Partners and Competitors

Coming to terms with the U.S.- China economic relationship

Authors

Bates Gill

Sue Anne Tay

April 2004

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Bates Gill	Freeman Chair in China Studies
Savina Rupani	Special Assistant and Program Coordinator
Andrew Thompson	Research Associate
Sue Anne Tay	Research Assistant
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Center for Strategic and International Studies
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Introduction

In September 2003, U.S. Secretary of State Colin Powell declared that "U.S. relations with China are the best they have been since President Nixon's first visit" in 1972. Yet, since the summer 2003, economic relations between the two countries have become increasingly tense with a number of uncertainties and disputes coming to the fore. In fact, unlike in the past when political and security questions were the most contentious aspects of the bilateral relationship, economic and trade issues – traditionally among the most stable and positive aspects of U.S.-China relations – have become matters of considerable controversy and contention.

With concerns over heavy job losses in the United States, particularly in the manufacturing sector, attention has focused on the enormous U.S. trade deficit with China – approximately $135 billion in 2003, the largest bilateral trade deficit in U.S. history with any country[1] – and accusations that the Chinese currency, the *yuan* or *renminbi* (RMB), is unfairly valued. Three years after China's entrance into the World Trade Organization (WTO), the country also faces U.S. charges of inadequate market openness and purposeful barriers to trade.

Beyond questions of trade deficits, currency values, and market access, the U.S.-China economic and business relationship is entering a qualitatively new era. With bilateral trade surpassing $190 billion in 2003, China has become the United States' third largest trading partner after Canada and Mexico and its second largest source of imports. American investors are increasingly involved on the ground in China, not only to establish traditional manufacturing and export platforms, but to tap into the dynamic Chinese domestic market itself, seek bargains amongst the sales of state-owned enterprises, speculate in Chinese financial markets, and underwrite the initial public offerings of Chinese banks and other firms on international capital markets.

Interestingly, never in the post-World War II era has the United States had such an important economic partner that was not a close friend or ally. As such, China defies ready categorization in the American political and economic psyche. On one hand it is still very much an authoritarian country with a poor record in political and human rights. On the other hand, its pursuit of economic development has lifted some 200 million people out of poverty and brought tremendous and positive social change to the country, while providing unprecedented business and investment opportunities for U.S. companies, and a seemingly endless supply of inexpensive goods for the U.S. consumer.

More broadly still, while China through its economic development has become steadily invested in a peaceful and stable Asia-Pacific region, so too the country has become a more powerful political and military player in the region. That these developments and related questions arise in the midst of a hotly contested election year in the United States only adds to the complexity of these questions within the American body politic.

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[1] Figure drawn from the website of the U.S.-China Business Council, http://www.uschina.org/statistics/tradetable.html.

Thus, in increasingly complex ways, China is both an economic partner *and* an economic competitor, and the United States needs to come to terms with this new and dynamic reality. Moreover, while security and political relations are relatively stable, both sides should capitalize on the opportunity to improve and strengthen their economic relationship. Indeed, as the United States and China become all the more intertwined economically, it is all the more important they ensure their economic relationship proceeds as smoothly and beneficially as possible.

This report represents an effort to bring some greater clarity and understanding to the current U.S.-China economic relationship and its implications for U.S. interests. The report draws in part from a day-long conference organized by the CSIS Freeman Chair in China Studies on January 13, 2004 entitled, *Partners or Competitors?: Economics, Trade, and Finance in U.S.-China Relations* (a copy of the conference agenda is included as appendix to this report). The report also draws from ongoing research and analysis by the Freeman Chair into these issues.

The report first examines past and current dynamics of the Chinese economy, capturing in a snapshot some of its most prominent strengths and weaknesses. That background provides context for a second section which focuses on specific bilateral disputes which have arisen over the past year and are likely to characterize U.S.-China economic, trade and financial relations for the foreseeable future.

The report concludes with several broad policy recommendations to help guide U.S.-China economic, trade and financial relations for the months and years ahead:

- Grasp the complexities of U.S.-China economic relations, place them in their broader context, and avoid politicizing economic and trade disputes
- Recognize and respond to the global and regional impact of China's economic policies
- Exhibit sharper instincts about each other's domestic concerns
- Sustain and deepen senior- and sub-cabinet level exchanges, upgrade the level of exchanges and press hard on key issues
- Stress WTO compliance and other international obligations and commitments to the Chinese, avoiding devolution into narrowly bilateral disputes
- Enlarge public and private support for "best practices" in China which strengthen corporate responsibility, administrative transparency, the rule of law, a more open financial system, and the emergence of a successful Chinese entrepreneurial and middle class

As we enter this new, dynamic, unprecedented – and often difficult – era in U.S.-China economic, trade and financial relations, similarly new, dynamic, and tough thinking should guide the way ahead. In providing an overview of current and future U.S.-China economic relations, and offering broad recommendations for managing them more effectively, this report takes us several steps forward.

The CSIS Freeman Chair in China Studies would like to thank the sponsors of the January 13, 2004 conference, Standard & Poor's and Honda, for their generous support, and the conference speakers for their contributions in the preparation of this report.

PART ONE

The China market: promise and pitfalls for investors

The China market is a maze of contradictions. On one hand, the chimera of a colossal market of 1.3 billion persons is often reinforced by seemingly endless upward projections, underscored by a vast pool of inexpensive labor and burgeoning consumer demand. In other cases, scores of burnt investors, both domestic and foreign, lament the massive losses they suffered due to widespread corruption, weak financial infrastructure and the absence of predictable rules, regulations and legal redress. One the one hand, the Chinese government has allowed capitalist frameworks to thrive in certain sectors of the economy and market dynamics have escalated beyond investor expectations. But in other areas, persistent remnants of the planned state economy still exist and politically motivated barriers thrown up by the same government frustrate and confuse investors.

The promise and pitfalls of the China market are two sides of a constantly evolving dynamic as the country undergoes unprecedented and still unpredictable change, making it at once an exciting but challenging partner for American economic interests. But as American economic interests become ever more entwined with those of China, it is imperative to gain a more comprehensive, nuanced, informed, and realistic understanding of the China market, both its strengths and its weaknesses. The paragraphs which follow take up this challenge by considering the plusses and minuses of China as an investment venue.

China’s remarkable growth: an overview

It has been 25 years since China embarked on the path of economic modernization and openness. China’s strategy of gradual economic reform is often favorably compared to the “shock therapy” debacles of East European and Soviet Union counterparts. China eschewed the conventional recommendation of rapid privatization, overnight price reform, and immediate dismantling of trade barriers. And although a variety of new forms of ownerships have flourished, private ownership is still limited (though formally recognized and officially protected under a new Constitutional article passed in March 2004), characterizing small firms and individual businesses for the most part. At the same time, the costs of postponing more sweeping and much-needed reforms of the macroeconomy are taking their toll, as seen in the persistently weak financial system, the drag of loss-making state-owned enterprises, and a difficult struggle with inflation and monetary policies.

However, this has not stopped the economy from taking off. China continues to enjoy spectacular economic growth. The already fast pace of 2003 – 9.1 percent GDP growth according to official figures – reached 9.7 percent in the first quarter of 2004. This is about three to nine times greater than GDP growth rates in other major economies such as the United States

(3.04 in 2003), Japan (2.5 percent) and the European Union (EU)(0.9 percent).[2] In 2002, China replaced the United States as the number one recipient of foreign direct investment and has become the world's third largest exporter after the United States and Germany.

China's remarkable growth leads to bullish assessments about China's future share of global output. It is undeniable that China is gaining a larger share of global economic activity, but it is not in the commanding position in the world economy as many seem to perceive. In nominal terms, China captures only about 4 percent of global output. This is far from that of the United States – about 28 percent – nor is that figure larger than the output of the European Union or Japan. In fact, at 4 percent, China's GDP as a percentage of global output is only slightly larger than the state of New York's and about twice as large as that of Texas (see Figure 1).

