

**THE EMERGENCE OF CHINA THROUGHOUT ASIA:
SECURITY AND ECONOMIC CONSEQUENCES FOR
THE UNITED STATES**

HEARING

BEFORE THE

SUBCOMMITTEE ON EAST ASIAN
AND PACIFIC AFFAIRS

OF THE

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UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

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**THE EMERGENCE OF CHINA
THROUGHOUT ASIA: SECURITY AND
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THE UNITED STATES**

Tuesday, June 7, 2005

U.S. SENATE,
SUBCOMMITTEE ON EAST ASIAN AND PACIFIC AFFAIRS,
COMMITTEE ON FOREIGN RELATIONS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:35 p.m. in Room SD-419, Dirksen Senate Office Building, Hon. Lisa Murkowski, Chairman of the subcommittee, presiding.

Present: Senators Murkowski, Voinovich, Feingold, and Obama.

**OPENING STATEMENT OF HON. LISA MURKOWSKI,
U.S. SENATOR FROM ALASKA**

Senator MURKOWSKI. We will call to order the Subcommittee on East Asia and the Pacific. We would like to welcome all of you here this afternoon. The topic of today's hearing is The Emergence of China Throughout Asia: Security and Economic Consequences for the United States.

We have two panels with us this afternoon. The first panel, we are honored to be joined by the Assistant Secretary of State for East Asia and the Pacific, Mr. Chris Hill. Welcome to you. Our second panel features Mikkal Herberg, with the National Bureau of Asian Research, who has done a considerable amount of research into China's growing energy needs. We also have Catharin Dalpino, an Adjunct Professor of Southeast Asian Studies at Georgetown and the George Washington Universities, who recently completed a survey of China's growth in Southeast Asia, and Dr. Minxin Pei, a Senior Associate with the Carnegie Endowment for International Peace, who has been published extensively on China's economic, legal, and political reforms.

I had also hoped to have a representative from the Department of Defense with us, as well, but I understand a security conference in Singapore, attended by Secretary Rumsfeld this past weekend, has occupied those officials who focus on East Asia and the Pacific. I do appreciate that Secretary Rumsfeld's focus on China's military buildup makes this hearing all that more timely.

Now, the purpose of today's hearing is not to air grievances about China or to discuss ways to contain China's development. The intent is, rather, to take a broad view of China's growth in the East Asia region, what that growth means for the U.S., and what policy

decisions should be taken to maintain and grow our presence in the region politically, economically, and militarily.

Individual actions by China around the region may not, in themselves, seem particularly significant, but, taken together, it is clear that China is moving forward with a long-term strategy to promulgate its influence. Whatever name you want to give it, whether it is charm offensive, smile strategy, peaceful rise, or development, it is proving to be effective.

China has replaced the United States as Japan, South Korea, and Taiwan's largest trading partner. In just the past few months, China agreed to invest \$10 billion in Indonesia as part of a new strategic agreement. President Hu met with two Taiwanese opposition leaders, and Beijing and Manila signed two agreements to foster better military and security cooperation.

Premier Wen's visit to India in April sought to defuse border tensions and led to the announcement of a strategic partnership to improve economic cooperation and bilateral ties. China and India are renovating the old Stillwell Road built by the U.S. and China during World War II and named after the U.S. Commander of Allied Forces for the China/Burma/India theater. The Stillwell Road stretches from Southern China through a good portion of Burma and into Northeast India and will facilitate increased commercial and military ties, not just between China and India, but all Southeast Asia.

China is also helping Pakistan develop the port of Gwadar, near the Iranian border, as it seeks friendly ports of call in Southeast Asia. And China plays a central role in the six-member Shanghai Cooperation Organization that is focused on combating terrorism in the region.

You throw in China's willingness to allow tensions with Japan to escalate, and it is clear that China is looking to exert its influence in the foreign policy area. The bottom line is that China has a plan and they are successfully implementing it.

Our question today is, what is the United States' plan as it relates to that? What does China's increasing influence mean for United States security concerns, and how does that impact our relations with our traditional allies?

U.S. and China interests do not always coincide. Will Asian nations be willing to offend their large neighbor to advance U.S. interests? It is not as if they can pack up their country and move in order to avoid potential conflict.

From a security standpoint, China's development of a blue-water navy raises concerns about our commitments under the Taiwan Relations Act and control of certain trade chokepoints—namely, the Strait of Malacca.

On the economic front, just last week the USA Today reported that China's investment in North Korea jumped from \$1.3 million in 2003 to \$200 million last year, yet China has not indicated a willingness to use its economic influence to bring North Korea back to the Six-Party Talks. So, where will it use its economic influence? With Japan and South Korea now more trade dependent on China than the U.S., does that impact the United States' ability to promote its interests in the region?

China runs a trade surplus with each of the world's three largest economic centers—the U.S., the European Union, and Japan—yet because of their heavy purchases of raw materials from neighboring countries, some analysts believe China's global trade surplus will fall to zero in the next few years. So, those countries who export raw materials enjoy a trade surplus with China. How does that impact their interests?

At the same time, the U.S. economy remains a strength. We have been the driving force for the global economy for some time. Even as China is experiencing 9 to 10 percent annual growth rates, signs are appearing that China is seeking to cool its economy before it overheats. But could that cool-down result in a hard landing for other countries in the region that rely on exports to China?

Foreign-funded enterprises now account for about 55 percent of China's exports and imports. The United States consumer contributes to all of Asia's prosperity by buying goods made in Chinese factories, which, in turn, purchase components and raw materials from Asian suppliers. If there is a protectionist backlash in the U.S. at Chinese imports, it does not impact just China, but all nations whose companies export raw materials to China.

On the energy front, my state of Alaska is rich in natural resources. Our state budget is heavily impacted by the price of oil. China's rapid economic development has been a leading reason for the rising global demand for energy and raw natural resources.

Steel prices, once low enough, just a few years ago, to lead the President to provide import relief for domestic companies, have increased considerably. We are trying to build a natural-gas pipeline up in Alaska. The Chinese demand for steel for construction purposes makes our project that much more expensive to pursue. And although we are an ocean apart, China's demand for raw resources is having an impact on the United States, and we need to approach this issue with our eyes wide open.

When it comes to energy imports, Canada's importance to the United States is not widely recognized, but they are the United States' largest foreign supplier of energy, and China is investing heavily in Canada's oil sands, constructing a pipeline from Alberta to the West Coast to export that oil. Just as we often overlook the fact that Canada is our largest foreign source of energy, we also tend to believe that our northern neighbor will always be a secure energy source for the United States, not for other nations. Well, China has brought the competition for natural resources to our backyard.

In taking the long-term look, I would be remiss not to mention education. Our current strengths will not have lasting power if the next generation is not able to continue and build upon our successes.

I had hoped to have Mr. David Lampton, Dean of Faculty and Director of China Studies at SAIS and the Nixon Center, with us today, as well, but, unfortunately, scheduling conflicts did not allow that to occur. Mr. Lampton did provide the committee with written testimony for the record, and I would like to note that, in that testimony, Mr. Lampton points out that, in 2002, China and the U.S. graduated approximately equal numbers of graduate-level engineering degrees, but China graduated almost 3.5 times as many

undergraduate engineering degrees. He also notes that U.S. engineering schools have substantial enrollments of non-citizen students. The National Science Foundation predicts that by 2010 China could be turning out four times the number of engineering doctorates as the U.S.

[The prepared statement of David M. Lampton follows:]

STATEMENT SUBMITTED BY DAVID M. LAMPTON

Madam chairman and committee members: You have asked me to address two profoundly important questions: “What are the security, economic, and diplomatic implications of China’s rise for America?” And, “What U.S. policies are appropriate in light of those implications?”

China’s rise has implications for:

- *America’s competitiveness*: In the 1990s we seemed to have the notion that “globalization” was something that we did to others requiring them to reform. Americans have to get used to the notion that globalization also requires us to reform.
- *Asia’s security structures*: The post-World War II East Asian security structure, the “hub and spokes” system, is undergoing gradual and uneven change. U.S. allies are rebalancing their interests with America against their expanding interests and concerns about, a growing China.
- *The United States’ diplomatic toolbox and the mix of power*: There are three kinds of power—coercive, economic, and idea power. It is tempting to become fixated with the military dimensions of China’s rise, but it is the economic and intellectual dimensions that likely will be most important. China is leading with its growing economic and intellectual/cultural power in the region. America must rediscover and-utilize its own economic, cultural, and intellectual power (soft power) assets in East Asia.

China’s rise need not be at America’s expense, even though we must be prepared for downside possibilities. If China’s rise can push America to make the internal and external policy and behavior adjustments we should make (out of consideration of our own interests), the United States will be stronger for this productive competition, East Asia will become more stable, and we will have a more prosperous and effective partner in addressing the region’s humanitarian and developmental problems. Was China to move in less welcome directions and the United States to fail to make the needed changes, future prospects would be much more somber.

UNCERTAINTIES AND THE DIMENSIONS OF CHINA’S GROWTH AND CHANGE

The People’s Republic of China (PRC) is the largest, most rapidly changing international actor on the world stage today. It is traversing enormous tracts of previously uncharted social, political, economic, and diplomatic real estate. Never before has such a large economy moved so rapidly from a planned structure toward market operation; opened up so speedily to the world financial and trade system; changed so dramatically from a rural to increasingly urban society; switched from energy self-sufficiency to import-dependence so quickly; and, gone from an information-starved to information-rich status so abruptly, the many controls on the Internet notwithstanding.¹ Given the magnitude of these changes, it is impossible to anticipate all the conceivable outcomes. A lot could go wrong in China, not the least being a rigid political system crumbling under the accumulated forces unleashed by reforms. Simply projecting past trends and successes indefinitely into the future is risky, indeed destined to be wrong along some important dimensions. If nothing else, as China’s economy enlarges and exhausts the relatively “easy” gains that have produced spectacular growth thus far, the rate of economic expansion can be expected to slow. The straight-line projection of Japan’s spectacular economic performance of the 1980s into the indefinite future is a cautionary tale.

Uncertainties aside, America must plan for a future in which China continues to make progress across a broad front. The dimensions of the PRC’s emergence are everywhere apparent and the list below simply is suggestive:

¹Michael Chase and James Mulvenon, *You’ve Got Dissent: Chinese Dissident Use of the Internet and Beijing’s Counter Strategies* (Santa Monica: RAND Corporation, 2002).

- China's military modernization still faces enormous challenges, but the progress to date has exceeded expectations of a decade or so ago. We see this in China's space program, its downsizing and professionalization of forces, its shift toward naval, air, and missile capabilities, and in its evolving force-use doctrines.
- The PRC's GDP growth has been in excess of 9 percent on average since 1990, after having averaged above 10 percent in the 1980s, according to the world Bank. India, by way of contrast, had growth rates a little more than fifty percent of China's throughout the 1980s and 1990s.²
- China's imports and exports have grown eight times as fast as world trade in the 1980–2003 period according to the IMF. In 1978, China's turnover trade accounted for .8 percent of world trade; by last year it accounted for 6.4 percent. Cumulative foreign direct investment in China has gone from negligible in 1982 to \$500 billion (2003), taking off in the early 1990s. There is a downside here for China, inasmuch as a large share of PRC exports (55 percent in 2003) comes from foreign-invested enterprises. This means that many of China's wholly owned-domestic firms still are far from competitive internationally, though a few firms have emerged such as Huawei telecom and Haier appliances.
- China also is becoming a growing supplier of capital, particularly in Southeast Asia, as well as in the United States, Latin America, and elsewhere. The PRC's foreign exchange reserves (minus gold) were about \$659.1 billion in March 2005 and the PRC held \$174.6 billion in U.S. Treasury securities, second only to Japan (\$715.2 billion) in October 2004.
- In 1993, of China's total exports, 17.7 percent were machinery and electrical products; by 2003, 51.9 percent were in this category. The U.S. Census Bureau reports that in 2002 for the first time the U.S. trade balance in advanced technology products went negative, though we must acknowledge what constitutes "advanced" products is a broad category that includes items of comparatively modest technology.
- Since 2002, Japan, South Korea, and Taiwan have seen China become their number one export destination, replacing the United States, though this hides the fact that America remains a primary destination for intermediate goods sent to China, assembled there, and then exported.
- Intellectually, growing numbers of foreign students throughout Asia are studying in China. And, China's own students are achieving more internationally. In April of this year, "[T]he University of Illinois tied for 17th in the world finals of the Association for Computing Machinery International Collegiate Programming Contest."³ Shanghai Jiaotong University took first place.
- The OECD reports that Chinese R & D expenditures are growing rapidly now, from a low base, and a Stimson Center study by Kathleen Walsh⁴ reports on the growing number of foreign R & D facilities locating in China.

In short, America should plan on dealing with an increasingly capable China in the military, economic, intellectual, and cultural realms. The United States should not go into the defensive crouch of containment-like thinking. Instead, we must think seriously about how to cooperate and compete more effectively, and play a central role in the emergence of new patterns of economic, intellectual, and security interaction.

THE BUILDING BLOCKS OF NATIONAL COMPETITIVENESS

The PRC is becoming an increasingly able competitor on the global playing field America did so much to build. China wants to play ball with America. The question is: "Will America perform well in a game and on a field it long dominated?"

The building blocks of national power and competitiveness are national investment and savings; education; health; energy; and sound, legitimate governance. Though China has significant problems in each area, it is doing comparatively well in the first three—and less well in energy and legitimate governance.

In 2003, the Chinese had an investment to GDP ratio between 32 percent and 42 percent. Looking at domestic savings alone, the IMF says China's "gross national

²The World Bank, *World Development Indicators* (Washington, DC: The World Bank, 2004), pp. 182–183.

³Thomas L. Friedman, "Soon, Just Showing Up Won't Even Take the Bronze," *International Herald Tribune*, May 14–15, 2005, p. 4.

⁴Kathleen Walsh, *Foreign High-Tech R&D in China* (Washington, DC: The Stimson Center, 2003).

savings” rate that year was 47.6 percent. These rates make continued high economic growth very likely.

Chinese performance contrasts sharply with America’s. Harvard’s Larry Summers was right when he said:

In the last year [2003], the net savings rate of the United States has been between 1 and 2 percent ... It represents the lowest net national savings rate in American history ... In fact, net investment has declined over the last four to five years in the United States, suggesting that all of the deterioration of the current account deficit can be attributed to reduced savings and increased consumption rather than to increased investment.

The United States cannot long compete when it borrows for current consumption while China invests using its own savings. America must rebalance its saving, investment, and consumption priorities. If we do, Beijing’s competition will have done us a big favor. Such action would help us resolve our twin budgetary and trade deficits.

Examine the second building block—education. U.S. higher education is excellent. Nonetheless, considering its low current income levels, and the many severe education problems in China’s rural areas, the PRC has brought primary school education to 93 percent of the nation’s population; the percentage of secondary school-age children enrolled has risen rapidly in the last decade; and the percentage of China’s population in tertiary education has more than quadrupled since 1991/92. Many people say China is attracting foreign manufacturing investment because of cheap labor. In fact, the attraction is the combination of relatively inexpensive and relatively skilled labor, though we ought not to forget the millions of educationally deprived in rural areas.

Take as an example a field that is highly germane to economic modernization—engineering. China and the United States in 2002 granted approximately equal numbers of graduate-level engineering degrees, though China granted almost 3.5 times as many undergraduate engineering degrees. Moreover, U.S. engineering schools have substantial enrollments of non-citizen students. More startling, entering class sizes in engineering schools in China are growing rapidly. Looking to the future, and even discounting for quality differences, China will have enormous and growing human resources in technology. The National Science Foundation predicts that by 2010 China could well be turning out about four times the number of engineering doctorates as the United States.⁵

Go to most U.S. graduate schools in the hard sciences and you will see highly capable students from China in profusion. And, while the number of Americans studying in the PRC is in the low thousands each year, China for well over a decade has had about 60,000 students matriculated in American institutions of higher learning studying science, technology, as well as business, economics, and international affairs. China is turning out language proficient, culturally adept, and scientifically and technically capable people at home and abroad in ever-greater numbers. We must do the same thing. If Chinese competition motivates us to do what we should be doing, this is positive.

Public health is a tricky third building block. There are millions of people in China with virtually no medical care, the system is vulnerable to infectious diseases as the world saw with SARS in 2002–2003, and maladies once reduced to very low levels are increasing in incidence—not to mention a looming HIV/AIDS catastrophe. Nonetheless, China had a life expectancy in 2002 of 71 years, which compares favorably with the life expectancy in a much richer United States—77 according to the World Bank. And yet, in 2002 China only consumed about 5.5 percent of its still modest GNP on health expenditures while the United States consumed 13.3 percent by 2004, this figure had risen to 15.4 percent and the rate projected for 2014 is a whopping 18.7 percent. The point is not that Americans should prefer Chinese health care, but rather that if the United States is to remain competitive it must control health expenditures. Germany, France, and the UK each have longer life expectancy rates than the United States, and they have about half the per capita health costs of America according to OECD data. The U.S. Bureau of Economic Analysis reports that “Before the first energy shock [1973], Americans, spent \$1.56 on health care for every dollar they spent on energy ... Now, even with oil prices up, every dollar spent on energy is matched by \$3.81 on health care.”⁶

⁵Data cited by Ernest Preeg, “The Emerging Chinese Advanced Technology Superstate,” presentation at The American Enterprise Institute, May 13, 2005.

⁶Floyd Norris, “Compared with Health Costs, Energy is Cheap,” *International Herald Tribune*, May 14–15, 2005, p. 12.

And this brings us to energy policy, about which little need be said, other than the United States needs to get away from excessive reliance on imported petroleum and unstable regions of the world. Whatever nation first escapes the petroleum trap will achieve economic dominance for the next era; indeed, such liberation would define a new era. China is becoming rapidly energy-import dependent and this accounts for the near obsession Beijing has with securing sources of energy supply irrespective of the attributes of the supplying regimes. Energy is one of the principal Achilles heels of the PRC—along with water.

THE CHALLENGE OF BUILDING NEW SECURITY STRUCTURES IN ASIA

Turning to the security implications of China's rise, the trends merit vigilance. China's official, non-inflation adjusted defense budget has increased in the double-digit range every year from 1990 through 2004. Most outside estimates place China's military expenditures in a league with Russia, Japan, and the United States. Second, China has an active, space program, the dimensions of which would surprise most Americans, and emphasis is on modernizing air, missile, and naval forces, as well as enhancing cyberspace, communication, guidance, and reconnaissance capabilities. Beijing is developing these forces and capabilities to have military options if it determines Taiwan is moving unalterably toward independence; to deter Washington from entering a Taiwan Strait conflict; to safeguard China's nuclear deterrent; and to secure its resource lifelines. There is a non-trivial chance that Washington and Beijing could end up in conflict in the Taiwan Strait if the situation there is not handled well. Since early this year, however, there have been positive developments in cross-Strait relations—we must watch carefully and actively encourage positive moves.

Beyond Taiwan, however, the U.S. security situation in Asia is changing less as a consequence of China's growing military power than its economic growth. America's post-World War II allies in East Asia (Japan, the Republic of Korea [ROK], Australia, Philippines, and Thailand) increasingly depend on exporting to China and/or receiving increasing investment from it. Consequently, most U.S. allies will not allow themselves to be drawn into what they view as unnecessary friction with Beijing. Japan is the ally most tightly aligned with Washington. As China's economic power grows, the United States can decreasingly count on allies marching in lockstep. In some cases, such as the ROK, that day already is gone. The amorous effects on U.S. allies of China's economic aphrodisiac are nowhere more apparent than in NATO's contemplating arms sales to China in the face of Washington's opposition.

China's rise, therefore, is forcing many of our traditional allies in the region and farther afield increasingly to balance their interests with Beijing against their interests with Washington. Most Asian countries do not wish to be forced to choose between the two. As China becomes a bigger security and economic player, and if it continues with its trade and smile diplomacy, alliances that initially were directed against the PRC, and more recently designed to maintain balance and reassurance in the region, will become progressively less effective unless they adapt.

Institutions need to be developed that incorporate China into the Asian structure of peace. America needs to take the lead in developing this structure. The most critical strategic challenge in this respect is how to foster security cooperation between China, Japan, and the United States, a structure not premised on a "two-against-one" triangular logic that inevitably has one party feeling left out and vulnerable. No major regional challenge in Asia can be effectively addressed without cooperation among Beijing, Tokyo, and Washington. The recent surge in Japanese and Chinese nationalism and Chinese hostility directed at Tokyo signal the dangers.

THE IMPLICATIONS FOR AMERICAN DIPLOMACY AND THE MIX OF POWER USED

Presidents Bush and Hu Jintao both traveled to Australia in late 2003 and it is widely asserted that China's president was more warmly received by our ally's legislature than our president, reflecting the success Beijing has had in its dollar and smile diplomacy, the most notable features of which were signing two energy deals with Canberra each of which ranged well over fifteen billion dollars. China also is seeking to reduce tensions in the region by shelving most territorial issues, signing agreements to reassure neighbors, promoting free-trade agreements, engaging in military-to-military exchanges, establishing large and long-term investment relationships, and promoting its "early harvest initiative" that promises some agricultural producers in the region more favorable access to China's domestic market. Beijing is doing the latter to win support on Taiwan as well. This tightly coordinated diplomatic and economic strategy in the region is leading serious analysts of the

East and Southeast Asian system to talk about a “power shift,” though Asia is by no means sinocentric.⁷

The United States needs to react more effectively to these developments and possesses enormous resources to do so if it employs the appropriate mix of economic, intellectual and cultural, and military power. Washington has talked too much about military issues and done too little on the economic and cultural/educational fronts. This problem began under the Clinton administration when Washington reacted too feebly to the Asian Financial Crisis. Nonetheless, the United States is more trusted to be an honest broker, and power balancer, than anyone else in the region. Moreover, America is still the most important “end market” for most everyone in the region. Washington needs to be more active in multilateral diplomacy in the region and more active in expressing interest in multilateral free-trade possibilities.

China’s integration into vital regional and global production chains has an important implication for the use of economic sanctions. For many Chinese exports the value added in the PRC is 30 percent or less, meaning that 70 or more percent of the value is added in other countries or regions, most of which are friendly to us. To inflict sanctions against nominally “Chinese exports,” therefore, is to inflict the bulk of the pain on others. This is bad economics and bad international politics.

POLICY IMPLICATIONS FOR THE UNITED STATES

Americans believe in competition; China’s emergence is providing it. There are two categories of policy responses—those involving fundamental American domestic systems and those that more directly pertain to relations with China and East Asia.

