

DR. GONG: Led by your Chairman and Vice Chairman, this is a distinguished Commission. I appreciate testifying before you at a time when, to use Deng Xiaoping's phrase, we should be "seeking truth from fact."

Seeking truth from fact becomes more difficult and more important as we consider the political and economic realities of China trade during a U.S. campaign year. For many in China, the soul-stopping issue is: how does the civilization which invented gunpowder, the compass, moveable type, and paper, which often frustratingly finds itself on the periphery of the modern global system, compete in today's world of precision-guided munitions, global positioning systems, and AOL-Time/Warner mega-mergers, all involving information moving at dot-com valuations?

I do not believe the United States and China are destined to be enemies, trade or otherwise. I do, however, register a concern that China's strategic approach inclines it to structure trade and exchange rate policy under the WTO or otherwise so as to maximize competitive position with the United States, with neighbors such as Japan, Korea, and the ASEAN countries, and with Taiwan.

Let me raise for our discussion four issues with structural implications. You can see in my testimony that I am moving straight to the "Structural Implications" section.

Issue number 1, trade with United States and the world under the WTO remains essential to China's economic growth and, thereby, to its employment rate, social stability, and further economic strengthening.

Beijing will continue, in my view, to manage its trading system as part of its strategic development approach. It does so with a sharpened sense of vulnerability after the Kosovo War and, thereby, with an intensified imperative to use all means possible to accelerate comprehensive national strength and international position.

As did the Rumsfeld Commission to assess the ballistic missile threat to the United States, especially as global market transfers of technology and process accelerate economic and military synergies in countries, including China, the United States will want to monitor carefully continuing trade-related concerns regarding direct and indirect confrontation,

proliferation, and espionage, including as they may affect U.S. friends and allies.

Issue number 2, not as a consequence of WTO conditions but against U.S. expectations and projections, I believe the U.S. bilateral trade deficit with China will continue to increase over time, perhaps dramatically.

Many interlinked improbables remain regarding whether the WTO will facilitate China's resumption of a reasonable growth approach less dependent on domestic fiscal expenditure. Over time, China may shift towards an economic growth model based on greater domestic consumption.

Yet many China developments will remain double-edged. For example, Chinese use of domestic Internet and accompanying e-commerce capabilities, I believe, will continue to expand. However, even if information free-flow affects political change in China, Chinese public opinion may still affect strong nationalism, including strong anti-U.S. sentiment at times.

It was, after all, directly via the Internet that Chinese students first learned that a PRC embassy in Belgrade had been bombed. With no context

and without interpretation, this news sparked, as we all saw, widespread emotional protests.

Old issues, like pirating and counterfeiting, remain. Procter and Gamble losses amount to about 15 percent of a billion dollars on sales a year to counterfeit product. Microsoft says 95 percent of its Microsoft products in China are pirated or counterfeited and so on.

In WTO terms, the United States has spent considerable time and effort to develop China protocol or requirements that eliminate technology transfer requirements. Such provisions, however, are extremely difficult to enforce.

Companies pressed to trade advanced technologies for a share in China's market often see little alternative to accepting if they want to operate in China. My written testimony gives one example of such a company.

Issue number 3, as core elements in China's strategic approach to comprehensive national strength, Beijing will increasingly seek trade and exchange rate management as a means and measure and, thereby, as an instrument of national influence.

Some 15 years ago, a senior Chinese policy official familiar with the Central Bank's holdings of significant dollar-denominated reserves first introduced me to the concept that a country might use dollar holdings as an instrument to influence the United States.

As explained to me, Chairman Alan Greenspan's January 1999 China trip discussions touched on the U.S. interests that any shift in PRC reserves among euros and dollars occur gradually and that any PRC draw-down of dollar reserves during potentially volatile times includes sensitivity to U.S. markets.