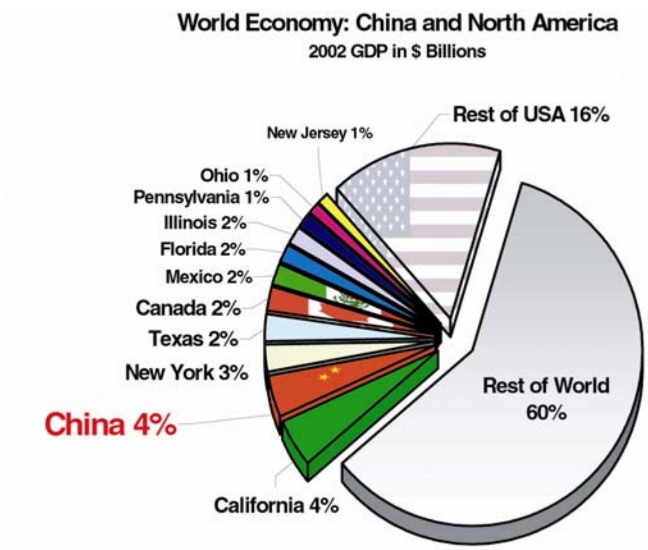
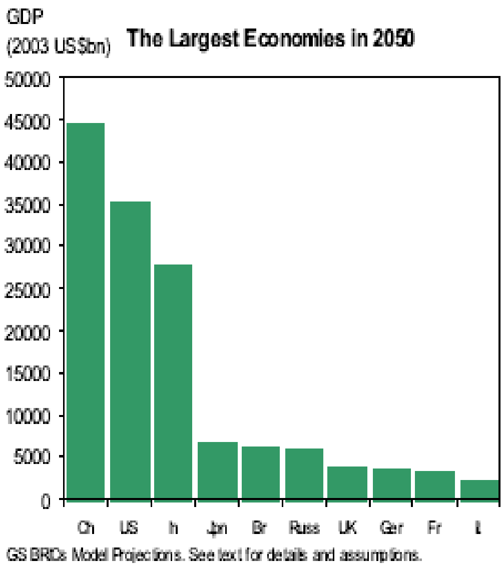


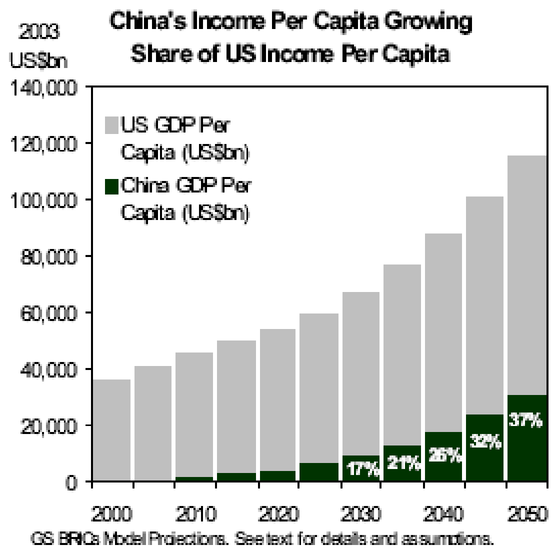
Figure 1[*]
Sources: "Domestic and International GDP Comparisons", Economy.com, accessed at

http://www.economy.com/dismal/pro/data/gdp_rank.asp; *World Economic and Financial Surveys: World Economic Outlook 2003* (Washington, D.C.: International Monetary Fund, April 2003).

Even modeling for relatively conservative future growth rates leads to impressive results. For example, based on an assumption that Chinese growth rates would steadily decline decade-by-decade to about 3 percent by 2050, China would at that point have the world's largest GDP. But even so, some caution is warranted about what that means: even if at that point China had a larger economy that the United States, its GDP per capita would still be lower than U.S. GDP per capita today, given the enormous size of China's population. (See Figures 2 and 3.)

[2] "Global economy surges in 2004, but dangerous imbalances continue to mount", *United Nations World Economic Situation and Prospects 2004*, released January 14, 2004.
[*] Figure presented by Daniel Rosen at the conference organized by the CSIS Freeman Chair in China Studies on January 13, 2004 entitled, *Partners or Competitors?: Economics, Trade, and Finance in U.S.-China Relations.*





Figures 2 and 3
Source: Dominic Wilson and Roopa Purushothaman, *Dreaming with BRICs: The Path to 2050,* Global Economics Paper no. 99 (New York: Goldman Sachs, October 2003), accessed at: http://www.gs.com/insight/research/reports/99.pdf.

Positive investment climate

Beyond the impressive numbers of China's economic growth, what are some of the specific factors which make China an attractive investment venue today and a tough economic competitor going forward? One of the most important points to come out of the conference discussions is that China's attractiveness and competitiveness is more than just "cheap labor." Americans need to recognize that China has turned a corner in many respects and has become more attractive and competitive owing to a burgeoning domestic consumption market, improved productivity, better infrastructure, and higher technology standards and quality control. Some of those points are outlined below.

The domestic economy: "unleashing 50 years of pent-up demand"

One of the most dynamic and new considerations for investors in China today is getting a piece of the increasingly lucrative domestic Chinese market. While China is first and foremost capitalizing on its role as a global export platform, China is also becoming a major importer and orienting investment inward.

At the consumer level, this phenomenon is just beginning to take off, as rising incomes (especially urban incomes), stiff market competition and low prices have fueled consumer demand. This is true even though the major new consumers are urbanites who comprise only about 30 percent of the Chinese population (even so, that would roughly equate to about 268 million urban consumers in the 15- to 64-year old age bracket alone). Coming of age at the end of Maoist austerity and in the midst of the go-go reform era, younger people are now the backbone of the consumer society: a majority of them are single children; 75 million persons are between the ages of 25 and 36 and have little to no memory of such national disasters as the Great Leap Forward or the Cultural Revolution.

The introduction of credit to a largely cash-society will be an important new factor driving growth. Today, about 80 percent of cars bought in China are paid for in cash, and some 50 percent of housing purchases are paid for in cash. Chinese tend to eschew debt and usually pay with savings, but if a safe and reliable credit system is introduced, credit services could further boost the economy. The higher consumer expectations of a new credit-wielding class of "Chuppies" – Chinese urban professionals – will drive the economy as well. As one on-the-ground economic analyst from China put it, "we are witnessing the unleashing of 50 years of pent-up demand."[3]

In response to this growing domestic market, investment trends have moved from a general focus on exports to one with a more inward orientation. In the early 1980s, the Chinese government restricted foreign investments to export oriented operations and required investors to form join venture partnerships in the form of equity joint ventures or cooperative joint ventures with Chinese firms to enter the market. Since the early 1990s, China has allowed foreign investors to manufacture and sell a wider variety of goods and services in the domestic market. By the mid-1990s, China authorized the establishment of wholly-owned foreign enterprises (WOFEs), but had strict guidelines for foreign investment in manufacturing.

By the period 1997-2002, there was a significant increase in WOFEs, largely attributable to the run-up to China's World Trade Organization (WTO) entry, which required the elimination of certain trade-related investment measures and the opening of specific sectors previously denied to foreign investors (see Figure 4). The growing number of WOFEs has corresponded well with the rate of investment into China. Contracted foreign direct investment (FDI) by WOFEs has increased 40.5 percent in 2003, and utilized FDI has increased by 6.4 percent in the same period. This indicates increased FDI activity in China, targeting the domestic market for the long term, rather than focusing on China as an export platform only. The growing number of WOFEs are gradually localizing their foreign mode of operations, internationalizing their management, and investing in local personnel to adjust to the customs and demands of the local market. Overall, they are steadily reducing their reliance on parent companies to become more independent operation entities.