(1) China’s rise forces Americans to reexamine fundamental systems in the United States, challenges we ought to address even if China were not in the picture. The issue is, “Are we going to be competitive?” If so, we need to:

(A) Increase our national savings rate. The solutions to our trade and budget deficits do not principally rest in Beijing, they lie principally in Washington. It may be emotionally satisfying to rail against foreigners, but this alone will not be economically effective. Having said this, Beijing now should modestly revalue the RMB out of its own, as well as U.S., interests (more below).

(B) Improve our schools—increase math and science training. Bill Gates has noted our high schools are broken overall, and one needs only look at foreign student enrollments in higher education science and technology programs in the United States to know that we are not producing sufficient numbers of our own citizens proficient in the hard, mathematical, and engineering sciences. As Gates put it in recent remarks:

By obsolete, I do not just mean that our high schools are broken, flawed, and under-funded—though a case could be made for every one of those points. By obsolete, I mean that our high schools even when they are working exactly as-designed—cannot teach our kids what they need to know today.⁸

(C) Get more of our students into first-rate language and area studies programs and put the same emphasis on being effective with other peoples that the Chinese do. Mainstream social science departments in major U.S. research universities have lost interest in area studies—this is a national security issue and should be taken as seriously in the 21st century as it was in the second half of the twentieth.

(D) Find a way to stop the steady increase of health expenditures as a percentage of GDP. The American auto industry, for example, cannot be competitive when its overhead includes \$1,525 of health costs on each car rolling off the assembly line as is the case at GM.⁹ And be assured, China is emerging as an international competitor in this most American of industries.

(E) Reduce U.S. dependence on external supplies of energy, contain costs, and decrease negative environmental consequences of energy use.

These are alterations that the United States can and must make—they do not particularly depend on Beijing’s cooperation but will have great bearing on how effective we are in competing with the PRC. If we fail to do these things, even effec-

⁷See, for example, David Shambaugh, ed., *Power Shift: China and Asia’s New Dynamics* (forthcoming, University of California Press, 2005).

⁸Bill Gates, “Remarks to National Education Summit on High Schools,” www.gatesfoundation.org (accessed May 15, 2005), remarks delivered February 26, 2005.

⁹Katie Merx, “Widening Burden: GM Confirms that Cost of Health Care is a Crisis,” *Detroit Free Press*, April 20, 2005.

tively pushing Beijing to alter its unhelpful practices (which we should do) will only marginally improve things.

(2) With respect to regional/bilateral policies, many things should be done:

(A) Because U.S. competitiveness relies on innovation, and this depends on protecting intellectual property (IPR), my first priority with respect to economic/trade policy is IPR protection. I recently was in China with a group of your fellow senators and representatives and had a hard time finding any genuine foreign goods for sale by small vendors. I note that in recent congressional testimony Charles W. Freeman III, Assistant USTR, said that: "The administration places the highest priority on stemming the tide of intellectual property rights infringement in China."¹⁰ I agree.

(B) With respect to RMB valuation and exchange rate issues, we must distinguish between a flexible exchange rate system and a one-time revaluation. The former should be our longer-term goal, but a modest upward revaluation of the RMB now is warranted. This would assist the global monetary system in appropriately realigning exchange rates and help Beijing manage its current inflationary pressures. However, I doubt that any feasible (likely) Chinese revaluation would have great impact on the bilateral trade deficit and pushing precipitously for a fully market-driven exchange rate is risky given China's problem-plagued banking sector.

(C) Washington should develop a means by which the United States, China, and Japan regularly consult about security concerns. The idea is to have, "three-two talks" once or twice annually. These would be discussions where cabinet or higher-level security and diplomatic officers of the three governments get together to exchange views on common concerns. Such talks might evolve into something more formal, though we have the problem that Beijing may view such interactions as two against one as long as Washington has a bilateral alliance with Tokyo that it feels is directed against China. With respect to Northeast Asia, there were hopes that the Six-Party Talks might evolve into a more formal security structure. Those prospects seem dim now, but there is a role for five of those six parties to consult about regional security issues and perhaps something more formal could emerge. The main point is that bilateral alliances, with the Cold War patina of being aimed at China, are going to be decreasingly effective as Beijing's power and attractiveness increase, assuming those trends persist. We must bring China into the regional security architecture.

(D) America needs to rediscover its soft power in the region. Washington should become more active in multilateral regional free trade discussions, talk about a broader range of issues than the global war on terror, and most immediately fix visa, exchange, and related policies so that businesspersons and students from the region have traditional access to America. The late-1999 move of the public diplomacy function from the stand-alone United States Information Agency to—the Department of State was not wise inasmuch as public diplomacy suffered a relative decline in priority given the State Department's other responsibilities. We should increase the effectiveness and credibility of public diplomacy and restore America as a place people can expeditiously enter for education and business. The 2.4 percent decline in international student enrollments of 2003/4 is not in the national interest.

(E) And finally, China's rise has daunting implications for Taiwan. Taiwan has bet its economic future on financial, trade, and manufacturing integration with the PRC, but there are significant forces on the island that desire independence, a quest that basically is incompatible with the island's security and economic needs. To maintain this fundamentally inconsistent policy, Taipei will require increasing levels of security commitment from Washington, the cost of which will grow as Beijing's power increases. The security of a Taiwan that is highly integrated into the PRC's economy cannot be maintained by military means alone. Therefore, recent trends toward cross-Strait economic cooperation, cultural exchange, and political dialogue are logical, desirable, and to be encouraged. Getting back to a situation of cross-Strait dialogue that proved productive from 1992 until later in the 1990s should be a priority U.S. goal. For, if the Taiwan Strait were to erupt into conflict, our hopes for a pacific, Pacific region would be grievously set back.

¹⁰Charles W. Freeman III; "Testimony Before the Committee on Government Reform," May 13, 2005.

Senator MURKOWSKI. Since the attacks of September 11, many foreign students have found it more difficult to get a visa to study in the United States, so with substantial non-citizens in our engineering schools and fewer foreign students entering the U.S., keeping the U.S. competitive in the world marketplace is more than just about tariffs and foreign policy; it is also about developing future generations of Americans to be competitive with their foreign counterparts.

In taking stock of all these issues, what we must not do is act in such haste that we act irresponsibly. We must keep in mind the lessons of the December tsunami. The United States' rapid humanitarian response and use of our military assets in the region generated a considerable amount of goodwill. Locals took note that despite China's increasing investment and activities in their countries, when disaster struck, the U.S. was the only country able to actually provide the muscle behind the response. It is a reminder, albeit not the way you want a reminder to happen, that even as we are looking at China's rapid expansion, they do not yet have the ability to be a superpower. They are well on their way, but they are not there yet.

The United States still holds plenty of cards in our hand. How we play those cards, however, will determine our future involvement in Asia. I do look forward to hearing from each of our witnesses as to your suggestions on how the United States should move forward, what policy changes need to occur, and what role we, in the Congress, can play in the process.

I would like to recognize my colleague, Senator Obama, and ask if you would care to enter any opening comments. And thank you for joining us this afternoon.

**STATEMENT OF HON. BARACK OBAMA,
U.S. SENATOR FROM ILLINOIS**

Senator OBAMA. Absolutely. Thank you very much, Madam Chairwoman.

I appreciate, Mr. Hill, you taking the time to be here. Thank you so much. Because I am sure that everybody's time is limited, I will just keep my remarks brief.

Obviously, part of what prompted this hearing this afternoon is the concern about ongoing economic relationships between China and the United States. I will be interested in hearing some of your perspectives, in terms of potential competition—hopefully, friendly competition—between the two nations when it comes to energy policy and how we are having an impact on trade agreements, not only in Asia, but also in places like Latin America. I am, obviously, curious, also, given just some of the recent reports coming out, about China's relationship with North Korea. I probably will, maybe, pose just a couple of brief questions, since that is obviously on our minds in the news.

Thank you.

Senator MURKOWSKI. Thank you.

And right on time, Senator Feingold, would you care to give any opening comments this afternoon?

Senator FEINGOLD. No, thank you. And I look forward to the question period.

Senator MURKOWSKI. You bet. Great.

With that, Mr. Hill, if you could please share your comments with us? And, again, welcome.

STATEMENT OF CHRISTOPHER HILL, ASSISTANT SECRETARY FOR EAST ASIA AND THE PACIFIC, DEPARTMENT OF STATE

Ambassador HILL. Thank you very much, Madam Chairwoman. I have a report, a statement, that I would like to enter in the record, and then read a short excerpt from it, and then go right to your questions.

Senator MURKOWSKI. Your entire comments will be included in the record.

Ambassador HILL. Thank you very much.

Madam Chairwoman, Members of the Subcommittee on East Asia and Pacific Affairs, I am pleased to appear before you this afternoon to discuss China's emergence in the Asia-Pacific region and the challenge and opportunity this presents the United States and its allies and friends in the future.

One of the most important foreign policy goals of seven American Presidents over 30 years has been to engage China in a way that helps it peacefully integrate into the international system. As the Secretary of State said on a March 19th speech in Tokyo, the United States welcomes the rise of a confident, peaceful, and prosperous China, and wants China as a global partner, but one that is able and willing to match its growing capabilities to its international responsibilities. We also seek a China that is moving toward greater openness and rule of law at home, though it clearly has a long way to go.

How China changes depends mostly on its own people, but how we and others interact with it will shape the environment in which China makes its choices. Our policy will be based on a realistic appraisal of our common interests and our differences. Our continued active engagement in the Asia Pacific region and around the world is vital. I can assure you that America is working hard today on all of its trans-pacific relations. The future of the Asia Pacific will depend on a strong and committed America.

The President said, on May 30, that our relationship with China is complex. In recent years, we have worked hard to address common challenges—regional and global and economic and political—with China. We do have differences with China on many important issues—human rights, nonproliferation, Taiwan, and, most prominently in the press recently, intellectual property rights, textiles, and currency. We have to handle these issues sensitively, but in ways that advance our values and our national interests.

We discern two major trends in China's emergence in the Asia-Pacific region. First and foremost is the development of a robust trade and investment relationship which fuels China's own domestic development. Second, China is clearly interested in matching its economic power with political influence and, thereby, giving it an opportunity to help shape the region and its own interests.

A brief look at China's trade and investment with Asia, on which I have provided more details in my prepared statement, illustrates why the PRC is already, rather than becoming, a major regional player. China's trade with ASEAN grew over 30 percent last year.

In North Asia, China is now the leading trade partner of both Japan and Korea. China also recently became one of the largest investors in Indonesia, buying oil and gas interests.

Nonetheless, U.S. trade and investment in the region remains robust, and is distinct from what China has to offer. China exports primarily consumer goods that, for the most part, do not compete directly with U.S. products like high-tech knowledge-based goods, services, and agricultural products. The U.S. has invested over \$85 billion in ASEAN; whereas, Chinese investments are less than two billion. And Asia needs and values our markets and our expertise for its own continued development.

China's size and growing economic links in the region ensure that its influence will grow in the years to come. But, as I said earlier, America's role in Asia has increased, not diminished, through our strong alliance with Japan, Australia, South Korea, Thailand, and the Philippines; thoughtful changes in our global force posture; extensive engagement in regional architecture, such as the ASEAN Regional Forum and the Asia Pacific Economic Cooperation Organization; and our own open and transparent markets.

Let me comment briefly on the impact of China's relationships with Taiwan, North Korea, and Japan on regional security issues.

In Taiwan, the anti-secession law, which China passed last March, including a statement that it would not renounce the use of non-peaceful means in its policy toward Taiwan, was unhelpful and, in our view, a step back from the kind of dialogue that would lead to a peaceful resolution of differences. The longstanding U.S. position based on our one-China policy and commitments under the joint communiques and the Taiwan Relations Act, has been that cross-Strait differences must be resolved in a way that is acceptable to the people on both sides of the Strait. To that end, the United States Government strongly encourages cross-Strait dialogue of all forms. While Taiwan's opposition parties' leaders' recent trips to Beijing have the potential to be helpful, it is crucial, really, that China take the important next step of reaching out to duly elected representatives on Taiwan.

In North Korea, China has been very supportive of the six-party process in its role as host of the talks. China has made clear, at the highest levels, that it shares our goal of a Korean Peninsula free of nuclear weapons. China has the closest relationship with North Korea of any of the six parties, and it is for this reason that we continue to believe that the Chinese leadership has the kind of leverage that can help make a non-nuclear Korean Peninsula a reality. It is incumbent on each of the parties, particularly China, to make very clear to North Korea that the time has come for it to return to the talks in a way that demonstrates that it is ready to make a strategic choice about its future.

In Japan—America has few stronger allies in the world than Japan; and, throughout this administration, we have worked hard to develop common approaches to global and regional problems. Thus, the unresolved tensions between China and Japan, exacerbated by diverging political and historical perspectives and differing military and economic priorities, disrupt a relationship of great importance to the region. Healthy China/Japan relations are essential to stability and prosperity in East Asia.

I will conclude with two observations. First, China's global emergence is a natural consequence of its economic growth and development, and need not occur at the expense of the United States. We are, as I said—and we will remain—a Pacific power by virtue of our shared values, economic ties, and defense relationships with many of the countries in the region. I assure you that a strong, secure United States and a strong, secure, prosperous, and stable Asia Pacific remain our goal, and a continuing reality.

Second, we must work with China, and with all our partners, to ensure that its emergence takes place within strong regional and global security, economic, and political arrangements. I believe that this will be one of the key objectives of our new China/U.S. dialogue to be held soon to be led, on our side, by Deputy Secretary Bob Zoellick.

With that, Madam Chairman, I would be pleased to take any and all of your questions.

Thank you very much.

[The prepared statement of Ambassador Hill follows:]

PREPARED STATEMENT OF CHRISTOPHER R. HILL

Madame Chairman, members of the Subcommittee on East Asian and Pacific Affairs, I am pleased to appear before you this afternoon to discuss a topic that has engaged policymakers, legislators, academics and citizens alike for the past quarter of a century—China's growing influence in Asia. Dealing with China's emergence—its economic and political development, its engagement in a rules-based international world, its evolution as a major military presence in the region—will be a key challenge and an important opportunity for the United States and its allies and friends and over the next quarter of a century and beyond.

GETTING OUR RELATIONSHIP WITH CHINA "RIGHT"

For three decades, seven administrations have sought to integrate China and its people into the international system. We have succeeded in developing a bipartisan policy that has met with considerable success since 1972. Today's challenge is different from thirty years ago: the key question is how a more integrated and powerful China uses its growing influence and whether it will do so in concert with the United States and its allies. Will it accept the challenge of the international community to help enhance the peace, prosperity and stability of the region and in doing so, positively change the international system as we know it today. As Secretary of State Rice said in a March 19 speech in Tokyo, the U.S. "welcomes the rise of a confident, peaceful and prosperous China . . . [and wants] China as a global partner," but one that is "able and willing to match its growing capabilities to its international responsibilities."

We also seek a China that is moving toward greater openness and rule of law at home, though it clearly has a long way to go. How China changes depends mostly on the people of China, but how others and we interact with it will have an impact on the environment in which China makes its choices.

To further integrate China into regional and global security, economic, and political arrangements will require us to maintain active U.S. engagement in the Asia-Pacific region and around the world. Remaining a steadfast partner to our allies and friends in the region is a fundamental tenet of American foreign policy.

Getting our relationship with China "right" is vitally important. A decade ago, we all wanted China to be more actively involved in regional and global affairs. We wanted China to engage with Taiwan in a dialogue that would lead to the peaceful resolution of outstanding differences acceptable to the people on both sides of the Strait. And we wanted it to open its market of 1.3 billion people to U.S. goods and services.

We have achieved much of what we asked for on the latter: China is a member of the World Trade Organization, it is the world's third largest trader after the U.S. and Germany, and it is investing around the globe in Asia, Africa and the Western Hemisphere. Among our tasks now—and one we share with our allies and friends—is to ensure that in its search for resources and commodities to gird its economic

machinery, China does not underwrite the continuation of regimes that pursue policies seeking to undermine rather than sustain the security and stability of the international community. We also want to ensure that China joins our efforts in the WTO to lower barriers to world trade; in short, that it cooperates across-the-board with the United States in ways appropriate to the first new great power of the 21st century.

U.S.-CHINA TIES NOT A ZERO-SUM GAME

China's success in extending its political influence in the Asia-Pacific region and throughout the developing world is, in my view, a logical evolution, closely tied to its emerging economic clout, and certainly is not a zero-sum game for the United States. Nor should China see our continuing pursuit of U.S. national and security interests in the region as a threat or a loss to them. I believe that China well understands that we are an Asia-Pacific power and that other members of the Asia-Pacific community—and here I would say China included—look to the U.S. market, U.S. investment, U.S. technical expertise, and to our open and vibrant society. And for the sixty years since the end of World War II, the Asia-Pacific community has looked to U.S. military forces in the region as a guarantor of peace and stability.

There is much that is complementary with China in our approach to the region and much on which we look forward to cooperating with them. As the President said on May 31, our relationship with China is complex, but at least in recent years we have been able to communicate often—in remarkably candid and direct fashion, when necessary—and to address common challenges—regional and global, economic and political. Of course, we do have differences with China on a variety of important issues, including human rights, non-proliferation, Taiwan, and some aspects of trade and finance, among others. We seek to ensure that our differences do not preclude cooperation in areas where we agree. All of these issues must be handled sensitively, but in ways that advance our values and national interests. Let me say again that we intend for our relationship with China to be based on a realistic appraisal of our common interests and the exploration of differences through dialogue.

THE ECONOMIC DIMENSION OF U.S.-CHINA RELATIONS

Let me turn to the economic side of China's emergence and especially how that affects the United States. China's WTO accession in 2001 was a remarkable event. Its implementation of its commitments has created many opportunities for U.S. firms and exporters. U.S. exports to China have grown by 80 percent since accession, while total global U.S. exports grew just 11 percent during that same time. Nonetheless, serious problems abound in a variety of areas, from ineffective enforcement of intellectual property rights and barriers to distribution of products, to non-tariff barriers in agriculture (including a ban on U.S. beef) and a dramatic surge in textiles with the termination of the quantitative restrictions allowed by the WTO Agreement on Textiles and Clothing.

We expect China to fully and effectively implement all of its WTO commitments and to take action on key trade and economic concerns to further open its market and eliminate distortions. We are determined to see change and have made that clear to the highest levels of the Chinese government. A number of these issues will be discussed at the Joint Commission on Commerce and Trade this summer. At the same time, extreme protectionism is not the answer. We need to find solutions that do not derail our broad, long-term commitment to free and fair trade. I believe the countries of the Asia-Pacific region share many of these same concerns about maintaining open markets and insisting on fair, rules-based trade.

Protection and enforcement of intellectual property rights (IPR) in particular remains a vexing problem and a top priority our trade relationship with China. If China does not provide effective enforcement of IPR, it will undermine the development of knowledge industries and innovation around the world. Piracy and counterfeiting in China are rampant. If we can make it, they can fake it. The items being pirated and counterfeited range far beyond DVDs and other creative media. They include automobile brakes, even entire passenger cars, electrical switches, medicines, marine pumps, processed foods and other items that create health and safety risks in China and abroad because of poor product quality regulation. The scope and magnitude of the problem is huge and increasing—some American firms experience wholesale theft of product lines. Premier Wen Jiabao, Vice Premier Wu Yi, and others have spoken of the importance of IPR to an advancing economy and of the need to enforce IPR more actively. Yet, piracy and counterfeiting rates are as high as ever. We need to see a substantial reduction in IPR infringement in China; that is the real measure.

As a result of USTR's Special 301 determination and out-of-cycle review of China's IPR regime, we are taking a number of actions, including considering using WTO procedures to ensure China's compliance with its obligations, invoking transparency provisions within the WTO to request that China produce detailed information about its enforcement activities, and using the JCCT to secure new, specific commitments to significantly improve IPR protection and the enforcement environment in China.

We are also urging China to take a responsible role with regard to its exchange rate policy. As Treasury Secretary Snow noted in his most recent report, China's current exchange rate policy is "highly distortionary," and poses risks to the Chinese economy and global economic growth. The Chinese leadership has committed to adopting a more flexible, market-oriented exchange rate regime; we believe the time is right for them to do so.

China's leaders say they do not want economic and trade frictions to spill over into other aspects of our growing relationship. That will only be the case if we hold firm to our insistence on China's fulfilling the obligations it took on when it joined the WTO and the commitments it has made in bilateral and multilateral discussions since then.

CHINA IN THE ASIA-PACIFIC

There are two main drivers behind China's emergence in Asia: a dynamic view of how trade and investment fuels its own domestic development; and a desire to match its growing economic weight with political influence to allow China to help shape the regional system to its advantage, where possible.

Trade and Investment

The ability to bring economic growth and prosperity to its citizens is a key function that defines the legitimacy of any government; in recent years, as China has gone from a strict command economy to one in which market forces have played an increasing role, China's leadership has been successful in reducing poverty and delivering a better way of life for the majority of its citizens. The economy has grown an astounding 9 percent per year for the past 25 years; of course, this growth is coming from a very low base. China's economic orientation remains largely domestic—focusing on domestic investment, infrastructure development, and renewal—as the country tries to create the equivalent of 2 million new jobs a month for a growing workforce. However, a significant part of China's economic growth now depends on its outreach to the Asia-Pacific region and to the rest of the world to secure inputs, especially raw materials and commodities and energy, and markets. This growth has inevitably meant increasing global engagement and expansion of China's national interests.

At this point, China's growing demand for resource inputs has contributed to sometimes significant price increases on world markets, but does not appear to have distorted international markets and caused physical shortages or debilitating price spikes, and China is working with international bodies such as the International Energy Agency on management best practices. The biggest impact on U.S. national interests is China's willingness to invest in and trade with problem states (Iran, Sudan, Burma). We are concerned that China's needs for energy and other resources could make China an obstacle to U.S. and international efforts to enforce norms of acceptable behavior and encourage China's participation in international organizations to counter this tendency.

China's most dramatic diplomatic, political and economic gains of the past few years have been in Southeast Asia. Two years ago China signed the ASEAN Treaty of Amity and Cooperation and last year it took steps to complete the China-ASEAN Free Trade Agreement. Following an initial lackluster response to the tragic tsunami in South and Southeast Asia last December, China, like the United States, gained a large measure of regional goodwill by offering considerable government and public aid, and providing medical teams to help in hospitals and displaced persons camps.

China has become one of the largest traders and investors with many Asian countries. Trade with ASEAN nations grew over 30 percent and surpassed \$100 billion dollars in 2004. China became South Korea's top trading partner in 2004: their two-way trade China grew nearly 40 percent last year to US\$ 79 billion. China also became Japan's largest merchandise trading partner last year, with total two-way trade reaching US\$ 214 billion.

