck continues to be agriculture and that China perhaps on agriculture is more open than the Europe and the United States?

DEPUTY SECRETARY ZOELLICK: Well, it depends. I think the role that China can play relates to the dynamics of how you bring a WTO round to conclusion. And what I'm going to explain is that I think what is going to be important is to move the process simultaneously forward on a number of fronts: agricultural market access; agricultural subsidies, both domestic and export subsidies, but the export subsidies is pretty much clear; but also, industrial market goods and, to a certain degree, services, although the structure of that negotiation is different.

The problem, in my view, in the negotiation right now is that you have certain people that have offensive interests in one, defensive interests in another. The United States tends to have a pretty much strong offensive package across the board, but we need an ambitious result because, frankly, we've already cut in a lot of different areas, and so to take the domestic subsidy issues down, we need to show we get additional market access.

And so it's my belief that it's important for sort of a core group of developed and developing countries to be able to say that point and move forward together. And given my own view of the dynamic of the negotiations, which is the ministers are going to have a hard time doing this themselves and at some point the Director General is going to have to put forward his proposals to do so, is to back that, and then this may -- you're familiar from your own government experience -- then it's the question of whether you're a constructive creative player in terms of trying to find solutions.

A lot of what this amounts to is, sort of, multiparty problem-solving under intense and sleepless nights, okay? And so I'll give you an example. In 2004, when I played a role in trying to pull those negotiations back together, I didn't have Chinese ministers even at the table. They weren't even engaged. But their Ambassador, Ambassador Sun, and their Assistant, Minister Lee were good players. They didn't go out of their way to cause trouble. They had some things that they wanted to take care of, so they weren't a negative force. But again, you see, my goal would be to try to have, you know, China, Brazil, India recognize that over the next 10 or 20 years in which such a round would be implemented, they're going to be major beneficiaries of it. So I would like to have a slightly more positive role in trying to find solutions among the parties.

MR. BERGSTEN: Yes, right here. And then Chris.

DEPUTY SECRETARY ZOELLICK: Oh, and one last point on this because it goes back to a point that Fred said and it's important. I agree with you that China has made some very important commitments and sort of lowered its bound rates in many tariff areas beyond developing countries that had been in the WTO for a much longer period. But when you look at these, you always have to say, "relative to what?" You look at those tariff levels compared to the U.S. tariff levels and they're still relatively high in a number of areas, at a time that we have a \$200 billion bilateral trade deficit and a \$700 billion current account deficit. It's a little hard to sell this to the American public unless it looks like China is willing to liberalize and open its markets further.

So again, to be fair to the Chinese, you know, they're relatively new members. As Fred knows, there are some longer-standing members in Asia that I wish would play a more active role in the global trading system that are major beneficiaries of it. So I don't mean, in making these comments, to be chastising the Chinese. I'm trying to encourage them to pursue objectives that I think suit all our interests.

MR. BERGSTEN: Yes.

QUESTION: Eric McVadon, the Institute for Foreign Policy Analysis. Two quick questions on security issues. I remember getting lectures by the Chinese about how we didn't understand their goals and strategies on the Korean Peninsula. I wonder if you think we're growing closer together on that, if that gap is closing.

And the other thing, in connection with the peaceful development, I note the PLA modernization and the way it's proceeding creates doubts in the minds of some. Should we be pressing them for better explanations of where they're going with the PLA and what their strategies are?

DEPUTY SECRETARY ZOELLICK: Let me take the second first. And the answer is yes, it's one of the topics that I've highlighted in my speech and I think Secretary Rumsfeld has talked about. And again, in advancing this, one doesn't have to see it as confrontational. What I tried to point out in my speech was, given the added resources that are being devoted to the Chinese military, it would -- it's in China's own interest to be able to do the types of things we do, where we put out a strategic document. It's open for people to criticize or examine or offer different views, greater transparency about their spending, greater discussions about how they see the purposes of these forces.

And as I pointed out to the Chinese, if they don't do that and China expands, as it will, it's going to create additional anxiety not just in the United States, but in others. And so, you know, China sometimes gets anxious about what it refers to as hedging strategies. What I tried to point out is, you're going to get more hedging strategies the more you grow and the more you add to your military and the more you don't explain the purposes. So that's exactly the direction that I believe we should try to go.

Now on the Korean Peninsula, I think China is torn because, on the one hand, I believe it does not want to have a nuclear North Korea, in part because of the implications for Northeast Asia, but it also doesn't want to have a collapse in North Korea. And so to use the sort of economic reference point, I think its discount rate is such that it's worried about the collapse perhaps more than it's worried about the nuclear program.

And so in terms of our discussions with them, as a good example, I have tried to draw them out to consider (a) what they see as prospects for change and development in North Korea, how they see this would affect the peninsular relations, and even try again to say how the changes under various scenarios could end up serving our mutual interests. And let me give one specific example.