[3] Remark made by one of the conference speakers at the conference organized by the CSIS Freeman Chair in China Studies on January 13, 2004 entitled, *Partners or Competitors?: Economics, Trade, and Finance in U.S.-China Relations.*

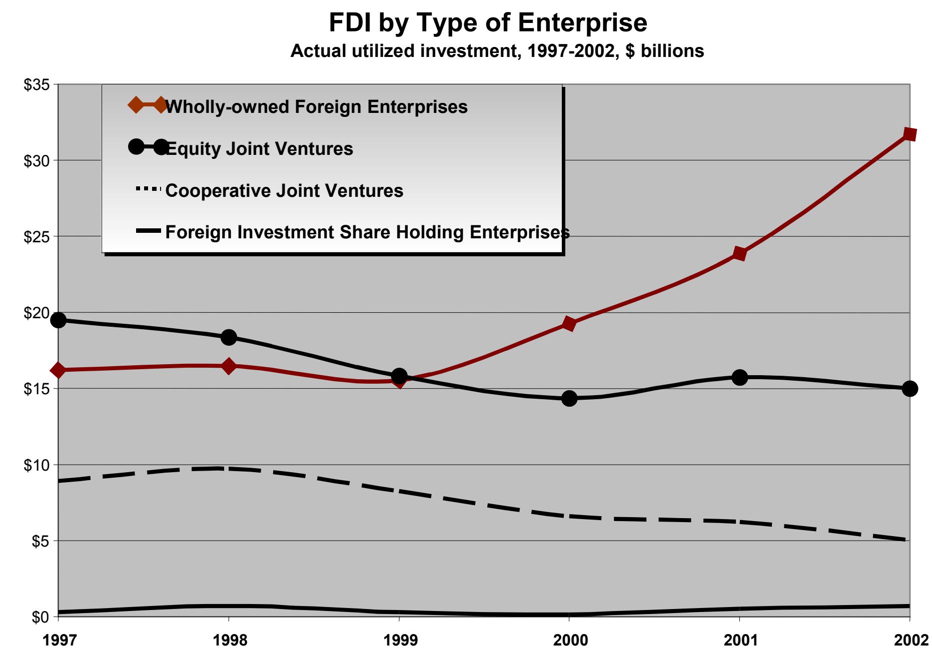


Figure 4*
Sources: *Chinese Statistical Yearbook 1990-2002* (various issues) and Chinese Economic Information Network (CEInet) for 2001-2002, accessed at: http://www.cei.gov.cn.

Whether accommodating production for exports or for the domestic market, foreign operations are increasingly contributing to a rising level of imports into China with purchases of plant equipment, high-value machinery, and other technology transfers. As a result, China has become the world's third largest importer. Its ratio of imports to GDP rose from 15 percent in 1990 to 25 percent in 2002, and that figure will likely rise to as much as 30 percent for 2003. Remarkably, China has overtaken Japan as an import destination, even though the Japanese economy is considerably larger than China's. This import growth trajectory is set to increase as demand for commodities (steel, oil, other raw materials), infrastructure (machinery and equipment), and technology inputs (research and development, education, and expertise) continue to grow.

China's labor supply and improving productivity

Many point to China's low-cost labor supply as the predominant factor to explain China's investment attractiveness and strong economic performance. This remains a key factor, but observers of the Chinese economy recognize that focusing on the cheap-labor factor alone obscures other important labor-related developments.

In terms of labor costs, China undoubtedly has some of the lowest wages in the world. On average, a Chinese factory worker earns a little less than $1.00/hour compared to about $15.00 to

* Figure presented by Daniel Rosen at the conference organized by the CSIS Freeman Chair in China Studies on January 13, 2004 entitled, *Partners or Competitors?: Economics, Trade, and Finance in U.S.-China Relations.*

$20.00/hour for a similar worker in the United States or Europe. In the garment industry, where China is the world's largest exporter, Chinese wages average approximately $0.40 an hour, less than a third that of Mexico.

China's massive labor surplus is one guarantee of low wages. Even as the Chinese economy grows at a pace of 8 or 9 percent, the country still faces massive un- and underemployment. The demand for cheap labor has not absorbed some 15 million urban unemployed, ensuring that labor costs will not rise or be regulated anytime soon. Workers in China also lack leverage in negotiating higher wages or more lucrative benefits, which also keeps labor costs to a minimum. Minimum wage laws have been set by some provinces, but are not rigidly implemented. Labor and environmental safety standards are also often neglected or less stringent, another factor in keeping labor-related costs down. Given massive surplus labor levels, persons with jobs are unlikely to rock the boat. Labor unrest around the country seems to arise most of all when state-owned factories fail to pay wages and social benefits, not over disputed wage levels per se.

China's labor productivity is also improving. In major industries such as garments and furniture manufacturing, companies exercise greater control over the lines of vertical and horizontal productivity, from the delivery of raw materials to production technologies, to assembly. JC Penny representatives testified before Congress that they oppose restrictions on Chinese-made furniture imports, arguing that the average proportion of defective products from the United States was 26 percent as opposed to a 1.6 percent rate in China, giving considerable incentive to move domestic production abroad.

China has put in considerable effort in improving its productivity, which has had the effect of either lowering the overall production costs, or attracting investors away from other investment destinations. The biggest losers in this process are not developed countries in Europe or North America, but developing countries such as Indonesia, Pakistan, the Philippines and Vietnam, which have not yet managed to achieve an effective combination of low costs and improved productivity as in China.

China's competitiveness

In addition to offering low labor costs and steady productivity gains, the China market has also built comparative advantages in other key areas of investor concern, such as basic infrastructure, market integration, and private sector participation.

Evidence of this is found in the recently-released World Bank report which cites China as one of the favorable investment climates in the world, especially when compared to other important emerging markets such as India and Brazil.[4] Taking a sample of 23 cities, ranging from large urban areas such as Beijing, Chengdu, Guangzhou, Shanghai and Tianjin, to mid-sized and smaller cities, the study covered a range of sectors including garments, textiles, auto

[4] David Dollar discussed most of the following points during the conference organized by the CSIS Freeman Chair in China Studies on January 13, 2004 entitled, *Partners or Competitors?: Economics, Trade, and Finance in U.S.-China Relations*. The World Bank report he referenced is *Improving City Competitiveness through the Investment Climate: Ranking 23 Chinese Cities* (World Bank, December 2003). David Dollar was one of the principal investigators for this study.

components, electronics and services. The study assesses micro-level indicators of competitiveness, such as infrastructural support and efficiency, financial services support for start up firms, labor services, and how regulatory frameworks in these areas affect the integration of firms into the international market.

For example, power outages are common in developing economies. India suffers up to 46 percent in sales due to common power outages, resulting in one sixth of their capital tied up in owning power generators. Shanghai indicated a 1percent loss of sales due to power outages, while China on average suffered a 2 percent loss in sales owing to power failures. The study found these rates to be lower than that of Brazil and Mexico, countries which enjoy a higher level of economic development overall.

Another area where China ranked favorably in the World Bank report is in customs administration and export clearance time, important indicators for companies connected to the international marketplace. Corruption prevails in many port areas, and within China its influence ranges from city to city. When asked how long it takes to get their goods cleared through customs, firms in China claimed that in the worst-case scenario, it takes up to 9 days; in San Paulo, that period is 32 days. For export-oriented firms, especially for labor-intensive sectors with tight production cycles, reliable and regular component imports are critical, giving China some edge in this area.

Overall, in a country as large as China, the investment climate varies across different regions and cities. However, even smaller cities have a relatively good investment environment: Jiangmen, in the Pearl River Delta, showed low export clearance times and relatively low levels of corruption. The cities with weaker investment environments tended to be located in the inner provinces and northeast parts of China. The gap in development between coastal versus inland regions persists in spite of Beijing's efforts to close it, and for the foreseeable future the most attractive investment areas will likely remain eastern areas. However, as start-up and infrastructure costs have increased in the coastal areas such as Guangdong and Shanghai, investment operations will likely move inland as competing provinces improve their investment climates.