Nonetheless, U.S. trade with these and other Asian nations remains robust. U.S.-ASEAN trade tops \$136 billion; U.S. two-way trade with Korea totaled US\$ 72 billion; and our two-way trade with Japan reached \$183 billion in 2004. U.S. trade and investment in the region is also qualitatively different from what China has to offer.

Our comparative advantage remains in high-tech, research and development laden, goods, services and agricultural products. China exports primarily consumer goods that, for the most part, do not compete directly with U.S. products.

China is not just trading; it is also investing in the region. China recently became one of the largest investors in Indonesia, buying into oil and gas interests. China's investment in Indonesia's energy sector now exceeds US\$ 1.2 billion. And China is the largest foreign investor in some of the smaller economies in Southeast Asia; for example, China has recently become Cambodia's largest investor. Even so, China's outward investment pales in comparison with that of the U.S. China's cumulative realized investments overseas totaled approximately US\$ 37 billion for all countries at the end of 2004; U.S. direct investment abroad stands at over US\$ 2 trillion. In ASEAN countries, the U.S. has invested over US\$ 85 billion; Chinese investment does not yet reach US\$ 2 billion.

China's approach to its Asian neighbors reflects recognition of its strategic considerations. By proposing to negotiate a free trade agreement with the ASEAN countries, China offered to share the benefits of its economic growth—while reminding the region of its growing reliance on China. We welcome China's willingness to expand the benefits of growth to others.

At the same time, the United States is working to strengthen its trade and investment ties with the region. In October, 2002, the President announced the Enterprise for ASEAN Initiative, which offers the prospect of Free Trade Agreements to ASEAN countries that are committed to reform and liberalization. Under this initiative, we have already completed an FTA with Singapore, are negotiating an FTA with Thailand, and have strengthened our trade ties with ASEAN countries like Malaysia, Brunei and Vietnam. We are also working together within APEC to bring down barriers to trade and investment throughout the region.

Political Influence

China also uses its growing trade and investment ties to achieve its political ends, which include continuing to isolate Taiwan. China's size and expanding economic integration ensure that its already significant role in East Asian security calculations will become larger in the years to come. China is a nuclear power with a large standing army and has become more of a "status quo" player in Asia. Its economic modernization increases its economic impact and enhances its political influence. Its military modernization aims at greater professionalism, upgraded aerial, naval and missile capabilities, enhanced command and control functions, and a rapid-deployment conventional force.

However, China's growing security and military relationships with traditional U.S. Asian allies should not suggest that somehow U.S. influence or capabilities in the region have been diminished. U.S. policy toward Asia is anchored in our strong and enduring alliances with Japan, Australia, South Korea, Thailand, and the Philippines, which continue to provide unprecedented stability and prosperity in the region, and is reinforced by friendships with others in the region. Our allies throughout the Asia-Pacific region believe good U.S.-China relations are important to regional peace, prosperity and stability. Our efforts to work with China in key regional groups like the ASEAN Regional Forum and the Asia Pacific Economic Cooperation organization will enhance, not impair, our regional alliances, which are the primary guarantors of security in Asia.

China's relationships with Taiwan, North Korea, and Japan deserve mention here.

The PRC strategy on Taiwan is based on a refusal to renounce the use of force while simultaneously encouraging economic integration by making itself attractive to Taiwan investors. China also seeks to leverage its economic influence with countries of the Asia-Pacific region and beyond to generate support for the PRC's stand on Taiwan. We saw this recently when a number of countries like Burma, Cambodia and Laos issued statements in March welcoming China's unhelpful Anti-secession Law.

The longstanding U.S. position, based on our one-China policy and commitments under the joint communiques and the Taiwan Relations Act, has been that cross-Strait differences must be resolved peacefully through dialogue in a manner that meets the aspirations of people on both sides of the Strait. To that end, the USG strongly encourages cross-Strait dialogue of all forms. The anti-secession legislation adopted by China's National People's Congress was an unfortunate and unhelpful step that did not contribute to cross-Strait stability. Under Secretary Burns testified before this Committee on the actions the U.S. government took to dissuade China from pursuing the legislation and register our disappointment upon its passage. Since then, China has reached out to opposition figures on Taiwan, culminating in the historic visits to Beijing by leaders of the Kuomintang (KMT) and People First

Party (PPF). We encourage any form of cross-Strait dialogue and believe that the unofficial KMT and PFP visits have the potential to serve as an important first step in the resumption of a dialogue between Beijing and Taipei. It is crucial, however, that China take the important next step of reaching out to elected representatives on Taiwan. We believe that recently stated positions on both sides of the Strait incorporate elements of flexibility that could form the basis of substantive dialogue.

For the most part, China's political goals need not be viewed as antithetical to our own. China has been very supportive of the Six-Party process in its role as host of the talks. China has made clear on numerous occasions at the highest levels that it shares our goal of a Korean Peninsula free of nuclear weapons. Our main problem is a North Korea that has boycotted the Six-Party process for almost a year. China has the closest relationship with North Korea of any of the Six Parties and it is for this reason that we continue to engage the Chinese leadership on the North's lack of willingness to make a non-nuclear Korean Peninsula a reality. It is incumbent on each of the Parties, particularly China, to make very clear to North Korea that the time has come for it to return to the talks in a way that demonstrates that it is ready to make a strategic choice about its programs.

Unresolved tensions between China and Japan reemerge from time to time, causing disruptions in the development of a relationship that is of great importance to the region. As we witnessed recently, grievances about Japan's wartime legacy periodically erupt in China, most recently over changes to Japanese history textbooks that led to anti-Japanese violence. While Japan and China are more integrated than ever on the trade front, recent controversies over the Senkaku Islands, East China Sea energy exploration, China's posture toward Taiwan, and China's public opposition to Japan's bid for a permanent seat on the UN Security Council have chilled the relationship. The recent violent demonstrations in China against Japanese diplomatic and business facilities only serve to prolong ill will among neighbors. Disputes should be resolved through peaceful dialogue and discussion.

Healthy China-Japan relations are essential to stability and prosperity in East Asia. The two nations have many common interests, and we encourage stable relations between them and engagement on a full range of issues. Recent senior government discussions between them were useful, but regrettably, a much-anticipated meeting between Prime Minister Koizumi and Vice Premier Wu Yi did not take place. We support high-level dialogue between the two countries to work through all concerns.

SOME FINAL OBSERVATIONS

Let me conclude with a couple of observations.

First, China's global emergence is a natural consequence of economic growth and development.

Second, we must work with China, and with our partners around the world, to ensure that its emergence takes place within strong regional and global security, economic and political arrangements and I believe that this will be one of the key objectives of the new U.S.—China dialogue to be led by our Deputy, Bob Zoellick.

Finally, we must guard against actions that threaten to disrupt our economic and security interests. I assure you that a strong, secure United States and a strong, secure, prosperous and stable Asia-Pacific remain our goal, and a continuing reality.

Senator MURKOWSKI. Thank you, Mr. Hill. And I would also like to welcome to the committee Senator Voinovich. Did you have any comments that you wanted to make prior to going to the question round?

Senator VOINOVICH. No, I will just wait—Madam Chairman, I will wait until the question round.

Senator MURKOWSKI. Great. Well, with that, we will go ahead and begin.

I want to touch on North Korea first, because that is something that is certainly on all of our minds. And in your former position, I know you spent a great deal of your life just focusing on this issue. As we recognize the economic ties now between China and North Korea, does this increasing investment, capital investment, just—again, that economic relationship—does it help or hinder the Six-Party talks, and how the U.S.'s strategy may be changed to reflect the reality of this economic relationship?

Ambassador HILL. First of all, we have seen the reports about the increase in the volume of trade. I would say, however, that, in terms of the volume of trade, this is not a major calculation for the Chinese. That is, when they look at the six-party process, they look at the need to get a nuclear-free Korean Peninsula. They also understand—and I can assure you they understand at this point—the absolute importance that we attach to this issue. Whenever we talk to the Chinese, we talk about the North Korean problem. And we are absolutely committed to working with China to try to deal with this.

So, to be sure, there has been a growth in trade. I am always skeptical of some of the numbers, because it is very difficult to tell. Some of the growth in trade has to do with the decline in various services in North Korea. We have an economy there that is truly in decline. Some of the trade represents privatized trade, growing cross-border trade, people carrying goods on their shoulders across the Yalu River. It is really hard to say to what extent there is this trade. Certainly, China is North Korea's major trading partner. Certainly, North Korea depends on China every single day for fuel and food. So, certainly China has a big influence in North Korea. But I believe—I firmly believe, on the basis of dealing with the Chinese—that they understand the absolute importance of solving the problem of nuclear weapons on the Korean Peninsula.

Senator MURKOWSKI. Well, in recognizing that, the degree of influence that China acknowledges that they have over North Korea, there have been some that have suggested that China is not using that influence to the extent necessary, or needed, to move forward on the Six-Party Talks, and has been hesitant to do so. Can you speak to that?

Ambassador HILL. Well, certainly we have asked the Chinese to do more to get North Korea—not only to the talks, because the exercise is not just getting them to the talks; it is getting them to the talks with a willingness to give up, permanently, their nuclear program—so, certainly we have looked to the Chinese to do more. We expect more, because, one, they are the host of the talks, and the talks are in Beijing, and, secondly, it seems that China needs to use some of its leverage. Now, we have not told it how to use its leverage, whether it uses its political leverage, whether it makes an important decision to use its economic leverage. But certainly the Chinese have a lot of influence, and we are encouraging them to use as much influence as they need to use to get North Korea, one, to the talks, and, two, to the talks in a willingness to give up these nuclear programs.

Senator MURKOWSKI. Let us shift over to Japan. You make reference to the unresolved tensions and the fact that this has, certainly, the possibility of disrupting this relationship. How has the tension between China and Japan impacted the rest of the region? And what, in terms of the United States' role in attempting to defuse the tension, is happening now?

Ambassador HILL. Well, let me make one point, with respect to the tension between China and Japan, on the Six-Party Talks. That is, I am satisfied that our cooperation with the six-party process continues, and that Japan and China are able to work together

on that common enterprise. Both countries have made very clear they want to see a solution to this.

But certainly the tensions between China and Japan are in no one's interests. It is not something we like to see. And, I would argue, when you look at the extent of the economic relationship between China and Japan, which is truly enormous, that this is not in either of their interests, as well. So, we are hopeful that they can resolve these issues.

You know, these are tough issues, and they do go back into history. And history can be, obviously, a very powerful force, and a very powerful memory for people. So, I do not mean to make light of any of the historical issues here, but they do need to address them, and they do need to move on.

I would make one other point, which is that when you compare how history has been dealt with in Asia, versus how history has been dealt with in Europe, you see that the Europeans have been able to get some things done in that regard, and move on in a way that—I think, those of us concerned about the situation in Asia, we need to do what we can to see if we can make some progress there, as well.

Senator MURKOWSKI. Now, China has come out opposed to Japan's proposal to increase the U.N. Security Council by ten members. And instead of permanent members, they would like to see only non-permanent members. Do you see any scenario where China would accept another Asian nation as a permanent member of the Security Council?

Ambassador HILL. Well, I think the issue of increasing the size of the Security Council is related to the overall issue of reform of the U.N. and reform of the Security Council. So, I certainly would not be in a position to say what the Chinese will or will not accept in the future in whatever format, except to say that I think the Chinese have a great interest in making the U.N. work, making the Security Council work. So, I would not try to rule out that they would include another Asian member, but I cannot speak for what they would do in the future.

Senator MURKOWSKI. Sure. Just for members' information, I arbitrarily said seven-minute rounds, just to give everybody a first crack at things.

But before I move on to Senator Obama, just a question to you about the comments that Secretary Rumsfeld had made in Singapore regarding China's military buildup being a threat to Asian security. Do you think that the rise of China is a stabilizing or a destabilizing force there in the region?

Ambassador HILL. Well, I think the rise of China is a fact, and it is a fact that we are going to have to live with and work with, and, in a certain respect, try to shape. Now, we have areas where we are cooperating with the Chinese very well; and, frankly, I would include the six-party process in that, even though we have not yet solved the problem there. But, to be sure, as Secretary Rumsfeld discussed, we do have some concerns about the trends in the Chinese military. This is not to say that the Chinese military is of a size that will somehow threaten our vital interests, but certainly there are trends, there are rather substantial increases.

But another aspect of the problem is the lack of transparency surrounding the military budgets there. In the United States, our military budgets are discussed openly in rather minute detail, as you know far better than I, but they are not done so in China. So, one of the problems is the transparency problem involving the budget and the procurement practices.

Senator MURKOWSKI. So you would not give a title to either—it is not a destabilizing force, but it is not a stabilizing force. Somewhere in the middle.

Ambassador HILL. Well, you were referring to the rise of China, generally, or to the rise of its military budgets?

Senator MURKOWSKI. Well, I think his comment was to the military buildup, in general.

Ambassador HILL. Clearly, it is something that we need to be looking at closely. And, clearly, it is something that we need to be concerned about. But, I would add, the difficulty of measuring it, the lack of transparency, and the overall trends do add up to something that we need to keep a watch on.

Senator MURKOWSKI. Thank you.

Senator Obama.

Senator OBAMA. Thank you very much, Madam Chairman.

Just to follow up briefly on the questions surrounding North Korea. You know, the New York Times reported, in May, that China ruled out applying economic or political sanctions to pressure North Korea to abandon its nuclear weapons program, appearing to undercut a crucial element of the Bush administration's North Korea strategy. I guess, you know, one of the major concerns that we have on this committee is, How do we get North Korea to stand down on its military without, at least from my perspective, creating a worse problem than currently exists? And it seems China is critical in this role. Is it accurate to say, from your understanding right now, that China has essentially ruled out these sanctions as an alternative? And if they have, and if the Security Council is not an option, then do—have the Chinese offered us some alternative pressure points that can be applied?

Ambassador HILL. Well, first of all, I do not want to say the Security Council is not an option. It is an option we always reserve for when we feel it is appropriate. To be sure, we want to solve this problem through the Six-Party Talks. I mean, we believe this is the right mechanism, and we believe it is in everyone's interest that this get done, including the North Koreans.

Certainly, the Chinese have attempted to persuade the North Koreans, but I think you are quite right, Mr. Senator, that the Chinese have been clearly reluctant to use levers such as economic sanctions. Their major shipments into North Korea have to do with food and fuel; and, so far, they have been reluctant to use those levers.

The Chinese, however, continue to believe that they will persuade the North Koreans to come back to the talks. And so, they take a somewhat longer-term view of it than some other people may. I mean, they believe that North Korea will ultimately see that its interests are in coming back to the talks, and they have constantly urged patience.

Now, our concern, of course, is that the last time the talks took place was in June 2004, and we are fast approaching the one-year anniversary, where we have not had talks. Americans are sometimes known for their impatience, but I think a year is a long time. So, we would like to see this process going. We are working with the Chinese every day, and the Chinese understand—as I said earlier, to the Chairman’s question—the Chinese understand that this is a major issue for us. We cannot allow a country like North Korea to retain nuclear weapons. We cannot allow them to have nuclear materials with the potential or the possibility that these could be proliferated. We need to address this problem. There are a lot of options, but the one option we do not have is to walk away from this problem. We have to engage. And I think the Chinese have that message. And let us hope the North Koreans get it, as well.

Senator OBAMA. Okay—another follow-up off the Chairman’s question relating to Japan and China’s influence in Asia—I appreciate and agree with your point, that China is a world power and a growing power, and it would be shocking if they were not interested in exerting their influence in their backyard. And it is a fact. I it was not clear to me exactly what Secretary Rumsfeld’s point was in that Singapore interview. It strikes me that one of the things that we do have control over is our own behavior in that area. And, as you indicated, if we are doing a good job maintaining our military alliances in that area, if we are consistent in how we apply foreign aid in that area, then there is no reason why we can not have a strong United States in the Pacific, as well as a strong China. So, I appreciate that sentiment.

I am concerned about some of the anti-Japanese demonstrations that seem to have been orchestrated, to a large degree, by the Chinese Government. I think that your point about history is a good one. But some of this also has to do with raw politics and strategic interests. One area, in particular, that seems to have been raising some issues between the two countries is the dispute over gas fields in the China seas. And, according to press reports, at least, China has refused the Japanese request to stop exploring gas fields. The Japanese, in turn, have turned down the Chinese proposal for joint development.

I am wondering—on the specifics of that issue—how serious of an impediment is that to improved relations between the two countries. More broadly though, it strikes me that this goes to a larger issue, and that is China’s need for energy and how that is going to have an impact, not only in Asia, in its relationship with countries like Indonesia, but also its relationship to countries like Sudan, where we may have some contrary policies with respect to Darfur, for example.

I know that was a broad question, but—

Ambassador HILL. It was a broad question, but a very good question. First of all, with respect to the military buildup, I want to be very clear, we are concerned about this buildup, and we see some trend lines that are troubling, to be sure. And Secretary Rumsfeld spoke about those. Secretary Rice spoke about those the other day. But we have to track that situation very carefully, and we have to see what these military forces—what sort of capabilities they are trying to build up to. This is not just a question of raw numbers;

this is a question of the change in those numbers, the trends, and also the kinds of capabilities that they are developing. And then when you add to that the problem of transparency and the fact that it is a difficult process to measure how the budgets are being handled; it is something that keeps the analytical community very, very busy. So, we have to track that very carefully.

With respect to Japan, I completely share your point of view. To the extent that any street demonstrations were in any way officially inspired, this is obviously not acceptable. Now, the Chinese have said that they were not, but many independent observers say that they were. And, clearly, as someone who is served most of my career overseas as a diplomat, I like to make sure that, you know, the embassy that I am working in is going to enjoy the protection of the host country, as is required by the Vienna Convention. So, there are issues there to be concerned about.

With respect to the issue of China and Japan actually seemingly competing, in, sort of, 19th-century terms, for energy, indeed, this strikes us as, sort of, a mercantilist problem that should not exist in the 21st century.

Now, I want to say that although there has been some competition, there is also been some cooperation there, and we were pleased to see some Japanese delegations talking to Chinese delegations in trying to address this issue. Because, ultimately, the issue is not to remove energy resources from the world market; the issue is to develop energy resources so you increase the supply of energy and are able to moderate the price. So, we have seen some positive trends in terms of China and Japan working together on, especially, these offshore sources that you mentioned.

Finally, you mentioned the overall global issue. China's energy needs are going to be enormous in the future. And China is—

Senator OBAMA. Sorry to interrupt, but do you—just to give the committee a sense of, sort of, the level of magnitude, in terms of the increases there—and I know I am out of time, Madam Chairwoman—just briefly, as you are talking about it, do you have a sense of what—you know, how rapidly those energy needs are increasing and—

Senator MURKOWSKI. Senator Obama, I might just add that, on the second panel, we have got someone who will be specifically addressing those energy needs, if Mr. Hill does not have that information.

Ambassador HILL. China uses about six million barrels a day of oil, and the United States uses about 20. And, in some 20 years, we expect China to be up to some 20.

One other statistic that I think is worth noting is, the per-capita income of China is still in the neighborhood of \$1,200. If China continues to grow at, say, 9 percent, which is what they have been doing lately, probably by 2020, or something like that, they will be at \$3,000 per-capita income. Per-capita income in the United States is variously estimated at about \$30,000, just to give some order of magnitude to that.

But let me say that China is looking for energy resources. The question is, Are they looking to develop energy or are they looking to take it off the market? And that is the issue that we need to be engaged with the Chinese. And we do have a very good dialogue

with them on energy. The Department of Energy has an energy policy dialogue with China's National Development and Reform Commission. In the State Department, we have had a number of discussions with them, and will continue to do so.

And, finally, there are commercial opportunities for U.S. firms. China is looking to build some 40 new nuclear power plants, and these involve a technology that some U.S. companies can really have something to offer.

Senator MURKOWSKI. In keeping with the early-bird rule, we will, next, go to Senator Feingold.

Senator FEINGOLD. I thank the Chair. And it really is hard to imagine a more timely and important matter to have a hearing about, and I thank you for your leadership on this.

Mr. Hill, obviously you have a crucial job ahead of you in responding to the emergence of China throughout Asia and the world. And I am very pleased that you have talked previously about the need to prioritize human rights in China. I have tried over the years to be as vocal as I can be about the need for labor rights and religious tolerance and the promotion of human rights in China.

I would like to ask you to talk about what the United States can do to ensure that, as China gains greater economic power, the Chinese Government does not mistakenly assume that human rights will become a less important part of the U.S./Chinese relationships.

Ambassador HILL. Well, thank you, Senator Feingold, for mentioning that issue, because it is one that is very dear to my heart and, I think, really to every American, because I think human rights is really part of the basic fiber of what we are.

Let me say, though, that in every discussion—I mean, at every level with the Chinese officials—U.S. officials raise these issues. Sometimes we raise very specific issues about individuals, sometimes we raise broader issues, but I want to assure you, Mr. Senator, that human rights is very much a part of our ongoing dialogue and, I would say, an important part of our relationship with China.

Last year, the State Department programmed some \$13.5 million to promote legal reform and judicial independence, transparency and public participation in government and fostering civil society. So, we are not only talking about it, but we are actually identifying specific programs where we believe we can make a difference.

We have had some working-level discussions related to our human rights dialogue. They took place in November 2004 and February 2005. We do not believe there are any additional pre-conditions to resuming the formal bilateral human rights dialogue. But we based this dialogue not just on talking, but actually producing some results.

As China emerges on the world stage, I think it is important—China emerges, and other countries emerge, too—it is important to understand that human rights and rule of law are really part of the ticket of being on that stage. To be a world power is to subscribe to certain universal values. Our job is to make sure the Chinese understand that from our perspective.

Now, it is important to look at countries which have various levels of human rights, and to determine whether they are going in

the right direction. And that is where we want to see that China is heading in the right direction. And so, China is a vast country with some vast problems, especially rural/urban problem, where, you know, one would look at the human rights differently in different places. But what I want to assure you is, we are really on this one.

Senator FEINGOLD. I do appreciate that statement and look forward to working with you on the matter of human rights in China.

Another matter—this hearing really is not focused on it, because this hearing is focused on China's emergence in Asia—the fact is that China has been able to win goodwill in a fair amount of other places in the world by assisting with development in other projects. For example, the Chinese Government is offering rather tangible support across Africa that creates goodwill and longstanding relationships—I heard about 20,000 Chinese workers building housing in Algeria, soccer stadium financial arrangements in Mali, and other things that the presidents or leaders of the countries, sort of, went out of their way to let me know was going on; and, presumably, in some cases, to secure access to African oil markets, but not necessarily exclusively for that purpose. Obviously, there may be a variety of reasons. The fact is, there is quite a presence. And sometimes I am struck by our lack of presence in those same countries.