When Beijing signaled its intent to move seriously with its WTO accession negotiations, it sent that message to Chairman Alan Greenspan and then Secretary Robert Rubin. Beijing understands well trade and national financial leverage as part of its strategic strength.

Current Chinese discussions of cyber war, financial war, and economic war are evidence of concepts, concepts in search of operational principles.

One can imagine, especially given current news, speculative attacks against the Taiwan currency or

Taiwan stock market aimed at destabilizing Taiwan's political economy.

Over time, it may be difficult for us in Washington to distinguish an attack on Taiwan using nontraditional means, none of which might trigger traditional indications and warnings from a more conventional attack that would establish U.S. obligations under the three communiqués and Taiwan Relations Act.

This kind of thinking on the part of China and others should be one of several reasons for the U.S. Treasury's and others' responsible departments to do two things: A) to create greater monitoring capability regarding those who hold significant dollar reserves; B) to assess through interactive scenarios how much economic or financial leverage countries such as China might bring to bear against the United States or against key U.S. friends and allies.

Regarding greater transparency of international reserves, as I understand it, as a result of the 1994 Mexican peso crisis, countries now regularly publish international holdings. It may make sense to publish currency composition of those reserves as a way to extend useful transparency.

Regarding interactive scenarios, we should consider China, Japan, and other countries acting in parallel or individually to bring pressure against the United States or, equally importantly, against economies smaller than ours, including Korea, Japan, Taiwan, and the ASEAN countries.

Issue Number 4, the most significant structural implications of China's WTO-enhanced trade and financial competitiveness may not be in those affecting bilateral Sino-U.S. relations but those improving China's competitive position in Asia and the world.

Yesterday, Allan Mendelowitz and I attended a briefing by Gene Sperling, who was making the Administration's case that WTO accession would facilitate China's economic reform.

It may well do so. I asked, however, Gene Sperling whether a more market-oriented, economically competitive China might expend its trade surplus with the United States. Mr. Sperling answered that the U.S. trade deficit with Asia was more or less constant, that China's surplus with us was increasing because China was taking market share from other Asian traders. This is exactly my point.

Some U.S. projections suggest China's export competitiveness under WTO may increase significantly vis-à-vis the ASEAN countries, especially Thailand, Indonesia, Malaysia, and the Philippines.

In third country areas, increased China's exports may not take U.S. market share, but they may come at the expense of Korea or Thailand or someone else.

The timing of Beijing and Taiwan's WTO entry may prove politically mutually reinforcing in terms of U.S. domestic politics. But the structural implications for mutual WTO obligations by mainland China and Taiwan remain unclear. It seems to me we will want to watch carefully how structures of PRC Taiwan trade under the WTO relate not only to U.S. trade and economic interests but also to regional security interests.

My point, short-term bilateral analysis of the impact of China's WTO entry is insufficient to reveal potential longer-term regional and global consequences for China's neighbors as Beijing increasing its ability to exert economic and financial pressure on Tokyo or more immediately perhaps Seoul, Jakarta, Thailand, or Taipei, thereby possibly

loosening strategic ties important to the United States.

You can read in the first part of my written testimony four points regarding context in process. I'll leave that for our discussion and move now to conclusion.

I returned to Washington from a State Department assignment in Beijing that included the period of June 4th, 1989 Tiananmen tragedy, from the early MFN debates the beginning of the 1990s, I have consistently said congressional revocation of China's most favored nation status was too blunt an instrument to calibrate overall Sino-U.S. trade relations.

Today, I still support under appropriate conditions China's WTO entry and the U.S. granting China permanent normal trade relations status.

But I underscore the important effort this Commission represents. It is analyzing over longer time frames the wider bilateral, regional, and global implications involved in China's trade and exchange rate future.

Moving beyond straight up or down votes is required to bridge the burden of proof for those debating China's trade and WTO future.

VICE CHAIRMAN PAPADIMITRIOU: Thank you
very, very much.

Mr. Harding? First of all, welcome.