The World Bank report has also highlighted weaknesses in the investment climate, such as the country's poor financial structure and inability to provide efficient financing to firms, especially small- and medium-sized private enterprise. This is largely tied to misguided and even corrupt lending policies and a lack of familiarity with risk assessment, all of which contributes to the weak banking structure.

Technology

Despite Chinese government ambitions to foster far greater levels of development, Chinese domestic companies have yet to truly compete with foreign companies in terms of technology competence. This actually helps make the country a more attractive place for foreign investors. By and large, foreign companies have considerable comparable advantages over domestic Chinese competitors in terms of research and development, financial engineering, resource management, and maintaining intellectual property rights standards. Most technology-intensive manufacturing is set up and operated by foreign-owned companies or joint ventures with a strong foreign management presence. Over time, however, the presence of these companies, their technologies, and their expertise, helps further develop the Chinese economy.

Weaknesses in the Chinese economy

While it is easy to get carried away with the upside of doing business with China, numerous questions attend China's economic future and the viability of investments there. Typically, bullish forecasters downplay the internal dynamics of political, social and economic change and their potentially negative impact on stability in China. Overall, the prospects for the Chinese economy appear good, but potential problems need to be weighed carefully by Americans, not only for near-term investment decisions, but also to gain a more complete picture of U.S.-China economic relations and their impact on U.S. interests. Two potential weak spots are highlighted below: the widening prosperity gap between urban and rural areas, and the fragile banking and financial system.

Increasing prosperity gap, income disparities, and unemployment

China economy is increasingly defined by a growing "prosperity divide" – between urban and rural residents, and between the rich and poor . The World Bank describes the ongoing rural-urban prosperity gap as the fastest increase in inequality ever measured. Some 60 to 65 percent of China's people live in the countryside or in rural townships, or nearly 800 million persons. Official government estimates, using national standards defining poverty, suggest about 5 percent of the population, or about 65 million persons, live in poverty. Using different standards to gauge per capita income, the United Nations Development Program (UNDP) *Human Development Report 2003* finds that 16.1 percent of Chinese (about 208 million) survive on under $1.00 a day, and 47.3 percent of the population (about 615 million) live on less than $2.00 a day.

However poverty might be measured, all observers would agree that rural income in China is stagnating, and the gap between rural and urban income is widening. This is attributed to a number of factors, including increasing competition from cities, bad management of rural enterprises, and corrupt practices among local authorities. Today, urban residents earn on average three times as much as those in the countryside, and that figure is going to increase. According to the Government Work Report delivered by Premier Wen Jiabao to the National People's Congress in March 2004, urban income per capita grew by 9 percent and rural per capita income rose by just over 4 percent in 2003. This continues a longer-term trend underway since the early 1990s (see Figure 5).

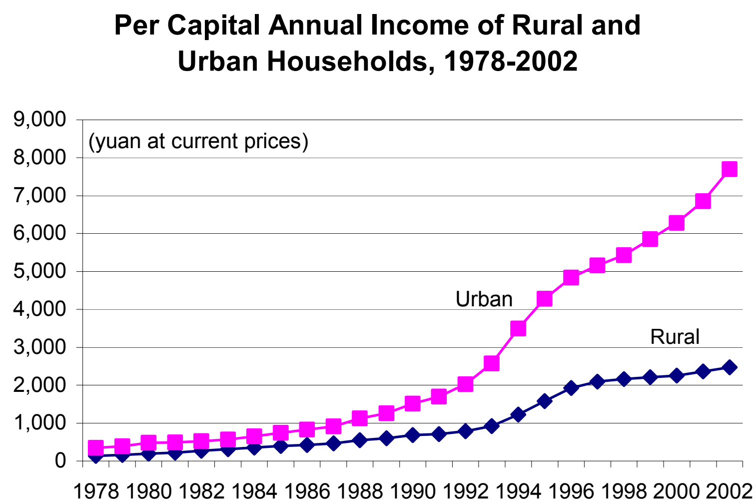


Figure 5
Source: *China Statistical Yearbook* (Beijing: National Bureau of Statistics, various issues).

This rural-urban divide fuels labor migration into the cities from the countryside, which in turn puts pressure on urban services, employment, and wages. The prevalence of poverty in cities is on the rise (though not as fast as per capita incomes): on the one hand, unskilled, migrant laborers lack affordable housing and insurance, and are not typically eligible for social welfare programs in urban areas; on the other hand, they are prepared to work for less pay, making jobs and wages more scarce for many urban dwellers. In response, central and local governments aim to develop and urbanize rural area townships as a way to stem labor migration and boost rural income.

But in spite of these measures, urban unemployment is on the rise. Since joining the WTO in 2001, 35 million mostly urban workers have lost jobs as state-owned enterprises are either put out of business or downsized. According the “Government Work Report” delivered in March 2003, some 8.59 million urban residents became unemployed in 2003, though 4.4 million previously laid-off workers found employment. Nevertheless, the Ministry of Labor and Social Security announced at the end of 2003 that 24 million more jobs are needed in 2004 to adequately absorb China’s ever-growing work force. Keeping people employed is one of Beijing’s strongest motivations for keeping the *yuan* at its current value so as to keep exports cheap and factories humming.

In any event, the central government is clearly concerned about social stability in the countryside and in urban areas, particularly where state-owned, “smokestack” industries predominate. In addition to the massive urbanization plans in place to absorb labor in rural areas and plans to “develop the West” more broadly, the government issued new regulations in February 2004 to reduce agricultural tax rates and improve rural financial reforms to spur growth in the rural areas with hopes of raising rural incomes. In 2003, a major new effort aiming specifically to “revitalize northeast China and other old industrial bases” was undertaken to grapple with the problem of "old economy" cities. Sporadic but increasing instances of public disturbances, demonstrations, and rioting in rural and urban areas underscore the urgency of these plans for Chinese leaders.

The fragile financial sector

In postponing fundamental reform and restructuring of its financial system, especially with regard to banks, the Chinese government is paying a heavy price, and one which could become a much more onerous burden on economic development in the years to come. Currently, China's four major state banks hold approximately 61 percent of the country's loans, and a significant share of these loans are insolvent or non-performing. These non-performing loans (NPLs) are estimated by the Chinese government to account for 23 percent of total loans, and are valued at about $290 billion. But foreign credit agencies and investment banks are more skeptical, appraising the real NPL ratio to be between 35 to 50 percent of total loans. Standard & Poor's estimates that NPLs may range from $384 billion on the low end to as much as $864 billion. A true resolution of the bad debt problems, as calculated by some economists, could cost some $600 billion, which is approximately 40 percent of China's $1.4 trillion GDP.

A lending cycle has trapped many banks from resolving their NPL problem. Chinese banks are warned to turn profitable and bring down NPLs while maintaining sufficient funds to observe minimal capital ratios. Hence, they increase new loans to earn interest income. Banks will then report lower NPL ratios, mainly due to an increased denominator of total loans. Reporting lower NPL ratios improves the look of a bank's portfolio when it seeks a stock market listing, which, if successful, gains much-needed cash to maintain NPL ratios while doling out more bad loans.

Lending practices are a major problem. Loans are made on the basis of social, political, and often corrupt considerations rather than financial viability or creditworthiness. Loans are also increasingly speculative in hopes of profiting off such "hot" sectors as real estate, construction, and the automobile industry. In addition, most NPLs are made to already-failing SOEs, and are essentially subsidies to prop up loss-makers and avoid widespread unemployment. As a result, the government is forced to infuse ailing banks with cash. The latest bailout of Chinese state banks was in January 2004: up to $45 billion to two of China's largest banks, China Construction Bank and Bank of China.