What is the United States Government doing, and what is it not doing that it needs to do, to respond to such efforts by the Chinese?

Ambassador HILL. Well, first of all, we maintain a very active foreign policy throughout the world. There is no country, including China, that has as many embassies, as many diplomats, aid missions engaged throughout the world dealing with these problems. I think it is important that, when you make contributions to a country, you are taking precious resources—I call them “precious” because they come from our citizens—and you are making sure that those tax dollars are going to helping these countries deal with economic problems, helping them deal with problems of governance and capacity. And I would hope that, as China is growing, and China develops the ability to provide assistance, that they do it in a way that makes these countries better able to cope with problems of development.

So, to be sure, we probably need to talk to the Chinese about some of these issues. I think it is very important that the Chinese, when they look to provide support to a country, that they do it in a way that is going to make that country better able to cope in the future.

Frankly speaking, if you go back through our history and look at some of our early efforts at assistance, some of them did not pan out very well. And I think we have learned a lot in assistance. And if China's desire is to help poorer countries become better off, and ultimately become markets or become sources of goods, they should really be very careful how money is spent, so that it is encouraging good governance, not bad governance.

Senator FEINGOLD. Thank you, Mr. Hill.

I thank the Chair.

Senator MURKOWSKI. Senator Voinovich?

Senator VOINOVICH. Congratulations on your new responsibility. I have had the privilege of working with Mr. Hill when he was Am-

bassador to Macedonia, and then the Ambassador to Poland, and I was very delighted to see you get this assignment.

In your remarks, you said China's growth need not be at our expense, and—I am from Ohio, and if you travel my state, you will find that many people have said that their growth has been at the expense of our state, and particularly of manufacturing. We have a \$162 billion trade deficit with China. Most of it is in manufacturing. And the question I have is, how involved—I know that you have got the State Department, and you have your Foreign Commercial Service offices that are part of the Commerce Department, located at the embassy—but how are you going to be involved in this whole issue of intellectual property rights violations that is occurring today, is rampant, and also the issue of the fixing of their currency, which many of us feel needs to be dealt with very soon?

Ambassador HILL. Well, first of all, Senator, it is great to see you. We first met in a refugee camp in Macedonia, and it is a great pleasure to see you here.

I think, on the issue of U.S. jobs, of U.S. goods and services, we absolutely have to be able to export. We need markets for our goods, and it is really not enough just to talk generally about the problems of free trade when people are losing their jobs in places like Ohio. I must say, Mr. Senator, every time we have talked, we have talked about the problem of people in Ohio and jobs and things like that. So, what I want to assure you of is, I understand that this is of crucial importance, because, ultimately, our country is not going to be able to be successful in the world if we can not export, if we can not have access to the markets. We have given access to our markets in a way that is simply unprecedented in the history of the world. I mean, we have basically helped countries come from nothing to being wealthy countries, thanks to our market. So, we do have to find ways—and, frankly, insist—that our goods have access.

Now, IPR is a very important issue for us, because a lot of what we do in our economy depends on—

Senator VOINOVICH. Pardon me, is that going to be part of your portfolio, though? Because you have got intellectual property rights, you have got the Commerce Department, and you have the Patent Office, you have USTR—

Ambassador HILL. Intellectual property rights are something that whenever you—whenever I see a foreign official in Asia, it is one of the things I raise. And, certainly, whenever we talk to the Chinese, it is one of the things I raise. So, I raise it, and the question is, Do I go through the motions, or do I take it seriously? And I want to assure you that I absolutely take it seriously.

With respect to the issue of the exchange rate, as you know, Treasury takes the lead on that. I think you know, obviously, that this is an issue involving our leadership at the very highest level—and, certainly, I do my part there, but that is something that is being led by our Treasury Department.

Senator VOINOVICH. Well, I think that one of the things that took my attention, I think it was a couple of years ago, is, when we got into the whole issue of China's fixing their currency, and the only people that could talk about it were the Secretary of Treasury and Condoleezza Rice, who was over at the National Security Council.

And there are many people that think that perhaps we have not been as aggressive as we should be on the economic side, because of the fact that we are relying so heavily on China to provide leadership to dealing with the problem that we have got with North Korea. Would you like to comment on that?

Ambassador HILL. I deal, quite often, on the problem of North Korea. And I believe pretty firmly that when you look at our policy toward China in the economic area, especially in the exchange-rate area, that it is not constrained by our policy to North Korea. North Korea is a big priority for us, obviously—the presence of nuclear weapons, the danger of the nuclear weapons, the danger of proliferation—but that does not mean that we cannot pursue policies that can help the American worker. So, I think we are prepared to do both and to make them both very high priorities.

Senator VOINOVICH. Well, I will say that, you know, we are going to be getting various trade agreements coming before Congress, and I think one of the biggest impediments, in terms of getting those trade agreements passed is the enforcement of our trade laws. And I am glad to know that the State Department is going to be active, in terms of letting people know how important they are.

The other issue is the issue of the environment. We have been criticized roundly because we have not signed the Kyoto Treaty. And one of the reasons we have not done it is because the developing nations are exempt from it. Is there anything on the table at the State Department to perhaps get involved in that issue, in terms of China? Because I think if they are not brought on to—in to the table, we are never really going to get anywhere with the environment. I spent a week over there, and their environmental problems are horrendous. In fact, some argue that 20 percent of the mercury in the Great Lakes comes from the ASEAN. Is that going to be on your plate as one of the issues that you are going to be talking about?

Ambassador HILL. That is definitely on the plate of the State Department. We have a bureau that deals with that—OES—and it is certainly something that the Commerce Department and others have been concerned about. It has not directly been on my plate, as the Assistant Secretary for East Asia Pacific Affairs, but, Senator, I can not agree with you more. I have been to China, I have seen some of those problems. In fact, I lived in Korea and felt some of those problems in the air. So, I completely agree with you, the environment is an issue that I think the Chinese, themselves, understand the need to do more about. We do have a dialogue with them, conducted through the State Department, and, I agree, we need to do more.

Senator MURKOWSKI. Thank you.

Mr. Hill, I have a couple of more quick questions, and then we will see if others have any additional questioning.

You mentioned, in your initial comments, just very briefly, Taiwan and the impact, if you will, or the recognition that the anti-secession law was unhelpful and is—essentially, is a step back. Given China's, certainly, increasing role in the area, and the relationships that we are seeing being built, how does this affect how

the U.S. is handling, or dealing with, the policy regarding Taiwan? Does it change at all?

Ambassador HILL. Well, our policy has been pretty firm and pretty consistent. We have encouraged both Taiwan and China to engage in a dialogue that will lead to a peaceful resolution of their differences. And it is based on our one-China policy, the three joint communiqués, and the Taiwan Relations Act. And, again, we have been very consistent about this, that we do not support Taiwan independence. But I also want to emphasize what President Bush told Chinese Premier Wen in December 2003, which is that we oppose unilateral moves, by either side, that would try to alter the status quo.

We have made clear to the Chinese—including Secretary Rice, during her trip—that the anti-secession legislation was unhelpful and did not contribute to the kind of dialogue we feel is essential, but we do believe that there is now some basis for a substantive dialogue, that there were some trips by the Taiwan opposition, of course, and we would like to see this carried over to discussions with the Taiwan authorities.

The United States continues to pursue unofficial relations with the people of Taiwan. We also support Taiwan's engagement with the international community in appropriate venues that do not require statehood for membership. And that is why we continue to support the goal of Taiwan's participation in the World Health Assembly. Taiwan was not successful in obtaining World Health Assembly observer status this year, but this does remain our goal.

And, again, our support for observer status for Taiwan does not conflict with our one-China policy.

Senator MURKOWSKI. So, nothing really has changed, in terms of how the U.S. is viewing the situation or its policy as it relates to Taiwan.

Ambassador HILL. We are certainly very keen observers of the situation. We have certainly made clear our views of the need for dialogue and our opposition to unilateral moves, but I would not say these are new policies.

Senator MURKOWSKI. And then, just one last question. How will the stability of the region be affected if the E.U. arms embargo should be lifted?

Ambassador HILL. Well, we have made clear to the European Union that we think this is really the wrong way to go. We have a Chinese military that has rather steep growth, as Secretary Rumsfeld and Secretary Rice mentioned. So, we do not feel this is any time at all to be lifting the arms embargo on China. The original reasons for it, for the embargo, are, I think, still in place. And, moreover, I think, in the wake of the anti-secession law, it should be abundantly clear to everybody that this would be a very unwelcome move.

We are trying to engage the Europeans in a strategic discussion of how we see the situation in Asia, of how they see the situation in Asia, to try to bring our understanding of the situation in Asia closer together so we will not have any kinds of miscommunications. But, clearly, we remain very firm in our opposition to changing the embargo.

Senator MURKOWSKI. Do you feel you are making progress in those discussions, then?

Ambassador HILL. Well, I do. I think we had a very good discussion in Brussels recently, where we discussed how we see the situation in Asia, where we had a strategic dialogue with the Europeans. And I was very pleased at the level of discourse and the fact that I think we have a lot of common ground.

And I want to stress that, although we often disagree with the Europeans, and this was one of those issues, we do retain a lot of common ground with them, and I think this was very much on display when we were talking in Brussels last week.

Senator MURKOWSKI. Thank you.

Senator Obama?

Senator OBAMA. Yes, just a couple of quick follow-up questions. You know, Senator Voinovich and I share a similar economic profile in our states, a manufacturing base that is deteriorating rapidly, so two comments just to follow up on his questions.

The first is, What is your assessment of how much difference a revaluation of the yuan would actually have, in terms of our constantly spiraling trade deficit with China? And if that is not the main problem, is there any administration policies that are in the works that might try to reverse that trade imbalance? That is question number one.

Question number two, with respect to intellectual property, I mean, this is an area where I think there is less dispute, that there just are no serious intellectual property protections in China. You know, I was meeting with the CEO of Starbucks, and he was remarking on how if you go to China, there is Starbucks everywhere; the only problem is, they are not owned by Starbucks. People have just started up a bunch of—they have the same logo, it looks identical. I guess the coffee is not as good.

So, you know, this is different from just, you know, bootleg DVDs. I mean, this is something where you have got a physical store there for everybody to see, in which a U.S. trade market is being encroached upon.

But my question on the trademark issue is, Are we being flexible enough and thoughtful enough about how to structure trademark protections in an economy in which grafting U.S. trademark law, or intellectual property law, copyright, may not be perfectly appropriate? I can not imagine that people in, you know, rural China can afford whatever it is that I am paying for a DVD for my kids, the Little Mermaid or something. So, that it may not be an exact transplantation of all our laws, but we might still have some semblance that—of intellectual property protection that takes into account that China's at a different stage of development? I am wondering whether we are being sufficiently flexible and creative in exploring how we can get around some of those problems.

Ambassador HILL. Well, first of all, you are absolutely right, there is a big problem; and it continues to be a big problem, in terms of China improving its intellectual property rights protection. In fact, we really do need to see some actual reduction in the counterfeit rates—in the piracy and counterfeit rates, and we are not seeing those yet. So, this is—I am not going to hide it from you, this is a big problem.

The U.S. Trade Representative recently elevated China to the priority watch list under the Special 301 review. And we are using WTO TRIPS agreement's transparency provisions to formally request specific evidence from China on the operation and administration of its IT enforcement. That is to say, we are really pushing them very hard, using the various levers that we have available through international trade agreements to push them on it. So far, it does not seem to be enough. And I think we have to continue to push them on this. We are——

Senator OBAMA. Can I just interrupt you on that point——

Ambassador HILL. Yes.

Senator OBAMA (continuing). ——on the WTO issue? China feels it is benefitting from its WTO membership. Is the problem here that it is just there are so many exhaustive requirements and steps we have to go through before we finally go ahead in getting a ruling from the WTO that they are violating——

Ambassador HILL. Well, I want to emphasize that I am interested in this issue. I raised this issue with the Chinese, but I am not the expert that can talk to you specifically about the questions of rights and responsibilities under the WTO. But, you know, certainly, we need to continue to press this. And what I want to assure you of is, we do not just leave this for the Department of Commerce, for example, because I think the Chinese need to hear this from all of us—State Department, as well—to make very clear that we are very concerned about this, and this is a major issue in our bilateral relationship.

With respect to the currency question, most analysts—first of all, I—again, I want to be very careful about this. This is something that the—Secretary Snow speaks to, in the Treasury Department, not me. But I will say that the locus of analysis on changing the exchange rate—the analysts do not feel it would make a big difference in the short run, but certainly if it were done, it would be a very key indication of China's willingness to do more and address this overall problem.

You know, ultimately, I think one can borrow a term used normally in the environment, "sustainable development." I think, ultimately, China needs to look at the U.S. market as something that it needs, not just this year or next year, but for decades to come. And I think when the Chinese look at our market, for decades to come, they will see the need to work on these issues, to clean up these issues, so that this trading relationship we can have is sustainable. And that is the kind of approach I would try to get, very specifically, on these issues. And, you know, there is not much macro-management of these things. You have got to get right into the individual subjects and go after each and every one of them. And what I want to assure you is that I am willing to do that.

Senator OBAMA. Just one last comment. This is more of a comment than a question, but feel free to share your thoughts on this. On a couple of these issues, one of the things that I hear from businesses that are concerned about intellectual property encroachment in China, or trying to break through non-tariff barriers in China to increase our exports, is a lack of coordination among the various branches of the U.S. Government and a preference, in certain circumstances, to simply avoid the U.S. Government entirely in deal-

ing with China, because they are fearful that, either because of the lack of coordination or a not-very-nuanced strategy, that sometimes the U.S. Government can do more harm than good, and the Chinese Government can end up penalizing them in ways that they are not happy with.

So, just an observation. That is something that I have heard directly from those who are doing business in China. It is not something that I have firsthand knowledge of. But I think it would be useful, since, during the testimony, you referred to the fact that this is Commerce's issue, or this is Treasury's issue. And I appreciate lines of responsibility and expertise and divisions of labor, but it just seems to me that—with such a critical relationship at stake here, and so many concerns on the part of our constituents back home that it is very important that we have very good coordination between USTR, Commerce, Treasury, and your Department, as well.

Ambassador HILL. I absolutely share your sentiment on that. We do need to be well coordinated. And I stress to you that, while I said that this is Commerce's area, I take a great interest, and I think it is important for China, and any other country, to understand that this is a thought-out position across-the-board in the U.S. Government because we too work for your constituents back home, and we are very aware that we cannot have free trade if our people do not support it.

Senator OBAMA. Thank you.

Senator MURKOWSKI. Senator Voinovich?

Senator VOINOVICH. Yeah, I would like to comment. Senator Obama, one of the things that I have been working on for the last, probably year and a half is the very issue that you are talking about. And I brought this issue of lack of coordination—in fact, I had a hearing on the Oversight of Government Management Restructuring to look at Commerce, USTR, Customs, Patent Office, and the Commerce Department has come up with a new program called STOP. And it is a one-stop shop, where a small company that feels that they have been stepped on can go to Commerce and get some quick results, in terms of their problem. I am going to be having another hearing to find out whether or not they have the manpower to enforce the law—or, not the law, but the program, and also to see if they have had any success. And I am going to be interested—when I was with Premier Wen, I spent about an hour and 20 minutes with him about two months ago, and we talked about intellectual property rights. I brought to his attention, Mr. Hill, Ambassador, three cases, exactly—Ohio, the company that makes these lights on tops of police cars; Gorman-Rupp, that makes pumps; Step2, that makes toys—and basically challenged him to do something about it. In other words, we get a lot of lip service from them, but the real issue is to have them follow up and really show that something is happening. And I applaud you for what you are doing, but I think you need to redouble your efforts, because if we do not get this thing straightened out, as I mentioned to you earlier, we are going to have a real problem, in terms of international trade. Now, certainly, Ambassador Zoellick gets it. But we have really got to do some work in that area if we expect

to be—if we are going to have any more trade agreements and, you know, move our—us ahead in international trade.

The other thing I would like you to comment on is that everyone seems to think that this anti-secession legislation the Chinese passed was very bad. And one of the points of view that I got from Premier Wen was that, “Yes, we did that. But the fact of the matter is that we are probably going to—increasing more dialogue and more commercial exchange under this administration than at any time before.” The question I have is—you mentioned that he met with the minority representatives from Taiwan. Do you see any other activity there that shows that perhaps they did pass the anti-secession legislation, but that, on the other hand, they have improved their relationship with Taiwan in some other regards over what it was before?

Ambassador HILL. Well, I think, clearly, the dialogue with the opposition leaders was a good step, and I think it did allow a change in the dynamic following the anti-secession law. And the problem with the anti-secession law is, of course, that it reiterates that they reserve the right to use non-peaceful means. And that is what, I think, many, many people were concerned about.

Whether they are able to capitalize on this step, whether they are able to follow through, remains to be seen. The Beijing Government is not yet prepared to deal with the elected authorities in Taiwan, because they are rejecting the condition that the elected authorities set forward. And I think our view would be, dialogue should just be dialogue, and should not depend on any conditions, and that, ultimately, when—anyone who has been to Shanghai and looked at the region there, or anyone who has looked at the Taiwan coast, realizes this has to be solved by peaceful means. There is absolutely no other way to do it. And the way to solve it is to have broader dialogue. So, I hope that they will follow up and pursue it.

Senator VOINOVICH. North Korea, the way I observe the situation is, that both the South Koreans and the Chinese do not seem to appreciate the nuclear threat of North Korea, and that they are trying to go about doing it through an economic relationship that is going to soften them up a bit and get them to realize that life will be better if you back away from this and open your doors and start to work with the rest of the world.

Ambassador HILL. Well, I would rather emphasize that, in the six-party process, there is a lot of agreement on how to proceed. And I think we have been really in sync with the South Korean Government on how to do this. Now, to be sure, South Korea has a special situation, in that their country, Korea, was divided, brutally divided, in the middle of the 20th century. And I think those of us who deal with the South Koreans, who encourage them or who are concerned about some of their policies, we have to bear in mind that very brutal fact that is so deeply, deeply troubling to their people there.

But, you are quite right, they do have an idea that—in the long run—engagement is probably the way to go to change that society, and certainly that is an important priority for them, as reflected in the inter-Korean dialogue, which has gotten going again this month. In fact, there are some meetings coming up next week. But, at the same time, they understand, they fully understand, that

there cannot be nuclear weapons on the Korean Peninsula. And I think the question—you know, there may be nuances of difference over how to solve it, but I think everyone understands this needs to be solved.

Senator VOINOVICH. Thank you.

Senator MURKOWSKI. With that, thank you, Mr. Hill. Appreciate your time that you have spent here this afternoon with the subcommittee, and for sharing your thoughts as China emerges and develops.

And, with that, we will call the second panel.

We will welcome to the second panel Dr. Minxin Pei, the Senior Associate for the Carnegie Endowment for International Peace; Dr. Mike Herberg, the Director of Asian Energy Security Program at the National Bureau of Asian Research; and Professor Catharin E. Dalpino, the Adjunct Professor of Southeast Asian Studies.

So, welcome. Thank you all for joining us this afternoon. We have a little bit less time for the second panel, but I am certainly looking forward to hearing your comments. And thank you for taking the time.

With that, why do not we start at this end, with you, Dr. Pei, and we will move to the—to my left, following that. So, if you will give your comments, please?

STATEMENT OF MINXIN PEI, SENIOR ASSOCIATE, CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE, WASHINGTON, D.C.

Dr. PEI. Thank you very much, Madam Chairwoman.

I have prepared an extensive written comment—written testimony for today's hearing. In the time allotted to me today, I will summarize the main points of my testimony, but I request that the full testimony be entered into the record for today's hearing.

Senator MURKOWSKI. Your full testimony, as well as that of the other panelists, will be included in today's record.

Dr. PEI. Thank you.

The emergence of China as a major global power is one of the most important developments facing the United States. In designing its policy toward China, one of the most critical factors that should inform American policymakers is China's internal political evolution. As we all know, China has been transforming its economy since the late 1970s, and this process has brought China into the international community and improved lives of Chinese people.

During this process of economic modernization, China's political system has also begun to evolve. One of the most important aspects of this political evolution is the reform of China's legal system. Generally speaking, China has made mixed progress in building a modern legal system that can effectively protect property rights and human rights. On the positive side, China has, over the last 25 years, passed nearly 400 laws that have laid the foundations for a modern legal system. Especially noteworthy is the progress made in the passage—implementation of commercial laws designed to facilitate trade and protect investment. Considerable progress has also been made in modernizing administrative laws. Some progress has also been made in improving the criminal code. The Chinese Government has also amended the constitution and enshrined the pro-

tection of human rights and private property rights in the constitution.

Also on the political side, legal reform has begun to have a healthy impact on China's social and economic activities. Chinese citizens and private entrepreneurs are increasingly using the legal system to protect their personal and property rights. The number of lawsuits filed in civil courts has been rising steadily. Chinese courts handle about five million civil suits today. This indicates some rise of confidence in the court system. Chinese citizens have also begun to sue local governments for abuse of power.

However, despite such progress, China has not established a genuine modern legal system or a rule of law. The momentum of legal reform has slowed since the 1990s. Many important legal reform measures that ought to have been taken are delayed, some indefinitely. There is no sign to indicate that the Chinese Communist Party is genuinely committed to building a modern legal system.

The following are the most glaring weaknesses of the Chinese legal system today:

First, lack of judicial independence. The court system is controlled by the Chinese Communist Party and local governments. Judges are appointed by the party and local governments. Judges lack job security and power to adjudicate court cases. The courts are dependent on local governments for funding. Party and government officials routinely interfere in court decisions.

Second, weak judicial authority. Because Chinese courts are really part of the state bureaucracy, they typically lack the political authority to enforce their decisions. As a result, court judgements cannot be enforced if they are resisted by local authorities.

Third, judicial corruption. The political control over the court system has led to widespread corruption in the legal system. Unethical judges routinely take bribes in exchange for judgements favoring those who offer the bribes. Chinese press often carries reports of senior judges being prosecuted for corruption.

Finally, low respect for the law. This is largely because laws on the books in China are not enforced, or are ignored, by the government, itself, in reality. This has created a huge discrepancy. While a large number of Chinese laws have strong provisions for individual and property rights, in reality such provisions have little meaning, because the government, especially local authorities, can ignore them with impunity.