At times, and this is from my prior experience outside government in discussions with some Chinese think tanks and security tanks in the 1990s, I know there was always an anxiety that if one moves to a Korean unification under some scenario, would this mean that a Korean ally, the United States, has U.S. forces, you know, on the Yalu border, on the Yalu River? As I pointed out to the North Koreans*, if that happens, number one, I believe it's very much in the system's interest for the United States to have an ongoing security alliance with South Korea, and I could explain why and I think the Chinese could understand that logic. But number two, the U.S. military position would probably shift to more naval and air assets in the south and so the prospects of having large forces on the Chinese border, in my view, is very, very small, if at all.

Now I think it's useful to have that sort of discussion so that you can start to compare and draw out how to, one, see interest in Northeast Asian and security and how the Korean Peninsula fits into that. If you look back at the six-party document that Chris Hill negotiated with his colleagues last September, you'll see that there are elements that go beyond the nuclear issue, that go to this question of the peace regime for the Korean Peninsula, that go to sort of Asian security, go to economic and development issues.

So I believe that is something that needs to be a key part of our dialogue and for this visit, to be specific, you know, I don't think our presidents have had a chance to talk since Kim Jong-il took his reprise of the '92 Deng Xiaoping tour. I have been to China since then and have had discussions but I think it would be very interesting to get President Hu, I would encourage him, to talk to President Bush about what conclusions does China draw from that about the prospects for North Korea.

QUESTION: Thanks very much. Chris Nelson from the Nelson Report. I wanted to follow up on Eric's question. A lot of people who have tried to watch this dance that's between the U.S. and North Korea are worried that U.S. policy has evolved to the point where we really don't think that the North Koreans would engage in a leveraged buyout of their nuclear program and that this really is just a dance that's going on that isn't going to resolve the nukes.

And I'm wondering (a) if you share that basic conclusion and (b) did you sense, in the last week or two, a little bit of Chinese frustration at us that when Secretary Hill was in Tokyo last week he wasn't allowed to meet bilaterally, that everybody else was and, obviously, that looked a little strange. I'm wondering if you have some comments on both of those points.

DEPUTY SECRETARY ZOELLICK: Well, in the first one, I'm not trying to engage in semantics, but it's just a caution I developed over the years. When you use a term like leveraged buyout, that's a very loose term. It could mean lots of things to lots of people, so I've tried to describe kind of how we've been approaching North Korea. So let me take the second element.

I think the Chinese have positioned themselves as a mediator in the process and there can be some constructive things that come out of that. But what we are urging the Chinese to recognize is that they need to be more than a mediator. They need to be a participant that recognizes that they have an interest in trying to solve this problem. And it relates to the nuclear issue, but it also relates to the notion of what sort of change in the context of the North Korean peninsula.

And so -- look, if you're then trying to play the mediator role, that will lead the Chinese to take some actions, but I really would hesitate to say, you know, where the point of frustration is. I think the Chinese have wanted to play a constructive role, have played a constructive role to a certain degree. I think there's more they could do.

MR. BERGSTEN: Professor Gordon.

QUESTION: Thank you. Bernard Gordon, University of New Hampshire. Mr. Secretary, the book, I have had a chance to look at just a little bit here today. And it deals a little bit with the regional issue and you know I have a strong interest in that issue.

Ten years ago, the U.S. opposed Mr. Yen's -- Sakakibara's -- approach for an Asian monetary fund. Now there's much more discussion of an Asian bond market. When you put that issue together with the notion as the book deals with a little bit of a China regional approach, is the United States likely to again oppose the idea of an Asian bond market as it did under Secretary Summers about a dozen years ago as part of perhaps a broader concern about China in its regional role vis-à-vis the United States?

DEPUTY SECRETARY ZOELLICK: Well, I'm going to defer to Secretary Snow on what's fundamentally a Treasury question, but what your question triggers in my thinking is this, and I think this is a point that Fred has raised, if not in the context of this book and others. I think when you look at the China currency issue, it's important

to look at its connection to overall Asian currencies. And there has been some thinking about whether you might create more of a process of change across Asian currencies.

And so frankly, I think some of the studies that show sort of modest changes in terms of our account balance with the change in their renminbi don't fully account for the fact that this probably should be something that happens in terms of Asian currencies as a whole. So at least where I personally have an interest is in that sort of question about sort of currency relationships -- I won't go so far as to say integration, but currency relationships in East Asia.

Secondly, I think that, you know, when one talks about kind of Asian bond markets, I believe most of that's going to be driven by private market conditions. So this is, in part, currencies. It's, in part, the nature of the financial markets and their liquidity and availability. You know, it's -- while the problems that Japan has had with its financial system or one reason why Japan was not able to replicate the circumstances that say the United States or London were able to develop, and what that would suggest to me is that another key component of what we're seeking in terms of Chinese development and exchange rates needs to be the further modernization of their financial system and liberalization of their financial system.

And again, you know, it may just be the way I think, but I try to find kind of mutual win-win possibilities here, things that are in their own interest for capital allocation and development which, frankly, will also help them in terms of their position internationally, which will also help maintain or strengthen the system that we're sort of alluding to. So in that sense, if China succeeds in modernizing its financial system and having open, transparent financial systems that are connected with the international system, you know, I think you're not just going to have Asian bond markets. It's really going to be part of a global bond market system.