During the third quarter of 2003, the central authorities directed banks to restrict lending to overheating sectors, and repeated those warnings in early 2004. But with a 53 percent year-on-year increase in fixed-investment growth in early 2004, those warnings apparently went unheeded. Instead, the rapid expansion of fixed investments in already overheating industries such as construction and real estate suggests that sources of funding for such projects are still ample and bank lending restrictions are not fully enforced. The Central Bank has also not cracked down on lending to rural credit cooperatives. Such lending as seen in part as a way to boost flagging rural economies and slow labor migration to increasingly crowded urban centers. These developments reflect the government's persistent conundrum: trying to control rampant over-investment and an overheating economy on the one hand, while maintaining a rate of economic growth that can still consistently generate employment for its millions of unemployed workers on the other. Striking this balance will remain a challenging process.

But issuing warnings and capital infusions will not solve the problem over the longer-term. It will be more important to alter the practices, mindsets, and accounting framework within the banking industry and within the financial sector more broadly. The central government and outside investors alike are concerned that a weak financial system is susceptible to abrupt disturbances in the social, economic or political environment, triggering a possible financial crisis.

Some potential scenarios could include a rush for liquidity or the flight from domestic currency in times of political, social, or economic uncertainty. In an economic downturn or bursting financial bubble, should major infrastructure and development projects fail, overstretched lenders will need ever larger bailouts from government coffers – which may or may not be forthcoming in future years. Foreign investors in particular are watching to see what kind of confidence they should have in guarantees from the government to the banks.

Future plans include further bank restructuring, new financial sector leadership, greater foreign ownership and competition, and raising capital by listing on foreign exchanges, such as the proposed initial public offering (IPO) of China Construction Bank (CCB) to list its shares in mainland China, Hong Kong and the United States sometime in late 2004 (CCB was one of the state banks benefiting from a $45 billion capital injection in January 2004). The period ahead will be marked by fragility, experimentation and, hopefully, much-needed innovation in the Chinese banking sector. As such, serious concerns will persist over the Chinese financial system.

Overall, to understand the new dynamism in U.S.-China economic, trade and financial relations, Americans should cast aside traditional perceptions of China as solely an export platform with low-quality products and low labor costs. China has begun to more effectively harness its many comparative advantages, and investment trends are changing at least if not more rapidly than the much-vaunted pace of economic growth. But at the same time, as attractive as the investment climate appears to be in the near-term, positive economic reform and change in China remains politically and socially motivated in many respects, especially concerning such sensitive areas as social unrest, unemployment and the banking sector. Domestic stability is very highly valued by the Chinese government, and it aims to pursue economic modernization without upsetting stability, even at the cost of stultifying badly-needed reform in the near-term. It is a delicate and difficult balancing act which may or may not succeed, and which will pose problems for the U.S.-China economic relationship, a subject to which this report turns next.

PART TWO

U.S.-China economic relations: current controversy and contention

Having reviewed the dynamics of China's economy, we turn to the increasingly complex and often contentious economic relationship between the United States and China. With the United States granting China Permanent Normal Trade Relations (PNTR) in 2000 and with China's accession to the World Trade Organization (WTO) in 2001 after 13 years of bilateral negotiations with Washington, the two countries finally set certain lingering economic and trade differences to rest and placed this aspect of their relationship on firmer footing.

However, with China's increasing economic growth and integration into the world economy, three key areas of contention have arisen in the U.S.-China economic, trade and financial relationship. The first set of issues concerns the burgeoning trade deficit the United States has with China, the related issue of U.S. job losses, and the view held by many that the these problems are caused, in part, by China's undervalued currency. A second basket of issues concerns China's WTO compliance record and a growing number of specific trade disputes brewing between China and the United States. A third set concerns the United States and China as competitors on the regional and international economic scenes. With 2004 marking an election year in the United States, these issues are likely to gain all the more attention over the coming months.

Yuan revaluation, job losses and the trade deficit

The U.S. debate

Even before China's accession to the WTO, many analysts warned that China's trade deficit with the United States would continue to grow and that U.S. domestic industries, especially in manufacturing, would face intense Chinese competition. This was particularly true as China would take time to fully implement and enforce some 2,500 new trade rules and regulations it had accepted as part of its WTO accession.

As the U.S. trade deficit with China surpassed that of Japan, it came under increasingly tough scrutiny and criticism. In May 2003, the President of the National Association of Manufacturers (NAM) published an important opinion piece alluding to the growing loss of manufacturing jobs in America as a result of China's dominance of lower-end manufacturing and intensified foray into higher-technology production.[5] He cited unfair business practices in China, such as rampant

[5] Jerry Jasinowski, "Made in China", *Washington Post*, May 20, 2003.

piracy, rebates for foreign companies to set up operations in China, and retaining quotas on imports.

But the underlying cause, he emphasized, was the undervalued Chinese currency, the *renminbi* (RMB) or *yuan*. With the slide in the dollar in recent years, Chinese imports have become increasingly cheaper for the United States. As a result, the trade deficit with China ballooned well past $100 billion and reached some $135 billion by the end of 2003.[6] To close this gap and help keep jobs in the United States, advocates of a tougher economic policy toward China called for a revaluation of the *yuan*.

Many economic analysts found that the *yuan* was undervalued, with calculations ranging between 15 and 40 percent. Analysts asserted that the Chinese government was actively intervening to keep the nominal exchange rate stable, for example by amassing over $400 billion in foreign exchange reserves, equivalent to some 30 percent of China's GDP.

With flagging economic performance and mounting job losses in the United States – some 2.3 million jobs lost over the period 2000-2003, with manufacturing especially hard hit – China's currency became a much-debated topic. Should the Chinese government revalue? By how much, and what impact would revaluation have? If the Chinese government refused to revalue, was Washington prepared to take action against China? Treasury Secretary John Snow and Commerce Secretary Donald Evans traveled to China in September and October 2003, respectively, and delivered messages on the need for China to seriously consider revaluation of the *yuan,* reduce government micromanagement of the economy and adhere more to free market principles.

Over the fall 2003, new legislation was introduced in Congress with the intention of pressuring China to adjust its currency. In one high-profile measure, Senator Charles Schumer (D-NY) proposed a 27.5 percent tariff on all Chinese exports to the United States. The measure was not passed, but it brought high-profile attention to the issue of China's *yuan* revaluation. Manufacturers formed the Fair Currency Alliance, pledging to join with other industrial and agricultural groups in filing a trade complaint under Section 301. The Bush administration came under criticism for caving to Chinese interests.

However, the debate in the United States was not one-sided in favor of revaluation. A number of economists and businesspersons argue that the globalized nature of production patterns today render traditional understandings of bilateral trade relations far less meaningful to interpreting real trade and investment flows.

According to this line of analysis, China's competitiveness has little to do with China's currency since most of its exports have a high content of materials and products made elsewhere. Stanford University-based economist Lawrence Lau and others calculated that for every dollar of Chinese exports, only 30 cents reflect value added by domestic Chinese production. For Chinese exports going to the United States, the domestic value-added share is 20 cents to the dollar, meaning that a substantial revaluation of the *yuan* would not make much of a difference to the

[6] Figure drawn from the website of the U.S.-China Business Council, http://www.uschina.org/statistics/tradetable.html.

price competitiveness of Chinese exports.[7] Others argue that China's increased exports to the United States are largely products from foreign-owned companies, typically Chinese subsidiaries of global multinational companies. Pieter Bottelier, a former advisor to the World Bank in China, estimated that 13 to 15 percent of China's exports to the United States originated from U.S.-owned enterprises located in China. He also calculated that the values for affiliated sales by U.S. invested companies operating in China are substantially larger than direct U.S. exports to China, and will keep growing.[8] (See Figure 6.)