It is clear that the Chinese Government is aware of these problems, and reformers within the Chinese Government have been trying to address them for a long time. But, so far, judging by the facts on the ground, it appears that China remains far away from its own declared goal of ruling the country according to law.

Thank you.

[The prepared statement of Dr. Pei follows:]

PREPARED STATEMENT OF MINXIN PEI

I want to thank the committee for giving me the honor to testify today on China's legal reform in recent years. My remarks are divided into three parts. The first part describes the progress made in the strengthening of China's legislative institutions and analyzes the limits of this process. The second part addresses the progress and

limits in China's legal reform. The last part comments on policy options for the United States.

I. PROGRESS AND LIMITS IN BUILDING LEGISLATIVE INSTITUTIONS IN CHINA

The emergence of the National People's Congress (NPC) and, to a lesser extent, local people's congress (LPC), as major actors in decision-making in China in the reform era has been hailed as a sign of political institutionalization or even pluralization. The growth of the NPC as one of the most important political institutions in China has been extensively documented.

Legislative Output: The most important achievement of the NPC was its enormous legislative output (Table 1). The several hundred laws and resolutions-passed by the NPC since 1978 have provided the legal framework for economic reform and rationalized administrative procedures. For example, of all the laws and resolutions that were enacted by the NPC from 1978 to 2002, 95, or about a third, were "economic laws." Of the 216 new laws passed from June 1979 to August 2000, 126 were classified as "administrative laws." But these numbers should not be taken at face value. In the passage of most laws, the NPC has largely played a secondary role, endorsing the bills drafted by the executive branch. On a few rare occasions, the Standing Committee of the NPC showed its autonomy by rejecting the bills proposed by the government. Like the NPC, LPCs rarely rejected bills proposed by local governments. When they do, it becomes national news, as in the case of the People's Congress of Shenzhen which voted down, in 2004, a law on auditing and supervising the local government's investment, an unprecedented act of political independence. Official figures also indicate that individual legislators play an insignificant role in law-making. Not a single bill proposed by NPC delegates has been enacted into law. For example, from 1983 to 1995, more than five thousand bills were proposed by delegates, but only 933 (18 percent) of them were referred to committees. There was no record that any of the proposed bills ever becoming law.

Table 1. Legislative Output of the National People's Congress (NPC), 1978–2003

Years	Laws Passed	Resolutions Passed
Fifth NPC (1978–1983)	41	19
Sixth NPC (1983–1988)	47	16
Seventh NPC (1988–1993)	60	27
Eighth NPC (1993–1998)	85	33
Ninth NPC (1998–2003)	74	n.a.

Constitutional Oversight Power: On paper, the constitutional oversight power of the NPC has expanded significantly. The NPC supervises the courts and appoints and removes officials. It also investigates and oversees the work of the executive branch, approves the work reports of the State Council, the Supreme People's Court, and the Supreme People's Procuratorate, reviews and approves budgets, and provides legislative interpretations. The NPC can review the constitutionality of laws, inspect the implementation of specific laws by supervising individual court cases, hold hearings, conduct special investigations, and impeach and dismiss government officials. But in reality, the NPC has seldom asserted its formal oversight power. For example, the NPC has never declared a law unconstitutional or rejected a working report by the State Council, the Supreme People's Court, or the Supreme People's Procuratorate. It had never refused to approve a budget, launched its own special investigations, or initiated proceedings of dismissal against a single government official. The NPC's inspection tours or hearings do not appear to have had any impact on policy, either. The most visible expression of the NPC's oversight power is rather symbolic: each year, about 20 percent of the NPC delegates voted against the work reports of the Supreme People's Court and the Supreme People's Procuratorate.

By comparison, in some provinces, cities, and counties, the LPCs occasionally have tried to be more assertive. LPC members sometimes take local bureaucracies to task for poor performance and corruption. Deputies of LPCs sometimes demanded audits

of the expenditures of local governments and criticized local governments' commercial deals and corrupt activities. In wielding one its most controversial oversight powers, LPCs also began to monitor judicial proceedings, mainly as a response to rampant corruption in the judicial system. LPCs' oversight of judicial proceedings in both civil and criminal cases can force courts to conduct trials with greater transparency and integrity. Typically, LPC delegates would review files, interview witnesses, and sit in on trial proceedings. In one instance, such intervention helped free a peasant wrongly convicted of drug trafficking.

Appointment and Removal Power: Another noteworthy development is that LPCs have become an arena in which bureaucratic and factional politics begin to influence, in a very limited way, the appointment of local officials. Because Chinese law mandates "competitive elections" (cha'er xuanju) for senior local officials, LPC delegates have an opportunity to use such (indirect) "elections" to foil the appointment of official candidates and elect their own choices. Under Chinese law, an official candidate cannot be appointed if he/she fails to gain half of the votes of the delegates. LPC delegates can also write in their nominees. In Liaoning in the late 1990s, for example, the CCP's provincial organization department (POD) reported that an increasing number of official candidates could not be confirmed by LPCs due to factionalism, poor lobbying by the party, and unattractive nominees. Local legislators occasionally were successful in nominating and electing their own candidates to local offices. In five cities in Liaoning, twelve "independent" candidates were elected to local offices. Similar incidents occurred in Hangzhou's twelve counties in the 1990s. Each time the county people's congress appointed officials nominated by the party, an average of six to nine official nominees would fail to be appointed, while the same number of unofficial candidates nominated by the delegates themselves would get "elected." In the counties where the LPC delegates were the most assertive, about 10 to 15 percent of the official nominees would fail to get elected. In practice, however, such revolt by LPC delegates is rare, and nearly all the candidates nominated by the CCP are appointed. According to a senior NPC official, from the mid-1980s to the mid-1990s, only 2 percent of the candidates nominated by the provincial CCP committee failed to win "elections" at the provincial people's congress.

Organizational Growth: Organizationally, the NPC has grown considerably as well. The body had only 54 full-time staffers in 1979. By the mid-1990s, the number had risen to about 2,000. The NPC's committee system grew as well. From 1983 to 2003, the number of specialized committees in the NPC Standing Committee rose from six to nine. Nationwide, the number of staffers in the people's congress system at and above the county-level reached 70,000 by 1997. However, as a whole, the membership of the NPC and LPC does not mirror Chinese society. Rather, it appears to better represent the bureaucratic interests of the Chinese state and the ruling CCP. For example, nearly all of the 134 members of the 9th NPC Standing Committee (average age 63.4) were retired government and party officials. CCP members make up about two-thirds of the delegates to the NPC and LPCs.

II. LEGAL REFORM AND ITS LIMITATIONS

The record in-legal reform since the late 1970s has been mixed. While the Chinese government has made unprecedented progress in many areas of legal reform, the Chinese legal system remains structurally flawed and ineffective because the CCP is fundamentally unwilling to allow real judicial constraints on the exercise of its power.

The motivations to undertake even limited legal reform were compelling for the CCP in the post-Mao era. To restore political order and create a new legal framework for economic reforms, reforming and strengthening the legal system was a top priority for the Chinese government. Indeed, China's legal system, developed under a planned economy and wrecked by a decade of political turmoil during the Cultural Revolution, was inadequate, outdated, and ill-suited for a transition economy. Economic reform would have been inconceivable without reforming the legal system. Thus, the CCP's need for survival through economic reform overlapped with the practical necessity for legal reform.

To be fair, the progress in legal reform since the end of the Mao era has been unprecedented in Chinese history, as reflected in the passage of a large number of new laws, the increasing use of the courts to resolve economic disputes, social and state-society conflicts, the development of a professional legal community, and improvements in judicial procedures. As a result, legal reform has greatly increased the role of courts in adjudicating civil, commercial and administrative disputes. As indicated by the data on the rapid growth of commercial, civil, and administrative

litigation, Chinese courts have assumed an indispensable role in resolving economic, social and, to a limited extent—political—conflicts (Table 2). A number of empirical studies on commercial and administrative litigation show that, despite its flaws, China's legal system is capable of providing limited protection of property and personal rights. In addition, China's legal profession, including judges and lawyers, has expanded rapidly during the reform era. The number of lawyers rose from a few thousand in the early 1980s to more than 100,000 in 2002. The number of judges nearly doubled from the late 1980s to the late 1990s. As measured by educational attainment, the qualifications of the legal profession have risen dramatically as well. The percentage of judges with a college or associate degree rose from 17 in 1987 to 40 in 2003. Of the 100,000 lawyers in 2002, 70 percent had undergraduate degree and better and 30 percent had only dazhuan (equivalent to an associate degree) or lower. However, the overall level of professional legal qualification remains relatively low, especially measured by western standards.

Table 2. Growth of Litigation, 1986–2002

(Cases Accepted by Courts of First Instance)

Year	Commercial	Civil	Administrative
1986	308,393	989,409	632
1990	598,314	1,851,897	13,006
1996	1,519,793	3,093,995	79,966
1999	1,535,613	3,519,244	97,569
2000	1,297,843	3,412,259	85,760
2002		¹ 4,420,123	80,728

¹Including both commercial and civil lawsuits.

But behind these numbers lies a different political reality. For all the progress in reform, China's legal system remains politically hobbled by the ruling party's restrictions. Legal reform was apparently losing momentum in the late 1990s. For example, the growth of civil and administrative litigation slowed in the late 1990s, peaked by 1999, and began to decrease afterwards. As Table 2 shows, the total number of civil and commercial cases fell from more than 5 million in 1999 to about 4.4 million in 2002 (a 12 percent decline over three years). Administrative litigation cases registered even more dramatic declines. After peaking in 2001, with 100,921 cases filed, the number of administrative lawsuits fell to about 80,000 in 2002, back to the level of 1996. Such broad and large declines in litigation may be indicative of the poor performance of the court system and the consequent erosion of the public's confidence in the courts' ability to adjudicate justly. Although there are no data available about the trial outcomes of civil cases, the trend of administrative litigation suggests that the decline in the number of administrative lawsuits filed against the government may be directly related to the increasing difficulty with which plaintiffs were winning these cases in courts (which in turn reflects the courts' pro-government bias). For example, plaintiffs suing the government had an effective winning rate of 38.3 percent (including favorable court judgments and settlements) in 1993. This rate rose to 41 percent in 1996, but fell to 32 percent in 1999. By 2002, the rate plummeted to 20.6 percent, half of the level reached in 1996. It is likely that the decreasing probability of receiving judicial relief through the administrative litigation process has discouraged many citizens from taking their cases to the courts.

The rapid growth of the legal profession has not led to the emergence of a genuinely independent bar or a well-trained judiciary. The government maintains tight restrictions on lawyers in their representation of their clients. The Lawyers' Law (1996) provides for inadequate protection of lawyer's rights, leaving lawyers vulnerable to harassment and persecution by local officials. According to the president of the Chinese Lawyers Association, the number of incidents in which lawyers were mistreated was large. Law enforcement officers frequently assaulted, detained, and verbally abused lawyers. Many lawyers were wrongfully convicted and sentenced to jail terms. Lawyers' rights to defend their clients in court were restricted. Some lawyers were ejected from courts without justification. Despite a massive effort to raise

the qualifications of judges, the overall level of professionalism of the judiciary is very low. For example, 60 percent of the judges in 2003 had not received a college or college-equivalent education. A large number of sitting judges, many of whom are former officers in the People's Liberation Army (PLA), have dubious legal qualifications. Perhaps the most revealing evidence that the rule of law is fundamentally incompatible with a one-party regime is the CCP's steadfast refusal to undertake the necessary reforms to correct the two following well-known institutional and structural flaws in the Chinese legal system—even though they have long been identified and numerous remedies have been proposed. For example, in a study commissioned by the Supreme People's Court to amend the "People's Court Organic Law," two leading academics detailed a long list of the symptoms that manifested these flaws. What is remarkable about the proposal by these two academics is that similar proposals had been floated before but were never acted upon by the Chinese government. To the extent that reforms are adopted to address the critical weaknesses in the legal system, the measures implemented by the government tend to be piecemeal and technical. They try to remedy the less controversial procedural flaws while avoiding the most sensitive political issues.

Politicization of the Courts and Lack of Judicial Independence: As a judicial institution, Chinese courts are heavily politicized and deprived of the independence crucial to their role as guardians of justice and adjudicators of disputes. The politicization of the courts is reflected in the control exercised by the CCP over the various aspects of the courts' operations. For example, each level of the CCP organization (down to the county level) has a special political and legal committee (zhengfa weiyuanhui) headed by a senior party official. The committee directly makes decisions on important policies and issues related to the courts and law enforcement. In many cases, this committee even determines the outcomes of major court cases. In terms of judicial appointments, the CCP's organization department nominates candidates for the presidents and vice-presidents of courts (often regardless of their judicial training or the lack thereof). In the case of the SPC, the members of the party committee of the SPC (who are the most senior judge-officials of the court) are appointed and supervised by the Central Committee of the CCP, and the members of the party committee of provincial high courts are jointly supervised by the party committee of the SPC and the provincial party committees. The members of the party committees of intermediate courts are under the direct supervision of the party committees of the provincial high courts. The CCP's control of the most senior judicial appointments profoundly affects how judgments are determined by the courts.

Additionally, judicial independence is compromised by local governments which wield enormous influence over the courts through their control of judicial appointments and court finances. Dependent on the local governments for funding, services, and political support, Chinese courts find it hard to try cases fairly where the economic and political interests of the local governments and officials are at stake. In the most crucial respects, Chinese courts are run like other government bureaucracies and follow a similar *modus operandi*. Administrative ranking or seniority, not judicial qualifications and experience, determine the hierarchical structure in the courts. For example, trial committees, which have the ultimate authority in determining judgments, are composed of individuals with the most senior administrative ranks, rather than the best judicial qualifications.

Inevitably, the politicization and administrative control of the courts corrupts judicial integrity. In public perception, the Chinese judiciary is one of the most corrupt government institutions. A survey of 12,000 people in 10 provinces commissioned by the CCP's Central Discipline and Inspection Commission in late 2003 found that the courts, along with the police and the procuratorate, were considered among the five most corrupted public institutions (39 percent of the respondents said corruption in these three institutions was "quite serious"). Chinese press frequently reports corruption scandals involving judges. In Hubei province, from 2002 to mid-2003, 91 judges were charged with corruption. The accused included one vice president of the provincial high court, two presidents of the intermediate court, four vice presidents of the intermediate court, and two presidents of the basic-level court. In 2003 alone, 794 judges in the country were investigated and punished (*chachu*). Corruption by senior provincial judges was reported in many other jurisdictions. The presidents of the provincial high courts in Guangdong and Hunan province were convicted of corruption in 2003 and 2004. In Heilongjiang, the president, a vice president of the provincial high court, and the head of the provincial judicial department were removed from office in late 2004 for corruption. In Hainan, a vice president of the provincial high court, along with the head of the enforcement depart-

ment of the court, a vice president of an intermediate court, and a president of a district court, were sentenced in 2004 to long jail terms for corruption.

Fragmentation of Judicial Authority: The control by the party and local governments of the judiciary has contributed to the fragmentation of judicial authority and undermined its effectiveness. In addition to the weakening of the judiciary as a result of the CCP's control of judicial appointments, the enormous power wielded by local governments over the judiciary undercuts the authority of the courts. Because judicial jurisdictions and administrative jurisdictions completely overlap with one another, the dominance of the administrative authorities in effect creates what Chinese observers call judicial "independent kingdoms" in which local political interests, instead of national law, hold sway. Under these conditions, laws made by the central government cannot be implemented or enforced, leading to the widespread problem of "local protectionism"—the phenomenon of local authorities providing political protection to local interests in violation of national laws. Consequently, enforcement of court judgments is extremely difficult when judicial authority is fragmented. In some cases, court judgments could not be executed without the explicit political backing from CCP officials. To remedy the structural weaknesses caused by such a fragmentation of judicial authority, Chinese scholars have offered several proposals for institutional reform. These proposals included the establishment of two separate judicial systems: a central system and a local system (similar to the American federal system), the formation of cross-regional courts, and the use of the central government's appropriations to fund courts. However, the government has adopted none of them. Such a failure to implement crucial reforms led to a growing sense among China's legal community that the court system has become so dysfunctional that more radical measures—or "major surgery," to use a colorful phrase—would be required.

In summary, the Chinese government's lack of commitment to a genuine system of rule of law is the fundamental cause of the limitation of legal reform in China. The CCP's goals in allowing legal reform are tactical in nature: such reform must serve the party's overall strategy of maintaining its political power through economic reform. Measures of legal reform must not threaten its authority or the institutional structure upon which its political supremacy is based. As long as this mindset dominates the party's thinking, legal reform in China will unlikely lead to the emergence of the rule of law.

III. POLICY RECOMMENDATIONS

The United States can play a crucial role in promoting the rule of law in China. Through high-level political dialogue, financial and technical support, and consistent diplomatic pressures, the United States government can help create the right incentives for reform within China. In the short-term, the Administration must engage China's new leadership in the area of legal reform. For example, President Bush may use the two upcoming summits with President Hu Jintao to seek specific commitments from the Chinese government in the area of promoting the rule of law. In particular, pressures on China to take specific actions to improve its human rights practices and protection of property rights must be combined with offers of technical assistance because this strategy will be more credible and less confrontational. The United States government should also facilitate and support the efforts of American non-governmental organizations that are implementing various programs inside China that are designed to promote legal reform. Of course, we must remain realistic about the limits of external pressure and assistance. The ultimate choice lies with the Chinese government. But, by offering the right mix of incentives and disincentives, we may make it more likely that Beijing will make the right decision.

Senator MURKOWSKI. Thank you, Dr. Pei.
Mr. Herberg?

STATEMENT OF MIKE HERBERG, DIRECTOR, ASIAN ENERGY SECURITY PROGRAM, THE NATIONAL BUREAU OF ASIAN RESEARCH, SEATTLE, WASHINGTON

Mr. HERBERG. Thank you, Madam Chairwoman. It is a pleasure and an honor to be here to speak to the committee.

Energy is getting to be an enormous topic when it comes to China. We have already heard some of those questions. I think you have to understand what is driving China's energy concerns and

what is driving China to become a major factor, both in the region and globally, in energy markets in key areas of the world.

The efforts come in two ways—trying to secure supplies in different places, both in Asia and outside Asia, through equity deals and long-term contracts—but also the attempt to control transit routes, pipeline routes, tanker routes, as well, those are two dimensions of that.

But I think it is important to keep in mind that China is the catalyst in Asia for what we see as a broader Asian scramble for energy supplies and what you can call a growing “energy nationalism” in Asia. They are not the only one; Japan, South Korea, India, and some others are pursuing the same direction.

In order to understand China’s insecurity about its energy supplies, and particularly oil supplies, a few statistics will help. From 1985 to 1995, oil demand doubled; from 1995 to 2005, oil demand doubled again. Imports, today, account for 40 percent of China’s total oil needs, as opposed to zero just 12 years ago. If we go out in the future, with IEA forecasts or DOE forecasts, within 15 or 20 years, China is likely to be importing 10 million barrels of oil a day, roughly 75 to 80 percent of its oil supplies. So, this has really focused the mind of the Chinese leadership, this kind of dependence on oil imports. Most of this oil has to come from the Persian Gulf. A little can come from Central Asia, Russia, and Africa, as well. But the majority of that is going to have to come from the Persian Gulf, through the Straits of Hormuz, the Straits of Malacca, and the South China Sea. This whole threat, or this perception, has really impacted the leadership. The fear is that oil and energy shortages will undermine economic growth, which means undermining job growth, which means undermining social stability.

They have added concerns that I think the U.S. does not always appreciate. From the Chinese perspective, the U.S. controls the sea lanes of Asia, through which most of China’s future oil will come, as well as the Indian Ocean. The U.S. is a major power in the Persian Gulf and in all the other key oil exporting regions of the world. China feels excluded from global oil markets and the global oil industry, which it feels are controlled largely by the U.S. Geopolitically, the U.S. is the power in the Gulf, as well as influences by big international oil companies from the Western World. So, China, on top of these other concerns, feels that it is excluded from the geopolitics of the industry, through which much of its oil will come in the future.

The response has been what we have talked about a little bit earlier today—this “going-out” strategy—what I call “energy diplomacy”—going out, trying to lock up supplies throughout Asia, but also in all the key exporting areas—the Persian Gulf, Africa, and Central Asia. You have Chinese national oil companies in probably 25 to 30 countries right now doing equity deals of one sort or another; some of those countries, Iran, Sudan, and other places that we are certainly concerned about. They are working on developing pipeline routes from Kazakhstan, Russia, and possibly through Myanmar, as well as trying to bypass their dependence, or at least reduce their dependence, on the Straits of Malacca and oil coming from the Persian Gulf.

Aligned with that is the diplomatic backup from the Chinese Government, in terms of aid, loans, development assistance, and other deals that come along with those energy packages. It is a very powerful set of incentives that these countries have to work with China on these energy security deals. The corollary is that China has really not shown much interest in regional cooperation and relying on markets in the region for its energy supplies.

Another troubling aspect of China's efforts is that it appears to be affecting their naval and military strategy in the South China Sea and Southeast Asia, due to this concern over the flow of all these tankers of Chinese oil in the future coming through that area. Beijing wants to have some ability to influence the maritime traffic in those regions, which means it is pursuing submarines and other base access agreements in those regions.

But I think you also have to factor in the other Asian powers that are doing many of the same things—Japan, India, and South Korea. In a sense, it takes two to tango. There is an increasingly nationalistic, contentious, competitive environment for energy supplies in Asia, which all the major powers are participating in, and this reinforces and overlaps the same existing geopolitical rivalries that exist in Asia over broader political and geopolitical issues.

So energy is contributing to those rivalries and aggravating those underlying geopolitical rivalries. The other side of that is that those geopolitical rivalries are now making it more difficult to solve the region's energy problems in a collaborative multilateral cooperative way.

For the U.S., I think it is very important for U.S. policymakers to become more engaged in Northeast Asia, particularly, regarding the region's energy security worries, because, without greater involvement from the U.S., it is going to be very difficult for Northeast Asia to solve its multilateral energy security problems.

Thank you.

[The prepared statement of Mr. Herberg follows:]

PREPARED STATEMENT OF MIKKAL E. HERBERG

Senator Murkowski, members of the committee, thank you for this opportunity to appear before the committee today to discuss China's energy situation and the implications for Asia and the U.S. It is an honor to be here.