MR. BERGSTEN: Bob, just to amplify your first point, remind everybody what we do say in the book on that, because we do address it -- we do believe that China's aggressive efforts to keep its currency from rising, the huge intervention, has led to many of the other Asian countries taking a similar position since they don't want their currencies to rise against their renminbi, therefore they don't let them rise against the dollar.

So my colleagues, Nick Lardy and Morris Goldstein, have estimated that if the RMB were to go up, as we think it should, at a minimum over the next few years, 20 percent, and the rest of the Asian currencies went up by a like amount, which we think is a good possibility, that would take something like \$60 to \$80 billion per year off the U.S. current account deficit, which is getting us a quarter to a third of the correction that's needed to cut the overall imbalance in half. So certainly to ratify what you say on that, the stakes are very large and China's role, because of its impact on the rest of the Asian currency markets, we think is very, very important.

DEPUTY SECRETARY ZOELICK: One last point about this. See, sometimes these concepts come up in a way about sort of (inaudible) currency (inaudible) and at least I think the way that I've heard Fred talk about it, and I know Morris and Nick and the way that I see it, is that it's important to always keep in mind a connection to the global system (inaudible) in capital markets and trade. It's foolhardy to bet against that. But in addition, what you're talking about is sort of degrees of integration or interconnectedness but always keeps in mind the connection as part of a global system as opposed -- and I think at times some of the ideas in the '90s, and I remember talking with Treasury a little bit about this but I don't want to be an authoritative source, was that some of the original Japanese ideas, as sometimes the Japanese ideas are, sort of efforts to try to create a foreign policy sort of model of a shield system, you know, against Europe and the United States. It wasn't going to happen and I wouldn't advise it.

MR. BERGSTEN: Secretary Zoellick has time for one more question. Jessica Einhorn (ph)*.

QUESTION: Thank you. You mentioned energy security (inaudible) it's a huge topic (inaudible) talking about how every part of international agencies (inaudible) now I'd be interested in anything you want to say about what his energy security conversation will be and in particular (inaudible) and I'm wondering whether you are beginning to think about in which that discussion might take place (inaudible) IEA and other efforts.

DEPUTY SECRETARY ZOELICK: Well, first point, I've learned, having had the opportunity to work for a couple of presidents, never to presume what a president is going to talk about, so I'm going to just mention what I have discussed with the Chinese and what I think some of the reactions have been.

The energy area with China could become a point -- has been and could be a point of tension or it could be a point of much greater cooperation. In my discussions with both the Foreign Ministry but also the NDRC, the planning body, I've tried to emphasize the core principles that Secretary Bodman has also talked about in his energy dialogue, which is: first, we have a common interest in expanding non oil and gas sources of supply; second, we have an interest in expanding oil and gas alternatives to more diverse locations; third, we have an interest in the demand side, increasing efficiencies and reducing the use of energy and the conservation and the environmental efforts; fourth, we have an interest in connecting the Chinese more effectively than they are today to things like the Strategic Petroleum Reserves system, which is one of the coordination systems with IEA referring to.

And then I think we also have an interest in terms of choke points and if you actually look at, you know, United States and Chinese interests as major consumers in this system, there's an awful lot that we can and should be working together on. Now, and there is -- there are things going on in each of these areas, you know, including the prospects, you know, for nuclear plants in China and elsewhere.

Now, what part of the challenge is that, you know, some people seem to forget that oil and gas is a global commodity and so that it's -- and you "lock up" your source means you're not using it from another source, and so that added amount is still on the international marketplace. But I think this is where the Chinese may need to be wiser in how they approach the problem in that -- and I think some of this is bureaucratic, just as in the United States -- you create these state-owned oil companies. State-owned oil companies have said the United States and Europeans have been out there dominating this energy market, we've got to get the places where they're (inaudible) and we'll "lock up" those resources. It doesn't really make economic sense. Some people actually think they may be overpaying. You know, it's not the way global commodities markets work.

But it conveys an impression to the rest of the world at a time there's anxiety that this is a competition. I will say that the Chinese recently actually tried to convene a users conference with a number of the major Northeast Asian players, including the United States. I think it was just a couple weeks ago. I think Secretary Bodman was unable to attend. But I think that was kind of a good sign on their part in overall interest. And then I think, as you refer to, Jessica, there's kind of a lot of roiling around in the international system now, some of it related to G-8 summit, about how sort of players will interact.

I am at the stage where I would just like, you know, major policy makers, including those in the legislative branch in our system, to see that their greatest points here are points of convergence and cooperation, and then we get some of the policy makers to be sort of acting in that fashion, including things like, for example, I think in the Strategic Petroleum Reserve. I've read recently where when we had one issue -- I think it was with Iran recently -- that China sort of quickly went in and tried to buy some additional oil, the markets popped the price up, which is exactly the reverse of what you'd want to try to do and which we were able to effectively calm with some of the Strategic Petroleum Reserves.

So this is one where I honestly think governments could get on the right track and the elements are there, but I also have been in public policy long enough to know it's easy for things to go wrong.

MR. BERGSTEN: Bob, we thank you very, very --

(end of tape)

* reference should be to Chinese

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