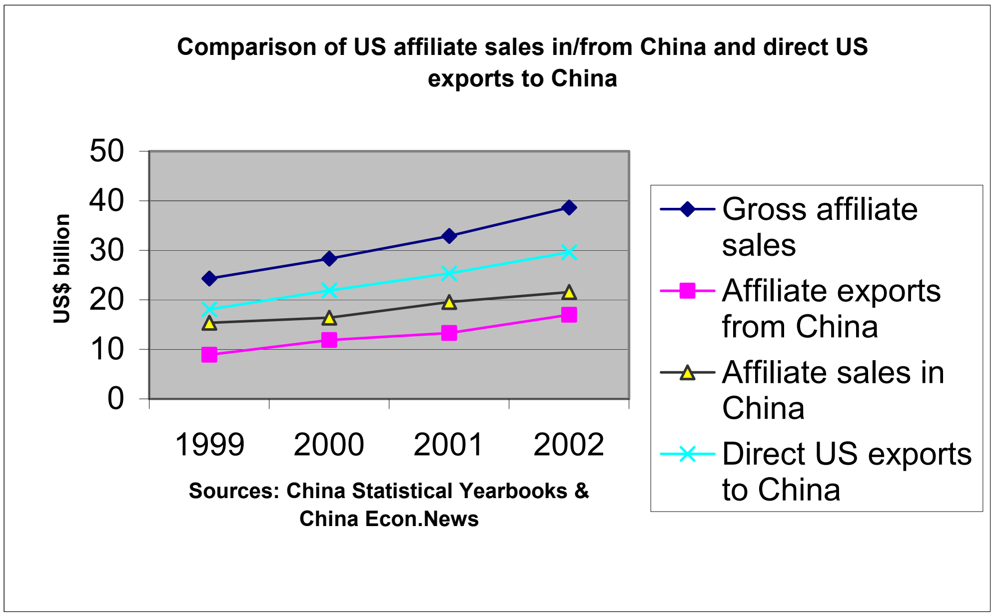


Figure 6[*]

In addition, a more accurate accounting of the trade deficit with China recognizes that foreign-sourced high-value components are often brought together for final assembly in and export shipment from China. For example, most of the fast-growing consumer electronics production in China is owned by foreign companies and their high-value components are sourced from within Asia: semi-conductors sold to China are sourced 25 percent from Japan, Taiwan and South Korea. Yet, these exports will register as exports from China. In another example, if U.S. semiconductors sold to Singapore are built into microprocessors later shipped to China, they

[7] See for example, X. Chen, L. Cheng, K. C. Fung, and L. J Lau, "The estimation of GDP and employment induced by exports: An application to Chinese exports to the United States", presentation to the Institute of Systems Science, Academy of Mathematics and Systems Science, Chinese Academy of Sciences, June 18, 2001, revised December 2001, and cited by Stephen S. Roach in testimony before the U.S.-China Economic and Security Review Commission, September 25, 2003.
[8] Estimates are based on assumption that sales by U.S. invested companies in China are proportionate to the share of the U.S. in total accumulated FDI in China, which is about 10 percent. Pieter Bottelier, "The U.S-China trade imbalance and other issues concerning bilateral economic relations", electronic newsletter from the CSIS Freeman Chair in China Studies, November 2003.
[*] The authors thank Pieter Bottelier for providing this graphic.

would register as an export from Singapore, even though the product would have high-value U.S. content.[9]

Analysts have also pointed out the need to consider China's overall trading patterns. While the United States and many European countries have large trade deficits with China, almost all Asian countries have a trade *surplus* with China. South Korean exports to China have grown so considerably that China surpassed the United States as South Korea's largest trade partner. China accounted for some 80 percent of Japan's export growth in 2003, helping drive Japan's economic rebound. Two-way trade between China and the 10 countries of the Association of Southeast Asian Nations (ASEAN) reached US$69.78 billion in the first 11 months of 2003, an increase of 42.6 percent over 2002; China has a trade deficit with its ASEAN neighbors. Overall, for 2003, China's trade balance was marginally in deficit at $20 million.

The analytic and policy implications of these arguments are clear: not only is the trade deficit by itself a simplistic measurement to gauge the real value of U.S.-China economic and trade relations, but any measures to aimed at curbing Chinese exports to the United States, such as Chinese currency revaluation, could have a direct and largely negative impact on U.S.-invested enterprises based in China. Rather than considering traditional trade flows alone to make the case for *yuan* revaluation, analysts and politicians alike ought to also look into the value of repatriated profits to better understand the true nature of U.S.-China trade and economic relations.

Some analysts have gone further to argue that the problems of job losses and trade deficits lie not so much with China and the value of the *yuan,* but with the United States itself. William Overholt of the RAND Corporation argues that job losses in the manufacturing sector in America are due to improving productivity since manufacturing output overall has increased. The rise of the service sector in the United States at the expense of manufacturing sector has also meant that Americans are forced out of high-paying manufacturing jobs and into lower-paying service positions.[10]

Moreover, even if Chinese exports are made more expensive as a result of currency revaluation, U.S. demand for inexpensive goods would not necessarily translate into American jobs to produce them. Rather, U.S. demand would simply draw from other cheap foreign suppliers.

Pieter Bottelier pointed out that the real issue facing the United States is not the bilateral trade deficit with China, but the American current account deficit which is largely attributable to loans in the form of U.S. Treasuries and bonds, foreign direct and portfolio investment in the United States, and U.S. currency circulating abroad. Estimated at 5 percent of the GDP in 2002, the overall U.S. current account deficit is regarded by financial markets as unsustainable, hence the decline in the value of the dollar since 2003. Perhaps even more discomfiting is the fact that Japan and China have financed an estimated 60 percent of the U.S. current account deficit in the recent years. The high overall current account deficit is a result of low domestic savings in the United States. Even if Washington could cajole a revaluation of the *yuan,* the current account

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[9] Nicholas Lardy raised this example at the conference organized by the CSIS Freeman Chair in China Studies on January 13, 2004 entitled, *Partners or Competitors?: Economics, Trade, and Finance in U.S.-China Relations*.
[10] William Overholt, "Exposing the Myths", *South China Morning Post,* November 17, 2003

deficit would not change unless accompanied by a change in U.S. domestic savings and investment behavior.[11]

Chinese response

Predictably, in response to American critiques, Beijing argued against revaluation of the *yuan,* and explained that the flow of cheap imports to the United States was due to lower costs of production in China. The Chinese also were quick to remind detractors that they had chosen not to revalue the *yuan* in the wake of the Asian financial crisis in 1999, even though China could have reaped considerable rewards by doing so. Instead, China earned the praise of many countries at the time, including the United States, by choosing to maintain its currency pegged to the U.S. dollar.

Beijing also warned of the social and political repercussions of devaluation, emphasizing first and foremost the need to keep factories humming and exports moving in order to create jobs and stay ahead of unemployment, especially in the manufacturing sector. Chinese analysts argue that the country must maintain 15 to 20 percent annual growth in exports in order to stabilize urban unemployment rates at current levels. For the Chinese leadership, export growth helps meet their highest priority of domestic stability and development, thereby curbing their enthusiasm for revaluation.

Another case against revaluation concerned China's weak financial structure: its sclerotic and debt-ridden state banks, poor capital market structures, and underdeveloped financial regulatory environment are prey to foreign exchange rate adjustments. Chinese expressed concern that floating the *yuan* would inevitably lead to speculative pressures and, in the worst-case scenario, massive capital flight. At a minimum, lifting exchange controls would leave bankrupt and poorly-run Chinese financial institutions at the mercy of global capital markets. Recognizing these weaknesses, businesses in China, both foreign owned and domestic, warned that the country's financial and banking system was ill-prepared to deal with the shocks of a major revaluation.