If I may, a few words about my organization may be helpful. The National Bureau of Asian Research (NBR), is a nonprofit, nonpartisan research institution dedicated to informing and strengthening policy in the Asia-Pacific. NBR conducts advanced research on security and globalization issues, with emphasis on those of interest to the United States. Drawing upon an extensive network of the world's leading specialists and leveraging the latest technology, NBR bridges the academic, business, and policy arenas. The institution disseminates its research through briefings, publications, conferences, congressional testimony, and email fora, and by collaborating with leading institutions worldwide. I direct NBR's Asian Energy Security Program which focuses on the future geopolitical, economic, energy market, and environmental issues raised by Asia's rapidly growing energy consumption, growing dependence imported energy, and growing reliance on fuels sources which raise other serious problems, such as coal-and nuclear energy.

We believe at NBR that the issues emanating from China's growing energy needs are so important that we are organizing a small, invitation only conference for this September here in Washington, D.C., entitled "China's Search for Energy Security and Implications for the U.S." We will have some of the top energy and geopolitical experts in attendance to discuss a wide range of issues, including the outlook for China's energy needs and energy imports, it is emerging and active energy security strategy, the implications for Asia, and the implications for the U.S.

Energy has become central factor in shaping China's deepening engagement and diplomatic strategy in Asia and this is virtually certain to grow rapidly in the future. Moreover, energy has become a central factor in shaping China's global geopolitical and diplomatic architecture in key oil and gas exporting countries and regions, such as the Persian Gulf, Central Asia, Russia, Africa, and, more recently, the Western Hemisphere. China is on a path to becoming a major player in the geopolitics of global energy.

Given the range of vital U.S. political, economic, and energy interests in the Asia region and in the world's key energy exporting regions, China's energy drive will undoubtedly have important implications for the U.S. However, at this point, it is not clear to what extent energy, on balance, will become a source of friction and tension in U.S.-China relations or, alternatively, a source of future cooperation. This will be determined both by China's policies on securing its energy security as well as on U.S. policies in response. And it will also depend heavily on the overall "tenor" of the U.S.-China relationship in the future, whether overall relations are largely cooperative and constructive or, alternatively, competitive and contentious. Nor is it pre-ordained that energy will be a source of conflict in Asia, although present trends are clearly worrisome. This too depends on both China's policies and actions in Asia towards securing its future energy needs, as well as the policies and responses of other key states in Asia, most importantly Japan, Russia, and South Korea. And it will depend on whether Asia manages the rise of China in a peaceful and constructive way or China's rise is disruptive and destabilizing. At present, energy nationalism is on the rise in Asia with ominous implications for Asia's future. In sum, energy and strategic relations in the region are becoming increasingly intertwined in the wake of Asia and China's booming energy demand and growing reliance on imported energy.

THE ROOTS OF CHINA'S ENERGY DILEMMA

First, it is important to understand the underlying context for China's growing impact on energy markets and geopolitics. China is now the second largest energy consumer in the world, after the U.S. Booming energy demand growth is a reflection of its two-plus decades of rapid economic and trade growth, urbanization, population growth, and rising per-capita incomes. In this it is no different than the rest of developing Asia which is also experiencing a period of extraordinary energy demand growth reflecting its rapid economic growth and industrialization. The primary difference is simply the sheer scale of China's energy demand due to the size of its economy and population and the peculiarities of China's domestic energy supply base.

Rapid demand growth is reflected across the fuel spectrum including oil, natural gas, electricity, coal, nuclear and hydroelectric resources. Large domestic supplies of coal have dominated domestic energy use and coal continues to account for two-thirds of total energy consumption. However, rapid economic growth has accelerated the pace of oil demand growth and the government's decision to expand the use of natural gas promises to boost future gas consumption. These developments will boost China's future energy import dependence and fuel its efforts to secure energy supplies in Asia and globally.

Oil is a special concern. Oil demand is rapidly outrunning China's domestic oil resources leading to rising oil imports which have surged over the past several years. China has been Asia's largest oil producer since the mid-1960s, in recent years producing roughly 3.5 million barrels per day (MMBD). However, oil demand accelerated during the economic boom of the 1980s and early 1990s while oil production lagged. Demand doubled between 1984 and 1995 from 1.7 million barrels per day (MMBD) to 3.4 MMBD and has doubled again to 6.8 MMBD in 2005. China became a net importer in 1993 and by 2003 it surpassed Japan to become the world's second largest oil consumer behind the U.S and is now the third largest oil importer behind the U.S. and Japan. China now imports more than 40 percent of its total oil needs.

China's leadership has responded with both energetic domestic reforms and aggressive global energy security policies. Domestically, efforts are underway to maintain production in the traditional northeastern oilfields while boosting production in western China where prospects for growing production are better, the so-called "stabilize the East, develop the West" policy. Offshore oil development also has been a high priority in both the South China Sea and East China Sea, although with relatively modest results. The domestic oil industry also has been repeatedly restructured to try to boost competition and efficiency and oil pricing has been brought more closely in line with global and regional oil markets.

Nevertheless, domestic oil production is unlikely to rise significantly in the foreseeable future while there is a widely held consensus among energy forecasters that oil demand, and therefore imports, are very likely to continue growing relentlessly. The TEA forecasts that China's oil imports will rise more than five-fold by 2030, from slightly under 2 MMBD in 2002 to nearly 11 MMBD, when imports will account for 80 percent of China's total oil needs.¹ The leadership now faces the long-term realization that oil import dependence is unavoidable and will grow. Moreover, as in the rest of Asia, China will become heavily dependent on the Persian Gulf for future supplies and its oil will increasingly have to transit a series of vulnerable maritime choke points. The East-West Center forecasts that by 2015, 70 percent of China's oil imports will come from the Middle East. Other significant shares of China's oil imports will come from Russia by pipeline and rail, from Central Asia by pipeline, and from Africa by tanker.

Electricity demand has also accelerated, in recent years forcing the government to scramble to find fuels to generate more electricity. Rising electricity demand is the key driver behind China's heavy reliance on its largest domestic energy resource, coal. China is the largest producer and consumer of coal in the world and coal accounts for over 80 percent of electricity generation and accounts for two-thirds of China's total energy use. Coal consumption is expected to double over the 2001–2025 period with truly frightening environmental and health implications. China is also expected to account for one-quarter of the world's CO₂ emissions over that period. Although presently a modest net coal exporter, it is likely to become a net importer of coal as early as 2015.

The electricity demand boom is also driving plans for the largest single country nuclear power building program in the world. China plans to build two large nuclear plants per year over the next 20 years. Extensive hydroelectric development is planned for the future, as well. Policies are also being developed to accelerate the use of renewables, such as solar and wind, but these will only make a small dent in the electricity demand curve even under the most optimistic of forecasts.

China is presently largely self-sufficient in natural gas but this is only because it uses so little: gas represents less than 3 percent of China's total energy consumption compared with a global average of 23 percent. However, the government has embarked on an aggressive policy to increase gas use to help replace coal to generate electricity, diversify overall commercial and household energy use, and provide cleaner-burning fuel for environmental needs. Current plans call for gas to make up 8–10 percent of total energy demand by 2020. The government is accelerating domestic natural gas exploration and development and expanding the national pipeline system to transport more gas from fields in north central and western China to the major cities on or near the east coast. A major 2,500 mile west-east gas pipeline has just recently been completed to move natural gas from the sparsely populated Xinjiang Uyghur Autonomous Region to Shanghai. The government also is working to develop gas markets by creating more effective regulatory structures and increasingly flexibility in the gas pricing system.

Over the long-run, although gas is an important element of China's overall energy needs and environmental concerns, it also will add to dependence on energy imports in the future. Beyond 2010 demand is likely to begin to outrun domestic production. China's first gas imports will commence in 2007, with the opening of a Liquefied-Natural Gas (LNG) import terminal in Guangdong Province, with plans for a string of LNG terminals along China's booming coastal region. The DOE forecasts that imports will account for 40 percent of China's gas needs by 2025. LNG supplies will come largely from Asia, including Australia, Indonesia, Malaysia, Brunei, and East Timor, but China will also likely rely on a growing volume from the Persian Gulf, including Qatar, Iran, Oman, and probably Yemen. China is also likely to import gas via pipeline from Russia's East Siberian Irkutsk or Sakha regions where a large regional gas pipeline scheme is being planned. Consequently, a significant portion and will have to be transported largely from the same volatile regions as oil imports, namely the Persian Gulf and Russia.

In sum, despite significant efforts to stimulate domestic energy production China faces an inevitable trend toward greater energy import dependence to fuel its dynamic economic growth. Import dependence will be most acute for oil but will become a growing concern over the longer term for natural gas supplies. Moreover, electricity needs are driving China towards fuel choices with serious environmental, safety, and nuclear non-proliferation implications for the region and the U.S.

¹International Energy Agency, World Energy Outlook, 2004, OECD, Paris.

CHINA'S GROWING ENERGY INSECURITY

China's rapid economic growth is highly dependent on finding the growing energy supplies needed to fuel this economic "Dragon." The erosion of the ability to rely largely on domestic energy supplies has created a powerful sense of energy insecurity rooted in a deep-seated fear among the leadership that energy supply disruptions and unpredictable price spikes could undermine China's rapid economic growth and job creation. To the leadership, slow economic and job growth raise the real specter of social instability which, in turn, calls into question the continued power and political control of the Communist Party. Hence, there is a visceral and profound connection in the minds of the leadership between reliable energy supplies, political and economic stability, and continued Party control.

In this context, energy has become a matter of "high politics" of national security and no longer just the "low politics" of domestic energy policy. Energy security is too important to be left entirely to the markets as China's economic prosperity is increasingly exposed to the risks of global supply disruptions, chronic instability in energy exporting regions, and the vagaries of global energy geopolitics. Energy has become a central concern for Beijing and the global search to secure future energy supplies has taken on great urgency.

The events of 9/11, the Global war on Terrorism, and the wars in Afghanistan and Iraq have heightened this sense of insecurity and vulnerability. First, China is increasingly concerned about the risks of potential terrorist attacks on energy infrastructure and attacks on key maritime transit points like the Straits of Malacca.² More broadly, from China's perspective, the aggressive U.S. response to the attacks on America risk further destabilizing the Persian Gulf and Central Asia and increasing the risks of supply disruptions, worsening Islamic extremism, and political instability. Moreover, China views the U.S. as a long-term strategic competitor meaning that the deeper extension of U.S. military power and influence in Central Asia and the Persian Gulf aggravates their already significant fears of strategic "encirclement" by the U.S. The U.S. dominates the Persian Gulf, from their point of view, and uses this to maintain control over global oil supplies and geopolitics. The U.S. navy dominates the Sea Lines of Communication (SLOC) in Asia and the Indian Ocean through which a growing share of China's oil supply will flow in the future. These things aggravate their fears over what they view as U.S. global "hegemony" and increases the sense of vulnerability over oil and gas flows vital to China's long-term strategic room to maneuver, its economy, and its social stability. Their fears over U.S. control of the sea lanes coalesce most clearly in their deep concerns that the U.S. would cut off their oil imports during any confrontation with the U.S. over Taiwan.

A variety of other factors aggravate this sense of insecurity. China has a strong sense of exclusion from the global energy management institutions, such as the TEA, and also sees itself as dependent on global oil markets and a global oil industry that is dominated by the U.S. and the major international oil companies of the industrial countries. Also, high oil prices and a growing fear of long-term global oil supply "scarcity" are feeding this sense of insecurity and the compulsion to try to unilaterally secure its future oil and gas needs in Asia and elsewhere by direct state intervention.

China is responding with a broad range of energy strategies internationally to try to guarantee greater supply security and reduce their vulnerability to potential supply and price shocks. On balance, these efforts reflect a "zero-sum" energy supply strategy which is deeply neo-mercantilist and competitive. It is built on efforts to gain more secure direct national control of overseas oil and gas supplies by taking equity stakes in oil and gas fields, promoting the global expansion of the three national oil companies, CNPC, Sinopec, and CNOOC, and promoting development through state-to-state deals of new oil and gas pipelines to channel supplies directly to China. The government is also employing an active "Energy Diplomacy" by developing broader government-to-government diplomatic, trade, financial, economic aid, and military ties with key exporter governments, promoting energy cross-investments between China and key exporters, and beginning to shape its naval and maritime military strategy to try to protect the SLOCs from the Persian Gulf and through the South China Sea to China. These efforts naturally converge on the Per-

²The two major chokepoints for Asia's supplies are the Straits of Hormuz exiting the Persian Gulf and the Malacca Straits between Indonesia and Malaysia entering the South China Sea. In 2003 roughly 15 million barrels of oil per day (MMBD) passed through the Straits of Hormuz, with around 10 MMBD of that headed to Asia through the Straits of Malacca. Another 1 MMBD passes through the Straits of Malacca from Africa. As a result, more than 50 percent of Asia's daily oil supplies must transit the narrow Malacca Straits. See "World Oil Transit Chokepoints," Energy Information Administration, U.S. Department of Energy, April 2004.

sian Gulf, Central Asia, Russia, Africa, Latin America, and, recently, Canada. For example, the Chinese government has signed “Strategic Energy Alliances” with at least eight countries over the past five years which include a varying mix of energy, trade, aid, and military agreements depending on the case.

IMPLICATIONS FOR ASIA AND THE U.S

China’s energy security drive is likely to significantly impact Asia and broader global developments in a number of ways which could become of concern to the U.S.

One set of concerns revolves around the growing perception that China’s booming oil demand and oil imports are driving the recent sharp rise in world oil prices and, by implication, that U.S. oil consumers are paying the price for China’s outsized demand growth. While China’s oil demand growth, particularly in 2004, when demand rose by 14 percent, has been a key factor in recent price hikes, it is only one of a number of factors. Even in 2004 China only accounted for roughly 30 percent of the world’s enormous demand growth of 2.8 MMBD, about the average for China’s share of global growth over the past decade. From 2000–2004, the growth in China’s oil imports has been only slightly larger than the U.S., 1.5 MMBD vs. 1.3 MMBD for the U.S. Oil demand growth has been strong globally since the economic recovery began in mid-2003. In the view of many, the most important factor in today’s high oil prices is the lack of increases in global oil production capacity in recent years to meet rising demand. The lack of global spare production capacity is the critical issue. Other issues like the lack of spare capacity in the global refining system are also central to today’s high prices.

A corollary to this concern is the widespread notion that the U.S. is increasingly “competing” with China for its oil imports. However, this makes little real sense: the U.S. is no more competing with China for its oil than it is competing with Germany or any other large oil importer. There is only one global oil market and prices and supplies equilibrate every nano-second responding to demand, transportation costs, and quality differentials.

Another aspect of this oil competition issue may be of more concern. One element of China’s mercantilist oil strategy is to gain direct state company control over equity oil production in key exporting countries to ship directly to China rather than moving it into the global market, as most international oil companies would do. To the extent China succeeds in the future in turning certain countries into their own personal “gas stations,” it risks reducing the flexibility of global oil markets to adjust to sudden supply shocks or demand surges. The industrial world learned during the 1973–74 oil shock that a zero-sum scramble for oil supplies during a crisis simply worsens the problem by reducing market flexibility and efficiency and intensifying national conflicts over supplies. This led to the creation of the IEA to avoid the risks of national competition for supplies that only drive prices higher and accentuate scarcity. U.S. policy since then has focused on promoting diversified sources of oil supplies to flow to the global market, letting the market determine the most efficient allocation of those supplies.

A second set of important concerns over China’s energy security strategy revolve around the potential impact on Asian geopolitics and stability. China’s increasingly mercantilist strategy to assert control of oil and natural gas supplies and transport routes risks fueling tensions and conflict in a region where the lack of regional institutions to manage conflict is already a major problem and a region which is facing a sensitive transition to accommodate China’s rising power over the next two decades. Energy competition is beginning to seriously aggravate existing and, in some cases, deepening rivalries between China and her neighbors. For example, China and Japan are currently locked in long-running and potentially highly combustible diplomatic battles over the routing of a proposed East Siberian oil pipeline that would move oil to Asia, and the ownership of a small offshore natural gas field in the East China Sea between China and Japan. These disputes are combining with other political and diplomatic disputes between the two to sharply worsen the overall state of relations. Nevertheless, this is not just China’s problem alone. A virulent form of energy nationalism is taking form in Asia today that threatens to aggravate Asia’s underlying national rivalries. Each of the major Asian states, China, Japan, India, South Korea, and increasingly some of the Southeast Asian states, are pursuing a largely mercantilist, nationalistic, competitive approach to securing future energy supplies and transit routes. This is preventing development of more cooperative and market-oriented approaches to the region’s common energy security problems. The United States has major strategic and economic stakes in how China responds to its energy insecurity and how this impacts Asian stability and geopolitics.

Another dimension of China’s energy insecurity that is of concern to Asia and the U.S. is its impact on China’s military and naval strategy. The growing volume of

oil that will be flowing to China by tanker through the Indian Ocean and South China Sea appears to be driving efforts to develop naval capabilities and arrangements that would allow it to project its impact well beyond the Taiwan Strait. China has been developing a major submarine capability and potential port access agreements with Pakistan, Bangladesh, Myanmar, and the South China Sea which appear aimed at protecting future Chinese oil tanker routes. In this sense, China's energy insecurity risks aggravating the potential future problem of military maritime competition to control the Sea Lines of Communication in Southeast Asia.

A third area of real concern for the U.S. beyond Asia comes from the fact that energy needs inevitably will propel China to become a major player in the world's key oil and gas exporting regions and in global energy geopolitics. There are a series of issues here. The most immediate concern is China's growing energy investments and alliances with a number of problem states, including Sudan, Iran, Myanmar, Venezuela, and Uzbekistan. In the case of Sudan and Iran, China's involvement is helping to undermine U.S. sanctions (although China is among a number of countries doing so) and is also complicating U.S. efforts in the United Nations. For example, China is the prime roadblock to taking Iran to the Security Council for sanctions over its nuclear program. Efforts to sanction Sudan for its human rights violations in the Darfur region are also stymied by China's opposition. Sudan happens to be China's largest foreign oil investment operation. China is on its way to greater involvement in Myanmar, recently signed a major energy investment deal with Uzbekistan, and has signed a Strategic Energy Alliance with Hugo Chavez and Venezuela.

A second set of issues is likely to arise from what inevitably will be China's greater diplomatic and political involvement in the Persian Gulf and Middle East in the future. China will become a major competitor for political influence in the Persian Gulf and the U.S. will increasingly need to come to grips with growing diplomatic and political ties between the key Gulf states and China, particularly Iran, where China is increasingly active. For their part, the key Gulf states are increasingly turning to growing diplomatic ties with Asia and China as their base of oil exports to Asia grows. Already, nearly two-thirds of the Gulf's oil exports go to Asia and this share will grow. The Gulf states are increasingly looking to balance their ties to the U.S. with ties to China. As the traditionally dominant outside power in the Gulf, the U.S. will find its regional diplomacy becoming even more complex.

Similar issues are likely to arise in relation to Eurasia as China deepens its long-term energy ties with Russia and the energy exporting Central Asian states. China's push to develop the Shanghai Cooperation Organization bringing together the key states of Eurasia is in no small part driven by its desire to forge stronger energy ties and more secure future supplies, particularly from Kazakhstan. China has major oil investments in Kazakhstan and is currently building a large oil pipeline from Kazakhstan to western China.

China's energy needs, along with the rest of the large Asian oil and gas importers, are also inexorably drawing Russia back into Asia as a key strategic and commercial player with a range of potentially important implications for U.S. interests in Asia and for future U.S. relations with Russia. Energy has the potential to strengthen long-term ties between China and Russia. However, this has not really happened yet due largely to Russian fears over China's growing regional power and fears that Russia's Far East region may be overrun in the future by Chinese economic power, influence, and population growth. Consequently, despite a series of strategic energy agreements between the two countries, Russia has largely frustrated China's efforts to forge major new energy deals and diplomatic ties. The most obvious case of this was Russia's announcement that it would build the planned East Siberian oil pipeline to the Pacific Coast where it would export oil to Japan and the rest of Asia, rather than live up to its previous agreement with China to build the pipeline to Northeastern China.

A fourth set of concerns over China's growing electricity needs arises from the environmental and nuclear safety and proliferation issues coming from China's rising consumption of coal and its major nuclear energy building program. China's coal consumption is expected to roughly double over the next 15 years. This raises a range of serious environmental and health concerns not just for China but for the region and the U.S. Acid rain from China's coal burning is already a major problem in Northeast Asia causing diplomatic tensions with Japan and South Korea. From the U.S. perspective, there is already evidence of mercury from China's coal burning being drafted by the jetstream all the way to North America. As coal consumption grows, these concerns are likely to rise. Moreover, rising coal consumption along with booming oil consumption will make China the largest source of carbon dioxide emissions globally in the future which raises serious concerns about the effectiveness of any global effort to deal with controlling carbon emissions.

POLICY ISSUES FOR THE U.S.

China's booming energy demand and growing energy insecurity are likely to deeply impact China's role in Asia and globally, with some of these impacts having serious implications, for Asia and the U.S.

There are several general policy areas that U.S. policymakers need to begin thinking about. First, U.S. policymakers need to step up efforts to help China improve energy efficiency and slow the rise in consumption which is underlying China's insecurity. This needs to proceed at the highest level. Second, the U.S. needs to look for ways to bring China into the global emergency oil sharing system currently dominated by the IEA, which, since it can only include members of the OECD, by definition excludes China. This again requires a senior policy level effort. China is presently beginning to build its own strategic oil reserves in four locations along the eastern coast. But it is vital that its efforts to build and use strategic reserves be coordinated with IEA and western strategic reserves to maximize their effectiveness during any supply crisis. Third, the U.S. needs to aggressively seek ways to build regional energy institutions in Asia to facilitate multilateral energy projects and encourage regional cooperation over competition. APEC is not an effective forum for this, nor is the ASEAN Regional Forum (ARF). New institutions need to be built and the U.S. needs to be involved in this. Without U.S. involvement, the risks are rising that nationalistic competition for energy supplies and naval control over transit routes could lead to serious political and military tensions among Asia's key powers. Fourth, U.S. policymakers need to begin planning for managing and channeling China's growing diplomatic and economic influence in the world's key energy exporting regions, most importantly the Persian Gulf and Middle East. Fifth, the U.S. needs to become more active in helping China find alternatives to rising coal consumption to meet its electricity needs and to support technology and investment to help China burn coal more efficiently and cleanly.

China's booming energy consumption will drive a number of important energy, environmental, and diplomatic challenges in the future for Asia and for the U.S. It is vital that U.S. policymakers at the highest level begin to engage China on these issues and seek creative ways to avoid a growing set of looming challenges outlined here.

Senator MURKOWSKI. Thank you.
Dr. Dalpino?

STATEMENT OF CATHARIN E. DALPINO, ADJUNCT PROFESSOR OF SOUTHEAST ASIAN STUDIES, EDMUND A. WALSH SCHOOL OF FOREIGN SERVICE, GEORGETOWN UNIVERSITY, SCHOOL OF ADVANCED INTERNATIONAL STUDIES, JOHNS HOPKINS UNIVERSITY, WASHINGTON, D.C.

Professor DALPINO. Thank you, Madam Chair.

I am here to speak on the Southeast Asia part of this puzzle. In the past 15 years, China has made dramatic strides in increasing its influence and presence in the region, and, as you noted in your introductory remarks, this is, in part, because of the natural consequences of its economic rise, and also because of very carefully crafted strategies.

In 2005, it is quite possible that ASEAN's trade with China will eclipse its trade with the United States, and China will, for the first time, be the major economic power in the region, the first time since 1873. This, alone, might not necessarily be a cause for concern, but I think there are two issues that, really, we need to look at in China's new relationship with Southeast Asia.

First is whether, in outdistancing the United States as an economic power, as China might, there might be a gravitational pull towards an Asian economic community that would exclude the United States. And this would not simply be a function of Chinese/Southeast Asian relations, but of the broader region. And, second would be China's overwhelming influence in the poorer states of Southeast Asia—and those would be Laos, Burma, and Cambodia—

and whether we should cede those countries to China as client states.

Both countries, China and the United States, have considerable strengths and considerable presence in the region. Certainly, the United States security umbrella is very important, and I would argue it is even important to China's development in Southeast Asia. It allows it to have the kind of relationship that it does have. Our markets are also very important. Most of the exports that Southeast Asia sends to China are raw goods. Most of the exports it sends to the United States, besides textiles, are in high-tech manufactured goods. And so, we are going to remain an important market.

China's aims in its economic strategy towards Southeast Asia are primarily to fuel development, particularly of the southern province of Yunnan. And, in that sense, it needs energy, it needs raw goods. It is a pressure valve for migration. There is considerable migration into the northern states of Southeast Asia. China is changing the physical face of Southeast Asia through road-building and also through its dams on the Mekong, and it is blasting the shoals of the Mekong to widen it for barges to go through.

Southeast Asia's aims in this new economic relationship are to recoup much of the income, or some of the income, that it is losing to China—in part, as a result of China's entry into the WTO. Some economists believe that, over the next 15 years, Southeast Asia can lose as much as 400 billion in FDI to China. And so, the increase in trade obviously is very strategic on Southeast Asia's part.

China's ultimate intentions in Southeast Asia are unclear. And most Southeast Asian governments tend not to see China as a predator at this point, tend to see it as a benign power, at least for the time being. The stronger, older states of ASEAN—Thailand, Indonesia, Singapore, and Malaysia—are confident that they can balance relations between China and the United States. The Philippines is still very close to the United States. Our treaty ally is embarked upon a new strategic dialogue with China, it is a process of re-balancing, but I do not think that we have a lot to worry about in that.

Because of its history, Vietnam is pursuing an omnidirectional foreign policy. It aims to have relations with all the world's powers. It maintains that it is not seeking a counterweight of one against the other. And, as I said before, the real imbalance is in these poorer states.

In terms of security, China has been slower to develop relations with Southeast Asia, but recently it has improved in reduced tensions in the South China Sea. It is an arms vendor. Malaysia and China recently concluded an agreement for midrange missiles. And, also, it is taking a role in regional security. It chaired the first security conference of the ASEAN regional forum last year.

Let me just point out two strategies China has. And one is to offer absolutely unconditional aid to Southeast Asia, in comparison to United States aid. And last year the United States had sanctions against seven out of ten Southeast Asian countries, or the threat of them. And this—certainly the countries took note.

The second is that China takes a more regional approach to Southeast Asia than the United States does. It interacts more with

ASEAN. And the greatest example of this is the ASEAN/China free trade area, which is—only exists in principle at this point, but, if it comes to fruition by 2015, will be the largest free trade area in the world.

There are, I think, numerous things that the United States can do to protect our interests and to make sure that our influence is safeguarded.

First of all, we can, through our own trade policies, participate more in regional integration in Southeast Asia, because that will keep us in the mix. And that would mean either stepping up the enterprise for ASEAN initiative or perhaps pushing more on the Doha round, which would have an integrative effect, but not divert trade as much as bilateral FTAs would.

We should help Southeast Asians think about the next financial crisis, and perhaps offer a second line of defense for currency—severe currency fluctuations. On a bilateral basis, we were not particularly well loved during the 1997–98 crisis, because we put most of our support through the IMF.

In terms of security, I think that we could be more active in ARF, as well. We tend to have APEC as our go-to regional institution. I do not think we want to cede that sort of a role to China, although both China and the United States are just dialogue partners in ARF.

I think we can also promote triangular cooperation on nontraditional security threats between China and the United States and Southeast Asia—epidemics, trafficking of all sorts—which would signal that we do see China as a potentially benign power, but also set up some tracks for cooperation.

We can also pursue our own very cautious and incremental policy in multilateralizing security in the region. And that has taken place mostly through our broadening the Cobra Gold exercises in Thailand. And I would note that China has been an observer to those exercises.

I think it is important that we not exacerbate the gap between the rich and poor countries in Southeast Asia, and that we do improve our ties with the newer members of ASEAN. And there are any number of things that we can do in that regard.

The Tariff Relief Assistance for Developing Economies Act, which is before both the Senate and the House for consideration this year, would boost trade with Cambodia and Laos, and it would help cushion some of the blow of the abolition of the textile quotas.

I do believe, with Vietnam, it is important to solve the political issue of Agent Orange. That is one that the Vietnamese care very much about, and we have not really given it sufficient attention.

And I think that by national public/private educational foundations with Laos and Cambodia, we do quite a lot, as well. Education is, as you noted, an increasing problem. There is an educational pull towards China. In 2004, twice the number of Indonesians got visas to study in China as got visas to study in the United States. And so, that is going to be an increasing problem that we should think about, seeing education as a quote/unquote “hard” area of policy, rather than a soft one, as it traditionally is.

And, lastly, I think we need to be careful not to over-rely on surrogates in Southeast Asia. We tend to view Japan, Australia, and

perhaps even India as carrying our water in the region at times. I think that would be a mistake. All of those countries have a great deal of commonality with the United States on some issues, not on some others, but we really do need to maintain our own profile in the region through high-level visits, both in the executive and the congressional sides.

And I would just point out that we recently had a meeting in Bangkok on U.S. policy in Southeast Asia, and one of the points that was made by some of the Southeast Asian leaders is, they would like to see more Senators in the region come out on CODELs.

[The prepared statement of Professor Dalpino follows:]

PREPARED STATEMENT OF CATHARIN E. DALPINO

Thank you for this invitation to appear before the committee to discuss China's emergence in Asia and its impact on U.S. relations with Southeast Asia. My views on this subject are informed by my work as an adjunct professor of Southeast Asian politics, security and international relations at Georgetown University and The George Washington University. In addition, I co-edit the Georgetown Southeast Asia Survey; direct the Stanley Foundation's project on "Southeast Asia in the 21st Century," and consult with the Fund for Reconciliation and Development, which work in the countries formerly known as Indochina. Some of the findings and recommendations in this statement are derived from research conducted by these groups related to China's role in Southeast Asia.

Without doubt, China has increased its reach and influence in Southeast Asia dramatically in the past fifteen years. This is an inevitable consequence of its emergence as a global economic power, but is also the result of carefully crafted Chinese policies which couple geopolitical interests with economic incentives and opportunities in Southeast Asia, bound together by a vigorous diplomatic campaign. It is a matter of genuine debate whether China's new role in Southeast Asia supports or threatens American interests in Southeast Asia. The United States wants Southeast Asia to be prosperous and stable, and that requires China's active involvement in the region.

The issue is whether China is on a trajectory to outdistance the United States in the region's economic affairs, as well as in political and security relations with specific countries. Southeast Asia's trade with China is its fastest growing economic relationship, and in 2005 the volume of ASEAN-China trade may eclipse that with the United States. This will make China Southeast Asia's most important trading partner for the first time since 1573. Indeed, some economists believe that this is the restoration of a very old pattern of Asian economics and trade, with China reclaiming the central role it held before the colonial era.

China's ultimate intentions toward Southeast Asia are unclear. Many Southeast Asians dissent from a predatory view of China's new relationship with the region. The public posture of ASEAN governments is to express confidence that China's intentions are benign, and that it will over time prove to be a responsible power in the region. They do not credit the present generation of Chinese leadership with either the ability or the inclination to pursue broad, strategic aims in the region in a deliberate fashion. There is considerable evidence to support this view at the present time. The exception to this is China's relationship with Burma. ASEAN's apprehension over growing security ties between Beijing and Rangoon contributed to its decision to admit Burma into ASEAN in 1997, in the face of strong resistance from the United States.

More to the point, Southeast Asian as a whole does not want to be the object of competition between the United States and China. The larger and richer states in the region—Indonesia, Thailand, Singapore, and Malaysia—will be able to balance relations between the two countries well into the future. Because of its history, Vietnam has taken a particularly studied approach to developing relations with global and regional powers. Hanoi seeks an omni-directional foreign policy and it is adamant that it is not attempting to use one power as a "counterweight" against another. Relations between the U.S. and the Philippines, a treaty ally, have strengthened measurably since the September 11 attacks, at the same time, Philippine-Chinese relations have also expanded. Late last year the Philippines entered into a "strategic dialogue" with China when President Arroyo made her first state visit to

Beijing. If there is an obvious imbalance, it is in China's relations with the poorer countries of mainland Southeast Asia. In recent years Beijing has quickly established itself as the primary economic patron in Burma, Laos and Cambodia, and as Rangoon's closest political partner.

The United States and China bring different strengths to their relations with Southeast Asia. Although China has improved security relations with Southeast Asia, it cannot supplant the United States as the security guarantor for the region. The tsunami relief effort demonstrated the rapid response capability of the U.S. military, and U.S. economic aid to the region was ten times larger than China's contribution. However, it would be a mistake to view the tsunami effort through the lens of triumphalism. China's role in the relief represented its first major international humanitarian effort, and Beijing received credit from Southeast Asia accordingly.

Beyond its market for exports, China has location on its side. Its proximity to Southeast Asia enables Beijing to dispatch an "A team" of leaders to the region on short notice. Diplomatically, Premier Wen Jiabao holds the ASEAN portfolio. Moreover, ethnic Chinese in Southeast Asia, whose numbers are vaguely estimated at 20 to 40 million, have helped open economic and political doors with China for their adopted countries. China also has cultural roots in common with many Southeast Asian societies, which extend to popular culture in the present day. In many younger generation Southeast Asians, kung fu easily tops hip hop. These factors combine in Chinese policy to stress the "family" aspects of China's relations with Southeast Asia, which the United States cannot as easily claim.

THE CENTRALITY OF TRADE

Questions of immediate and serious competition with China in Southeast Asia pertain to trade. Although the United States has made considerable strides in trade with Southeast Asia in recent years, China has pulled ahead much more quickly. The underlying issue is whether such a pattern represents a gravitational pull toward an Asian economic community that excludes the United States. This is underscored by China's agreement with ASEAN to form a regional Free Trade Area by 2015. While still in the early stages, if it is completed the China-ASEAN FTA would be the world's largest free trade area.

To be sure, ASEAN has strong interests in maintaining high levels of trade with the United States. Most Southeast Asian exports to China are in raw materials, while the U.S. is the established market for more high tech manufactured goods. Moreover, the United States is theoretically working toward a concert of free trade agreements in the region through the U.S. Enterprise for ASEAN Initiative, a ladder of steps intended to culminate in FTA's with each Southeast Asian country. However, these ladders are too steep for the weaker economies of the region, and FTA's with the U.S. are not tangible possibilities.

China's primary goal in its trade with Southeast Asia is to use the region's natural resources and markets to fuel domestic Chinese development, particularly in the southern province of Yunnan, which borders Southeast Asia. In Burma and Laos in particular, much trade is private and local and therefore likely to be underreported. Migration into these countries accompanies the increase in trade, particularly in the northern half of Burma, which some analysts have dubbed "Yunnan South." Chinese trade is also changing the physical face of mainland Southeast Asia, as roads are built in Laos to connect China to Thailand, and as China builds dams on the Mekong for energy and widens the river's shoals to permit barges to pass through. Southeast Asian NGO's and some governments are beginning to question the ecological costs of this process, but have few levers against Beijing to control it.

For its part, Southeast Asia views increased trade with China as an opportunity to recycle some of the trade and foreign direct investment the region has lost to the economic giant to the north, especially after China entered the world Trade Organization. Some analysts forecast that Southeast Asia could lose as much as \$400 billion to China, over the next 15 years. It is unlikely that the proposed China-ASEAN FTA will stem that loss to a great degree, indeed, there are likely to be economic dislocations that come with economic integration with China. Beijing has set 2010 as the target date for the reduction of tariffs with the original six ASEAN states, and 2015 for the four new members. However, early experience is showing that Chinese goods can overwhelm indigenous products in Southeast Asian markets. In Thailand, as the result of an agreement with China on fruits and vegetables, a kilo of Chinese garlic costs 5 baht (15 cents), versus 35 baht (\$1.05) for a kilo of Thai garlic.

SECURITY SHIFTS BELOW THE RADAR

China's intentions toward Southeast Asia appear to be overwhelmingly commercial at this time. However, this does not negate an increased interest in security in the region. Chinese leaders view a stable external environment as essential to achieving their internal economic and political objectives. In that regard, Beijing has attempted to project the image of a responsible power in Southeast Asia, and has taken steps in recent years to reduce tensions over the Spratly Islands in the South China Sea. Improved security with Southeast Asia also facilitates trade with the region, although greater dependence on Southeast Asia's energy and raw materials also creates a greater security imperative for China.

Beijing has been slower to improve security relations with Southeast Asia than diplomatic or trade ties. In 1992, after the withdrawal of U.S. bases from the Philippines, China issued a unilateral claim of sovereignty over the South China Sea. This policy resulted in a clash with the Philippines over Mischief Reef in the Spratlys in 1995. The incident was a red flag to both China and ASEAN that tensions over the Spratlys could derail broader progress in relations. In 2002, China and ASEAN negotiated a Declaration on the Conduct of Parties on the South China Sea, which called for greater consultative mechanisms. The Declaration had echoes of Chinese rivalry with the United States, however, when Beijing tried unsuccessfully to get ASEAN to agree to forbid foreign military exercises in the region. In the past year, Beijing has further reduced tensions by inviting Vietnam and the Philippines to join it in exploration of oil resources on some of the disputed Spratlys, although such cooperation did not include the renunciation of competing claims.

More generally, Beijing has recently been forward-leaning in regional security. In November 2004 China hosted first the Security Policy Conference of the ASEAN Regional Forum (ARF), attended by defense officials from twenty-four Asian countries.

Not surprisingly, China also presses Southeast Asian governments to purchase military equipment. Although some Southeast Asian defense communities see Russian equipment as the alternative to American, China has realized some success. Last year Beijing and Kuala Lumpur negotiated a deal for Malaysia to purchase mid-range missiles from China.

Southeast Asians are very frank in making clear their views that they do not fear a unilateral security threat from China, but they do fear the inherent threat in a military conflict between China and the United States, which they presume would occur over Taiwan. All of the Southeast Asian states follow a "one China" policy, although Taiwan has significant investments in the region, particularly in labor-intensive sectors. Southeast Asia occasionally feels the edge of this threat. For example, last year Beijing sharply rebuked Singapore when then-Deputy Prime Minister Lee Hsien Loong made an unofficial visit to Taiwan.

CHINA'S "CHARM OFFENSIVE" AND THE IMPORTANCE OF OPTICS

At a time when the United States worries about its image abroad, particularly in the Muslim world, China has mounted a wing diplomatic campaign in Southeast Asia. The primary purpose of this was to normalize relations with the ten countries of the region, which Beijing has accomplished, although there are significant differences among the ten in closeness to Beijing and levels of trust.

Although China and the United States are not in open strategic competition with one another in Southeast Asia, China has learned to capitalize on openings the U.S. has left in the region. In 1997, when the U.S. failed to offer bilateral bail-outs to Southeast Asian countries hit hardest by the economic crisis, Beijing offered those states the first Chinese bilateral loans in the region. In 2003, after the United States tightened sanctions against Burma in the wake of Aung San Su Kyi's re-arrest, Beijing gave Rangoon a grant of \$200 million to help cushion the economic loss.

Beijing employs two additional strategies that occasionally give it advantage over the United States. Chinese aid to Southeast Asia is conspicuously unconditional. This creates a contrast to perceptions of American aid, which are often entangled with sanctions and other conditionalities. In 2004, seven out of ten Southeast Asian countries were under U.S. sanctions or the threat of sanctions. Indeed, there were signs of a revival of the "Asian values" debate of the 1990's, when Beijing successfully lobbied to include Burma in the Asia-Europe Meeting last year, against the objection of some EU governments.

Another advantage is Beijing's regional approach to Southeast Asia. Although China has been scrupulous in developing bilateral ties, it also deals with ASEAN as a regional group to a greater degree than does the United States. This is seen not only in the China-ASEAN FTA, but also in Beijing's accession to the Treaty of Amity and Cooperation (TAC), one of the founding ASEAN treaties. Japan, India

and Russia have also signed the TAC, and ASEAN has urged the United States to do so as well.

By contrast, the United States is viewed in Southeast Asia as being overly bilateral, and at times unilateral, and therefore less supportive of ASEAN's development as a regional institution. In the near-term, the United States would be constrained in its efforts to work more closely with ASEAN as a group, because of political relations with Burma. Current U.S. policy toward Southeast Asia tends to bifurcate the region into countries with significant Muslim populations (and higher terrorism threats as a result), and those without them, paying greater attention to the former group. This split corresponds to the division between "old" and "new" members in ASEAN. As well, the U.S. Enterprise for ASEAN Initiative favors the older members over the new, and it can be argued that it exacerbates the economic gap between these two groups as a result.

The fruits of China's diplomatic efforts in Southeast Asia are increasingly evident. Chinese tourism in the region is ballooning. Each year, for example, 800,000 Chinese visit Singapore. Equally important, educational patterns are changing rapidly to favor China over the United States in some countries. Based on the number of student visas granted, Chinese educational exchange with Indonesia appeared to have increased by 51 percent in 2004 over the previous year. The number of Indonesian students receiving visas for China (2,563) was more than twice the number granted visas to study in the United States that year (1,333). This follows a larger pattern of plummeting levels of foreign students, Southeast Asian students in particular, studying in the U.S. In the 1980's, Malaysia sent more students to the U.S. than any other country, at present, Malaysian students do not make it into the top ten groups. According to the Institute for International Education, the number of international students enrolled in higher education in the United States was down by 2.4 percent for 2003–2004, the first absolute decline in foreign enrollments since 1971–72. However, the top two groups of Southeast Asian students studying in the U.S.—from Thailand and Indonesia—have declined by more than 20 percent each. Many go to Australia, which is establishing itself as a regional educational hub, but the trends toward China are also dramatic.

RECOMMENDATIONS FOR U.S. POLICY

If the United States frames its policy in Southeast Asia as a zero-sum competition with China, that will surely become a self-fulfilling prophecy. However, the U.S. needs to pay attention to widening gaps in economic and political influence in the region that could, over the long-term, create serious imbalances. For the most part, safeguarding American interests in Southeast Asia does not require a reversal of current policies; instead, it is a matter of expanding or accelerating existing measures in diplomacy, security, trade and educational and cultural exchange.

Economics and Trade

1. Although a comprehensive U.S.-ASEAN Free Trade Agreement is unlikely in the near term, the United States should support economic integration in Southeast Asia by accelerating U.S. trade policies in the region.

Participating more fully in Southeast Asia's economic integration will help prevent the marginalization of the American role at a future time. In this regard, the U.S. could pursue two paths. One would be to push for the conclusion of the Doha Development Round by 2005 or 2006, which would aid integration while it helps to reduce the potential for trade diversion due to bilateral agreements. The second would be to accelerate movement on the Enterprise for ASEAN Initiative, and attempt to ensure that the agreements it produces are compatible with one another, as well as with the FTA concluded with Australia and a potential FTA with South Korea.

2. The U.S. should support Southeast Asia in developing the financial infrastructure to avert or minimize the next economic crisis.

Southeast Asian leaders fear that sharp economic change in either the United States or China could spark an economic crisis in the region, and even that U.S. attempts to persuade China to revalue the renminbi could create dislocations in Southeast Asian economies. China pays increasing attention to such worries and has made loans to prop up Southeast Asian currencies in the poorer countries, often writing off the loans. U.S. policymakers should consider support to plans for regional currency swaps to stabilize capital flows, such as the Chiang Mai Initiative, and consider offering a second line of defense if signs of an impending crisis appear. Apart from the benefit to the US economic stake in the region, such cooperation could help dispel lingering bitterness toward the United States over the 1997 crisis.

Security

3. *The United States should continue cautious multi-lateralization of its security policy in Southeast Asia, tailored to Southeast Asian interests and needs.*

This does not necessarily mean the demise of the hub-and-spokes configuration of the American security umbrella in Asia. Rather, it blunts the edge of military competition in the region while maintaining a central role for the United States. The most concrete example of this is the incremental expansion of the Cobra Gold exercises. This year Japanese Self-Defense Forces joined the United States, Thailand and Singapore as participants, and a wide range of countries were observers. It is worth noting that China has been one such observer.

4. *The U.S. should take a more active approach to the ASEAN Regional Forum.*

China is carving out a leadership role in ARF, albeit as a “dialogue” partner, while the United States tends to focus more on AMC. Because ARF follows ASEAN rules of consensus, it is likely to remain a “talk shop” for the time being. However, those same rules help to reduce national sensitivities. In due course, ARF may be an appropriate vehicle to promote cooperation on maritime security.

5. *Washington should consider triangular cooperation—with Southeast Asia, the United States and China—to address transnational threats in the region.*

Beyond the obvious benefits of cooperation in such areas as epidemics (avian flu, HIV/AIDS) and transnational crime (human and drug trafficking), triangular efforts can help reduce underlying tensions about competing military exercises. Cooperation on non-military, non-traditional threats would be a tangible indication that the United States views China as a potential security partner in Southeast Asia, rather than a strategic rival.