The Chinese position was argued by Vice Premier Wu Yi during her visit to the United States in April 2004: the current exchange rate for the *yuan* "suits well the state of China's economic development, the capability of its financial regulation and the endurance of Chinese businesses" and that the key to resolving the trade deficit "is to expand American export to China rather than restricting American import from China."[12]

While floating the *yuan* in the near-term is generally viewed as a risky step, Beijing appears to recognize the need to take some interim measures. In addition, this recognition comes not simply as a concession to the United States, but because Chinese planners understand that over the medium- to long-term it is in China's interests to revalue, ease pressures on the currency,

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[11] These points drawn from Pieter Bottelier's remarks at the conference organized by the CSIS Freeman Chair in China Studies on January 13, 2004 entitled, *Partners or Competitors?: Economics, Trade, and Finance in U.S.-China Relations.*

[12] Wu Yi, "Consultation on an Equal Footing for Mutual Benefit and Common Win", speech given at the Fairmont Hotel, Washington, D.C., April 22, 2004.

reduce excess liquidity in state banking institutions, develop greater monetary policy flexibility, liberalize capital outflows, and eventually realize full convertibility of the Chinese currency. A more cautious and pragmatic approach toward revaluation foresees China moving toward a managed, banded float in the near term, possibly before the end of 2004.

Resolution in sight?

In the United States, high-profile jawboning on *yuan* revaluation gave way to a more patient approach by the end of 2003 and early 2004 which recognized the importance of stability in the global exchange rate and that immediate *yuan* revaluation would not solve America's economic problems.

As for Beijing, it not only recognized that longer-term trade deficit stabilization and currency revaluation was in their interest, but that near-term measures were also needed to preserve a stable and highly-valuable trading relationship with the United States. Since late-2003, China stepped up highly-publicized trading missions, the biggest associated with the visit of Premier Wen Jiabao to the United States in December 2003. Among other deals, these trading missions have resulted in:

- $6 billion worth of contracts for Boeing aircraft, General Electric aircraft engines, automobiles, and automobile components
- $1.4 billion contract to import US soybeans and electro-mechanical equipment
- $800 million contract to purchase fertilizer and alumina
- $2.3 billion worth of telecommunications equipment signed by China United Telecommunications Corp. and China Mobile Communication Corp. This included a $1.1 billion contract with Motorola

It was estimated these buying missions would reduce the trade deficit by some 8 percent, prompting Chinese Vice-Minister of Commerce Liao Xiaoqi to characterize the trade deals as "the sincere realization of China's efforts to balance bilateral trade."[13] Critics, on the other hand, called such efforts helpful, but not a real solution to the problem.

In addition, the two sides have taken other steps to help defuse bilateral trade and currency tensions. To facilitate China's transition to a flexible currency regime, the U.S Treasury Department and China's central bank established a Technical Cooperation Program in October 2003. The group aims to consult on monetary and financial policies to help China accelerate the liberalization of its capital account and shore up its banking system. This mechanism was more formally announced during the visit of Wen Jiabao to the United States in December 2003. The group has met twice in early 2004. After the group met in Beijing in February 2004, it was announced that the Treasury Department would place a representative in the U.S. embassy in Beijing to work on economic and financial issues on a more regular basis with Chinese counterparts.

To facilitate effective communication over specific trade concerns and serve as an early warning mechanism for emerging trade disputes, the U.S.-China "Trade Dialogue" was also established at

[13] "Big deals inked in U.S. mission" *China Daily*, December 20, 2003.

the sub-cabinet level in 2003. This mechanism brings together U.S. economic and trade agencies and various Chinese ministries and agencies with a role in China's WTO implementation, and addresses WTO compliance and other trade matters. In December 2003, President Bush and Premier Wen Jiabao agreed that meetings of the annual U.S-China Joint Commission on Commerce and Trade (JCCT) should be elevated to a more senior level.

The visit of Vice Premier Wu Yi to Washington in April 2004 was under the auspices of the JCCT, and marked a high-level occasion for the two sides to address bilateral economic and trade concerns. During the JCCT meeting, Vice Premier Wu Yi repeated China's proposal to reduce the trade deficit, urging the United States to ease national-security-related export controls on sales of high-technology goods to China. She compared exports by the two countries, indicating that while America's worldwide exports grew by only 9 percent in the past three years, exports to China had increased by 76 percent during the same period. During the JCCT meetings in April 2004, the two sides reached agreement on end-use verification procedures which may allow for some liberalization of American high-technology exports to China.

On the *yuan* revaluation question, just prior to the JCCT meetings, the head of the Chinese State Administration of Foreign Exchange (SAFE) announced tha China wants to move towards a floating currency system that would link the *yuan* to a basket of currencies. There was no mention of a timetable, but the Central Bank underscored the matter as a key priority. China faces some increasing U.S. pressure to revalue with the announcement that the Fair Currency Alliance, a coalition of U.S. farm, labor and manufacturing groups, will soon submit a formal petition to the Bush administration to investigate whether China's currency peg is an unfair trade practice that can be challenged under section 301 of the Trade Act of 1974 (this section allows the United States to take action when foreign countries violate U.S rights under trade agreements or engages in practices that are unjustifiable, unreasonable or discriminatory to U.S trade).

Going into the 2004 presidential and Congressional election season, it appears China and the United States will set aside the currency issue for the time being, while concerns with job losses, the trade deficit, and Chinese WTO compliance and business practices looked likely to persist as high-profile economic and political issues. As one indicator of the Bush Administration's increased concern with these matters, in April 2004 Paul Speltz was appointed to be a special emissary to China for the Treasury Department on economic and financial affairs, with a particular focus on financial infrastructure, capital transfers, financial services, and foreign exchange questions.

China's WTO compliance and increasing trade disputes

With currency issues apparently set aside for the moment, new tensions have focused on China's WTO compliance record and on specific trade disputes. Economic analysts and politicians alike tend to agree that China can do much better in meeting its WTO obligations, and that the country conducts a range of unfair practices which result in frustration and losses for many foreign investors. While a dramatic *yuan* revaluation is not seen as a viable way to resolve trade deficit concerns, more political support can be found for pressuring China to meet its WTO commitments and resolve a range of looming trade disputes.

The U.S. administration has clearly stated that China's full implementation of its WTO commitments must be a cornerstone of productive U.S.-China economic and trade relations. However, trade negotiations have proven frustrating, and the political weight of the growing number of disputes increasingly strains the overall economic relationship.

The Transitional Review Mechanism (TRM)

China was admitted to the WTO on the condition of submitting to an annual review of its implementation process known as the Transitional Review Mechanism (TRM). The TRM is intended to serve as an enhanced consultation and coordination mechanism for WTO members to engage China on its compliance record and clarify its trade practices. But there have been problems with the TRM from the outset. The Chinese side views the TRM as a discriminatory process since no other WTO member was subjected to such a review. The TRM, in the Chinese view, serves as special platform from which other WTO members (particularly the United States) can bring singular focus upon China's compliance record. From the U.S. perspective, China has become adept at challenging the fundamental procedures of the review mechanism itself.

The Chinese side has resisted providing complete and concrete evidence of its compliance and has not responded to some written inquiries and comments submitted within the TRM mechanism. The Chinese mission to the WTO in Geneva is seen by many as a work in progress. Frustration is also aimed at Beijing which has apparently not urged its WTO mission in Geneva to take the TRM process more seriously.

One of the United States' greatest frustrations with the TRM has not only been with China's behavior in Geneva, but the difficulty in coordinating with other major economic powers such as the European Union and Japan in order to deliver a stronger united front to the Chinese. The diversity of views within each industry and across national borders makes consensus in introducing trade dispute cases nearly impossible. The fear of retaliation through loss of major contracts in areas such as telecommunications and aircraft projects has undermined resolve in Europe and Japan to initiate dispute settlements against China.