Diplomacy and Development

6. *The United States should consider new mechanisms to step up dialogue with ASEAN as a group.*

There is little likelihood that the U.S. will sign the Treaty of Amity and Cooperation with ASEAN, not least because doing so implies an endorsement of the “Zone of Peace, Freedom and Neutrality” (ZOPFAN), which Washington has long opposed. However, the U.S. can consider two mechanisms to strengthen ties with ASEAN as a regional institution;

The first is a regular U.S.-ASEAN Summit, perhaps on the margins of the annual APEC meeting. Obviously, the problem of Burma’s participation would have to be resolved in such a meeting. A second measure is the establishment of a U.S. Ambassador at large to ASEAN, similar to American envoys to the European Union, the Organization of American States, and APEC. However, the appointment of an ambassador would need to be matched with the resources to expand and strengthen the regional office of the State Department’s Bureau of East Asian Pacific Affairs.

7. *The United States should help develop human capital in Southeast Asia by expanding programs to strengthen educational ties.*

Education is often a “soft” area in foreign affairs. In the case of Southeast Asia, however, it is very much a “hard” area of policy, albeit a long-term and potentially expensive one. Strengthening education will boost the region’s economic competitiveness, address some socioeconomic “root causes” of extremism and terrorism; and improve ties between the United States and Southeast Asia at the societal level. In several Southeast Asian countries, particularly the poorer ones, more than half the population was born after 1975, when U.S. presence in the region began to recede.

Educational programs promised for Indonesia and the Philippines when President Bush visited those countries in 2003 have been slow to come to fruition. These should be expedited. More broadly, beyond increasing funds for in-country education and U.S. scholarships, policymakers need to address the visa problems which discourage Southeast Asian students from study in the United States.

8. *U.S. policymakers should avoid exacerbating the gap between “old” and “new” ASEAN members and offer initiatives to increase American influence in the “new” a states.*

Taking steps to strengthen economic integration in Southeast Asia would go far in helping to close this gap. However, additional political and cultural measures can

help shore up U.S. bilateral ties with these poorer countries. Some possibilities include:

- Approving the Tariff Relief Assistance for Developing Economies Act (5191/HR 886), which would boost trade with Cambodia and Laos, and help compensate for lost income in the garment sectors of these countries due to abolition of textile quotas for WTO members.
- Addressing the lingering effects of Agent Orange in Vietnam, which have created an ongoing political problem in the relationship. This could also have a positive effect on military-to-military relations, since many high-level Vietnamese defense officials are war veterans.
- Establishing bi-national public-private educational partnerships for Laos and Cambodia, to provide scholarships for study in the United States.
- Establishing Peace Corps programs in Vietnam and Cambodia and, when appropriate, in Laos. The U.S. has reached agreement in principle to place volunteers in Vietnam and Cambodia, although their precise use is still under discussion. Negotiations for a Peace Corps program in Laos foundered at the eleventh hour in the late 1980's, but the U.S. might explore the possibility of resuming talks, particularly if programs are initiated in Vietnam and Cambodia.
- Supporting the work of field-based American non-governmental organizations in these countries. For example, The Asia Foundation works in Laos with a broad range of institutions, from the National Assembly to women's groups to business councils.

8. Washington should avoid an over-reliance on "surrogates" in Southeast Asia in favor of a more direct and activist policy in the region.

As the world's only global superpower, Washington's attention is often diverted from Southeast Asia to crises in other regions. Some policymakers and analysts assume that U.S. interests are protected by like-minded Asia-Pacific powers: Japan, Australia and India. Although there is commonality with these countries (and partnership in some areas with Japan and Australia), there is also competition for markets and influence. Moreover, Tokyo, Canberra and New Delhi have their own limitations in Southeast Asia that Washington should not borrow. In particular, despite the implications of Secretary Rumsfeld's remarks in Singapore last week, the U.S. should not assume that India will balance China in the region in the foreseeable future.

Beyond the substance of a more activist approach to Southeast Asia, some of which is outlined above, the United States should seek a higher profile in the region. The U.S. is unlikely to match the level of Chinese attention with Wen Jiabao as the designated point for ASEAN. However, President Bush should follow through on plans to attend the APEC Summit in Hanoi in 2006, and Secretary Rice should participate in annual ASEAN Ministerial Meetings. In addition, Southeast Asian leaders have suggested that cabinet-level officials in functional areas—health, labor, education—visit the region. Lastly, Southeast Asians also believe that increasing the number of Congressional delegations to the region would strengthen U.S. policy toward Southeast Asia.

Senator MURKOWSKI. We will have to make that happen. Thank you. I appreciate your comments.

A great deal of information from all three of you. My questions are going to be scattered as I am jumping back and forth here. And, Professor, since you just finished up, and it is fresh here, I will just start with you.

You have pointed out the situation with Vietnam, you know, a couple of times in your comments, recognizing that China's relationship with certain nations in Southeast Asia have not always been the most congenial, particularly with Vietnam. They have fought numerous wars over the years. And, I guess, as we look at the level of influence that China is exerting in the region, and, now, the economic ties that some of these countries have, particularly I will speak to Vietnam, the relationship that they have with China, what role do they look to the United States to play as China is emerging and as their economic ties are being strengthened? And let us speak specifically to Vietnam.

Professor DALPINO. Okay. Let me make a couple of comments about the Chinese/Vietnamese relationship, because it really is fairly complicated. They are historic enemies. They are historic allies. And there is a fair amount of party-to-party contact as Vietnam looks at the way that China is developing as a one-party system, but with a market system. And this is gradually liberalizing.

That said, I think there are two things the United States can do. One is, the Vietnamese are very much looking to us to help them enter the international market. And, of course, WTO is a big issue with them. They do still hope to enter by the end of this year. A lot of economists think that's unrealistic, although yesterday the ranking official in the WTO who has the Vietnam portfolio says he thinks it might be possible.

As you know, Prime Minister Phan Van Khai, is coming at the end of this month and will meet with President Bush, and I think that is probably at the top of his list, is U.S. approval for WTO, and then PNTR, of course, that would have to go along with it.

We do have a nascent security military-to-military relationship that has been building primarily through ship visits and through exchange of high-level defense ministers. That has built-in brakes. But I think that, to the extent that it does not raise any red flags with other powers in the region, particularly China, Vietnam would probably like to proceed at a cautious rate. But there's potential there, too. But we are talking about a matter of years, rather than months. But, here again, this loops even back to the Agent Orange issue, because the community in Vietnam that cares the most about that are the veterans who have high-level defense positions now.

Senator MURKOWSKI. The WTO's next ministerial meeting is going to be held in Hong Kong this December. What actions can the U.S. take at that conference to demonstrate its goodwill toward Southeast Asia? Now, you've mentioned a few particular items. You know, you pay attention a little bit more to the financial crisis, regional integration. Anything more specific that the U.S. might say or do at that time? And what actions, then, do you expect to see from China, as the hosts of this conference?

Professor DALPINO. I am really not an economist; and so, I am not really up on the December meeting. I would just make a couple of comments.

One, on the currency side, whether or not we support the Chang Mai Initiative and a regional currency stabilization fund or mechanism, I think, will be very important. As you know, China, itself, has flipped on that. When that was first proposed, at the beginning of the Asian economic crisis, China joined with us in opposing that. They've now gone around to that side. And I think we are going to be out-ringed on that in many ways.

Second, I think that, looking to our own enterprise for ASEAN initiative, which intends, at some point in the very far future, to also be a regional FTA—because all of the countries, at some point, would have an FTA—I think that we need to look for ways to accelerate that, that are consonant with WTO, that do not conflict with it, and that would show a little light at the end of the tunnel for some of the countries that wouldn't expect to profit from that. We have an FTA with Singapore. We are negotiating one with Thai-

land. Malaysia is probably next in the queue, and Malaysia has been surprisingly open to this idea. After that, there really is not a very good candidate. Indonesia has a lot of problems. And Philippines is not open to the idea of an FTA with the United States.

Another issue is the Millennium Challenge Account. The Philippines has been invited to apply, as a threshold country. Vietnam shares the same number of—numerically, shares the same ability to apply, but does not have the same scores on the political side, on the democracy and human right side. But seeing more South-east Asian countries become eligible for that, too, I think, would be appropriate, too.

Senator MURKOWSKI. Thank you, I appreciate your insight on that.

Let's go back to you, Dr. Pei. It was interesting, in reading your testimony and listening to your comments this afternoon, as we talk about China's emerging influence we tend to think of the actions that are happening outside of China's borders. But what is happening inside is certainly equally important when it comes to terms of legal and political reform.

As just a matter of coincidence, we have members of the National People's Congress, they are here in Washington this week for the annual U.S./China Interparliamentary Group meetings. It was interesting to read, and then to hear you again repeat, that the legislation that has been enacted into law by the NPC were all introduced by the executive branch, that that legislation that had been introduced by individual members hasn't, or just does not, become law.

What, if anything, can we, here in Congress, do to help those members—you know, our fellow legislators, basically—gain a reasonable level of influence within their own government?

Dr. PEI. I think this kind of exchange with the Chinese National People's Congress is very important and should be maintained. But I would urge that, because China is such a huge country, and, from my own studies, local legislatures in China are actually playing, perhaps, a more important and positive role than the National People's Congress. So, I would recommend that, in the future, attention—some attention be paid to developing programs that would reach out to China's provincial legislatures, because these provincial legislatures manage—have jurisdiction over millions—hundreds of millions of people, and if they can play a more positive role, then probably can create some differences on the ground.

Senator MURKOWSKI. Do you think that this can help in the areas—you spoke of the judicial corruption and essentially a judiciary system that is rendered meaningless because of the corruption, because of just the ineffectiveness of a judiciary. Do you think that the local level is where you can begin to effect some change within that judicial system?

Dr. PEI. Oh, yes. Because, according to Chinese law, the presidents of local courts have to be approved, have to be confirmed. They may be nominated by the local governments, but they have to be confirmed by the local legislature. That's a very important node—pressure point for local legislature to exert their influence.

In addition, every year local courts have to make—present working reports to local legislators, and local legislators can refuse to

endorse such reports. And while that does not happen very often, but, once, it did happen, and when that happened, that was national news, because that showed that the people's voice can actually be heard on such an important issue.

Senator MURKOWSKI. With the failure of a strong judicial system, and recognizing the inherent problems and issues of corruption within the system, and recognizing the impact that that has to those that are looking to invest in China—if I am an investor, I want some security that, if I come in and put money in—my company in your country, that there's going to be some level of recourse—how big of an impediment to investment is—are the failures within the judicial system right now?

Dr. PEI. I think the biggest victims of this ineffective judicial system are Chinese entrepreneurs. For political reasons—for very understandable political reasons, the Chinese Government and the Chinese Communist Party have placed a premium on attracting foreign capital. So, foreign investors, compared to Chinese private entrepreneurs, are actually much better protected under Chinese law. That's because lawsuits involving foreign investors are adjudicated at a higher level of the judicial system. For example, they are adjudicated in intermediate courts, which are less corrupt, than at the basic-level courts, which are far more corrupt—or far more susceptible to corruption and political manipulation.

Also, within China local governments compete for foreign capital. That's why local governments tend to be more friendly to foreign capital than to local capital. So, if I were a foreign investor, of course, you go into China, and you know it is a far more risky place than, say, of developed market, but you should also, perhaps, as a level for your own comfort, know that your own investment is at least a little bit more protected than Chinese domestic capital.

Senator MURKOWSKI. Interesting.

Now, we heard, from both Senator Voinovich and Senator Obama, the concern about intellectual property rights. And, going back to your comment earlier, that reform is more effective, probably, at the local level, what steps are the central and the local governments taking to improve protection of intellectual property rights?

Dr. PEI. I think, in this case, the central government probably is doing more than local governments. That's because Chinese local governments are closely intertwined with local economic interests. In many instances, a property—intellectual property rights violations, you are likely to find that local governments are heavily involved in the operations, or in the income streams from those operations. So, I think—and, also, we must understand that, given the diversity and size of China, the central government is not always effective in enforcing its laws. So, you may go to China and get promises from the central government, but you also must understand that the central government is not always in a position to keep its promises.

And I was interested to hear Senator Voinovich's story about his meeting with Premier Wen Jiabao. He mentioned three cases. I can tell you this story about Premier Wen Jiabao, as well. There was this peasant lady in China who bought fake melon seeds from a local vendor. And, of course, no melon grew, as a result. And she

pleaded the case to Premier Wen Jiabao, and Premier Wen Jiabao gave specific instructions to have her case looked into by local authorities on three separate occasions. And nothing happened. And that is—so, that is a very revealing story about how central authority in China can be, often, ineffective at the local level.

Senator MURKOWSKI. So, who, in your opinion, or what entity, would be in the best situation—or the most effective in improving intellectual property rights protection? Is it through the WTO? Is it the ASEAN? Is it bilateral relationships? How do we work this best?

Dr. PEI. Ironically, if we know that—who really controls the power in China, we will come to this surprising conclusion. The Chinese Communist Party is actually the entity, in my judgment, that is most capable of dealing with this issue. Of course, we have to persuade the Communist Chinese Party that protecting intellectual property rights is in the critical interests of the party, itself. But, unfortunately for the United States, there is no dialogue, in my—according to my memory, that exists between the U.S. Government and the Chinese Communist Party.

Senator MURKOWSKI. How do you get that?

Dr. PEI. Because the Chinese Communist Party, as an organization, is the most effective ruling organization in China that can actually enforce its decision, not a particular department at a central—in the central government—for example, the Commerce Department, which really has very little power at the local level.

Senator MURKOWSKI. Right. I guess until they decide that it is in their best interest, they are not going to follow through, to pursue that.

Dr. PEI. Indeed. The central—the Communist Party, at a very high level, has to make a critical political decision that this really involves its key interest.

Senator MURKOWSKI. Thank you.

Let's finish up with you, Mr. Herberg. Obviously, coming from an energy producing state, energy is always near and dear to my heart. And it is—it was interesting to hear you, kind of, describe this—just a tangled web of interests as the demand in the area grows at what we could—would just consider an incredible rate. We can't believe the numbers that we are talking about. And yet these are real. And in recognizing the pressures that we will see as China seeks to really control the aspects of energy—it is not just getting your oil from the OPEC nations, it is really looking to—looking for direct ownership over oil production, and all aspects of how we get there. I do not know whether we can clearly say China is unwilling to share their oil. You smile, like maybe, in fact, we can make that statement and be conclusive about it. But, you know, we talk about bringing China into the IEA for global oil-sharing programs. This is not something that they have—at least from their actions—they indicate a willingness to do that. How do you reconcile that?

Mr. HERBERG. Let me just say, I spent 20 years with ARCO, and, obviously, we were a major player in Alaska, so I know that oil—

Senator MURKOWSKI. Did you ever get up north?

Mr. HERBERG. I was in Anchorage, in the North Slope, quite regularly, but mostly other places in the world. But I did get familiar with Alaska.

But I think that is the tough issue with China, it views energy through this mercantilist-status lens. And the only way I can capture it is to say energy—in particular, oil, but energy is too important to be left to the markets. And so, the leadership focuses on this as a state strategic problem—it is high politics of energy security and national security, rather than just low politics of energy supplies—so that everything they do is through this prism of, How do we, by state effort, secure those supplies? Because it is this deep-seated fear that energy shortages are going to undermine economic growth, job creation, and, ultimately, social instability and the power of the party.

Senator MURKOWSKI. Well, but, you know, when you think about it—

Mr. HERBERG. This is very real.

Senator MURKOWSKI (continuing). —it is very real.

Mr. HERBERG. So, there is a visceral connection between energy supply—secure energy supplies, at whatever price, and the political power of the leadership and social stability. So, that is why this issue is so visceral for them, so important.

You can hope that, in the future, China goes down the—or up the learning curve that they did with the WTO and trade. Twenty years ago, trade was entirely state controlled in China. It took a 20-year learning curve for them to come around to the notion that trade, the WTO, and markets actually can work for China. I think, in the long run, China's going to make that journey up that learning curve on energy, as well; but, for now, they view it in this very zero-sum unilateralist, state-controlled prism that leads them to sponsor the state companies, the state-to-state deals on a whole series of these things, to see it in military and maritime terms, in terms of controlling sea lanes, to attach it very closely to their overall geopolitical architecture, both regionally in Asia, but also globally, and attach very much of it to their perception of the U.S. control of global energy and oil markets. And so, it is a very powerful mindset that is taken—that is there on the energy side. It is a very antique, mercantilist viewpoint. And until they begin to see that markets can actually work for them on the energy side, oil side, I think we are just going to see more of this.

And it is—I think part of the thing that the U.S. Government needs to do is engage China at very high levels. You know, DOE is working with China bilaterally and in working groups and a whole series of things, but I think the—at a higher level, we need to begin to talk to them about using markets, about regional cooperative mechanisms, joint development areas. There is a whole series of things that you can do to create confidence. IEA oil sharing, which you mentioned. You know, you have this huge imbalance between the old IEA system, which was built in the 1970s, based upon the oil-demand picture then, and today's oil market, which is driven by China, India, Southeast Asia oil demand. But they are not in the IEA. They are not in the oil-sharing mechanism. You have to find a way to get them into some global oil-sharing mechanism.

Senator MURKOWSKI. What happens if you do not?

Mr. HERBERG. It will just be more of this zero-sum competition for supplies. That is the outlook. Because the overall regional mistrust, broader—I mean, Japan/China, China/India, China/Russia—the overall rivalries, in the broader sense there, simply mirror themselves in the lack of trust over energy deals.

And let me give you a perfect example of that. China spent three or four years negotiating with Russia for an East Siberian oil pipeline to come down to Northeast China. At the last minute, Japan jumped in and offered \$10–12 billion worth of financing field development to build that pipeline, not to China, but to the Pacific coast, where it would go into Asia and, much of it, to Japan. China viewed that as a strategic denial strategy. It was simply a battle over strategic control in Northeast Asia. And I have heard that, frankly, from the Japanese side, as well.

And so, you see the same geopolitical triangle problems, particularly the Japan/China relationship, mirrored in their attempts to solve energy problems, or the way in which they go about seeking those energy supplies.

So, you have to, kind of, attack this thing, I think, at both levels, both to try to create mechanisms that de-link energy from the broader geopolitical context, so that you can talk about cooperative, mutual trust, oil sharing, pipelines, regional cooperation, but unless you deal with the broader geopolitical rivalries and distrust, as well, which there is no system right now in Asia for that—and, frankly, I am not sure the U.S. is deeply enough engaged in that—until you begin to work on those, as well, you may not make much progress on the energy side. But I think, at least in energy, you have to begin to try to steer China towards more collaborative, market-oriented strategies—as well as the others in Asia, because this is a—one provokes the other. I think you have to keep in mind that the others are doing similar kinds of things, and the Chinese are reacting to that, overlaying this deep sense of insecurity about their future supplies. And that is a scale problem. I mean, just a simple scale problem. Chinese oil demand will grow in the next 15 or 20 years by the equivalent of Saudi Arabia's total oil production today. China, alone.

Senator MURKOWSKI. In how long a time period?

Mr. HERBERG. In the next 20 years. And that is a very short period of time in a capital cycle in the oil business, as you know. So, it will grow by the equivalent of a Saudi Arabia, from, say, 2002 to 2025. These are big numbers, and it really focuses the mind of the leadership. Where is this oil going to come from? Where is the natural gas going to come from? Which—how much of it will be imported from—

Senator MURKOWSKI. Do you see the same picture, then, with natural gas as you do with oil, in terms of how China is viewing the need for the resource?

Mr. HERBERG. Natural gas is not as acute a problem, because they are not—right now, they do not import natural gas at all, and that is probably because they use so very little, 3 percent of their mix. They will be importing, over time, really—really, after 2010, imports will accelerate. But, even 20 years out, it would be unlikely that they would be importing more than 30 or 40 percent of their

gas. But that is still a significant number. And so, at some level, in the long run, that also feeds this sense of, “Where are we going to get these supplies?” And it is not a coincidence that virtually all that imported gas will come from many of the same places—the Persian Gulf, Russia. Fortunately, a lot of that from Southeast Asia, which has much better gas, LNG, capabilities—Australia, Indonesia, and Malaysia, for example. So, gas reinforces some of the same problems, but it is not nearly as acute a problem for China.

Senator MURKOWSKI. Well, recognizing that they will be looking to the Middle East for so much of their imported oil, with just ever-growing dependence on OPEC nations for their energy needs, how does this impact our—well, I guess, their foreign policy and the policy challenges that we face as a nation in meeting our energy needs, as it relates to oil?

Mr. HERBERG. I think it is—the Persian Gulf is where this is really going to be an important issue. China will become a major player in the Persian Gulf, politically, geopolitically. That is inevitable.

Senator MURKOWSKI. How much did they get—how much are they relying on Middle Eastern oil right now?

Mr. HERBERG. They import three-plus-million barrels a day. About half of that comes from the Persian Gulf.

Senator MURKOWSKI. About half.

Mr. HERBERG. A little over half. So, that is, you know, one and a half out of a total consumption of about six and a half. So, it is significant now. The long-term issue is that the bulk of reserves are in the Persian Gulf. Incremental supplies, globally, if you take world demand from 80 to 120, which is an IEA or a DOE forecast, probably half to two-thirds of that is going to have to come from the Persian Gulf. So, just by the scale of the resources, an estimate would be, for China, 20 years from now, it would be importing 75 percent of its oil, of which two-thirds would be from the Persian Gulf. So, it will be importing oil on the scale of five- or six-million barrels a day from the Persian Gulf 20 years from now. And you can already begin to see China beginning to focus its diplomacy on the Gulf, both in Saudi Arabia—on both sides of the Gulf and throughout the region. But it will become a major player in the region. I think, for the U.S., we need to begin to think about—we are used to being the dominant player in the Persian Gulf. How do we accommodate China’s growing influence?

Another piece of this, not to give you too many numbers, but roughly two-thirds of Persian Gulf oil exports now go to Asia. They do not go to Europe or the U.S., really, and—relatively small. Most of the Persian Gulf oil exports go to Asia, and a bigger and bigger share of that will be China in the future. That is not lost on the Persian Gulf producers. They are turning East, diplomatically, as well. So, you see a very real, kind of, nexus of interests there between the Gulf and Asia, and particularly China, because it is going to be such a big piece of this, and also as a geopolitical player, unlike much of the rest of Asia. We will have a competitor for influence in the Gulf. I do not know whether that is good or bad, because our interests converge in the stability of the Gulf, because we both will depend on flows being stable, oil flows from the Gulf.

But we also view Middle East and Persian Gulf politics in a very different way. So, I would think it is going to get a little stickier.

Senator MURKOWSKI. That is one way to put it.

I appreciate the time that you all have given to us this afternoon, and I greatly appreciate your comments. Thank you.

And, with that, we will stand adjourned.

[Whereupon, at 4:40 p.m., the hearing was adjourned.]

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