Thus the value of the TRM as an effective consultative and dispute resolution mechanism has been brought into real question. How China chooses to comply with the TRM mechanism signals how China will treat other multilateral engagement within the WTO, including the resolution of trade disputes, implementation of their remedies, and the broader responsibilities China has to the WTO as an institution.

China's compliance record

The first year review of China's WTO compliance by the USTR in December 2002 was generally positive. The report noted that China had made "significant progress" in fulfilling its obligations as a new member of the WTO, although there are many remaining issues to be addressed.

However, separate second-year reviews conducted in 2003 by the United States Chamber of Commerce, the U.S.-China Business Council, and the USTR came to far more dissatisfied conclusions. These appraisals found that China lost momentum in fulfilling its WTO commitments. Some observers noted that China's major leadership change in 2002-2003 and the severe acute respiratory syndrome (SARS) outbreak in early 2003 could be to blame for the country's lagging compliance record. But greater concern was voiced for the increased Chinese practice of trying to reinterpret its WTO entry terms line-by-line as questions arise about implementation problems. As expressed by the U.S.-China Business Council, "China's interpretations of certain WTO terms violate the spirit, if not the letter, of its commitments, and new barriers China has erected in some areas make matters worse."[14]

Certain key areas remain problematic for China's WTO compliance.

- **Enforcing intellectual property rights**. Widespread infringement of intellectual property rights (IPR) in China commonly affects a variety of products, brands and technologies, across a range of sectors, including film, music, publishing, software, pharmaceuticals, chemicals, information technology, consumer goods, electrical equipment, automotive parts and industrial products. While China has put in place a basic legal and regulatory framework meant to address this problem, it lacks an effective enforcement system. IPR infringement not only affects business profits, but also potentially exposes Chinese and foreign consumers to harmful products which have not met required standards. At the JCCT meeting in April 2004, the Chinese side agreed that penalties for IPR violations would increase and that nationwide IPR education and enforcement activities would be improved.
- **Eliminating discriminatory taxes.** A major and unresolved bilateral issue concerns Chinese value-added taxes structured to favor domestic producers over U.S. (and other foreign) imports into China. This has been a particular problem for the U.S. semiconductor industry, as well as for fertilizer imports. On March 18, 2004, the Bush administration filed a complaint with the WTO against China over its 17 percent value-added tax (VAT) on imported semiconductors. The downside is that WTO resolution may take up to three years, during which time the Chinese can continue its VAT policy. Bilateral discussions on the chip VAT will continue at the WTO in Geneva.
- **Achieving Chinese commitments in the service sector.** This is especially frustrating for U.S. companies which expected to make significant gains in this sector, including the provision of services such as distribution, banking, insurance, construction, and freight and package delivery.
- **Avoiding arbitrary limits on agricultural market access.** U.S. agricultural producers see great market opportunities in China, but the Chinese government, as in many other countries, may seek to protect its vast population of farmers. In February 2004, some progress was seen in this area as Beijing at last agreed to certify imported shipments of genetically modified soybeans as safe for the China market. This was an important step forward as soybeans exports to China were valued at $4.8 billion in 2003.
- **Maintaining market access.** In December 2003, China issued rules known as Wireless Authentication and Privacy Infrastructure (WAPI) stipulating that as of June 1, 2004,

[14] Julie Walton, "WTO: China enters year three", *China Business Review* (January-February 2003), p. 10.

> only WAPI-compliant equipment can be used or imported into China. The U.S. side viewed WAPI as a technical barrier to trade and a violation of the concept of "national treatment", a WTO principle which assures market access equality. During the JCCT meeting of April 2004, the issue was resolved for the time being, with China announcing it would suspend the implementation of WAPI as a mandatory standard for wireless encryption.

One cannot understate the importance of China's full WTO compliance as a key factor in a stable and improving U.S.-China relationship. Improved market access to China, and the introduction of institutionalized regulatory and enforcement mechanisms, would help stabilize and possibly reduce the bilateral trade deficit and help alleviate frustrations with unfair business practices, corruption, and market barriers. Unlike the increasingly difficult issue of invoking safeguards (see below), WTO compliance will be a much more drawn out process and offers opportunities for both the United States and China to cooperate in ensuring successful compliance.

The growing caseload of safeguards and anti-dumping petitions

China's WTO accession agreement includes two product-specific safeguard mechanisms, one for textiles and the other for all products, including textiles. The former was negotiated in a U.S-China bilateral textile agreement prior to China's WTO accession agreement and was later incorporated into it. The product-specific provision, on the other hand, is available to all WTO members coping with market disruptions caused by increasing economic integration with China. Codified as Section 421 of the Trade Act of 1974, the product-specific safeguard mechanism is available until December 2013. The principle differences between the two are the duration of protections and the mechanism for seeking approval.

For textile safeguards, petitions are filed with the Commerce Department. Remedies, if granted, would last for one year. This textile safeguard provision will remain in effect until 2008. The decision to invoke the textile mechanism is made by the interagency Committee for the Implementation of Textile Agreements (CITA), which is chaired by the U.S. Commerce Department and includes the State Department, Treasury Department, Labor Department, and USTR. On November 18, 2003, the CITA announced its decision to seek safeguard relief on three textile products from China (robes, knit fabric, and brassieres). A maximum 7.5 percent growth rate limit was placed on placed on imports of these textile products in December 2003 while both sides began consultations on the resolution of this trade problem.

With regard to the product-specific safeguards, a petition has to be filed with the International Trade Commission (ITC), an independent, nonpartisan, quasi-judicial federal agency that provides trade expertise to both the legislative and executive branches of government. For a petition to be approved, the ITC must find that domestic producers' markets are disrupted. If yes, then the finding is passed on to the U.S. President to approve or reject. The President can reject the ITC recommendation if he determines that an adverse impact on the U.S. economy is greater than the benefits of import restrictions. Under the provisions of this safeguard, Chinese imports can be restricted for up to three years with no retaliation and for longer with the possibility of retaliation.

Given the size of the U.S. market for certain Chinese goods such as textiles and other products, the safeguard mechanisms carry significant economic and political weight. Predictably, the safeguards cases brought thus far have generated a great deal of attention and tension in the U.S.-China economic and trade relationship.

Since China entered the WTO, five product-specific safeguard petitions have gone before the ITC. These cases are:

- **Pedestal actuators.** The first case involving complaints of market disruptions by producers of pedestal actuators. On October 18, 2002, the ITC ruled in favor of remedies for the producers. China lobbied hard against this petition: the Chinese Vice Minister for trade at the time, Long Yongtu, traveled to Washington to meet with Commerce Department officials in December 2002 and warned that approval of the petitions could undermine access to the Chinese market. The Chinese side was especially concerned that an approved petition would set an early precedent for a flood of new cases to come. The President rejected ITC-recommended remedies in January 2003; many in the United States argued the President unnecessarily compromised the interests of U.S. industries by making an essentially political decision in favor of good U.S.-China relations.
- **Wired rods for coat hangers.** The ITC ruled in favor of remedies for domestic producers on February 5, 2003. The President disapproved these remedies on April 25, 2003.
- **Certain brake drums and rotors.** The ITC rejected the complaint regarding imports of these products on August 3, 2003.
- **Certain ductile iron waterworks fittings.** Two petitions were filed. The first alleged "critical circumstances" and requested provisional relief. Such cases require the ITC determine, on an expedited basis, whether delay in taking action would irreparably damage the relevant domestic industry, and, if so, whether imports of the product subject to the investigation have caused or threatened to cause market disruption. On October 16, 2003, the ITC decided against a critical circumstances finding in one case, but approved the other on December 4, 2003. The President declined approval for remedies in March 3, 2004.

Another source of trade tensions has been the growing number of anti-dumping cases brought by U.S domestic industries against Chinese companies. Some of the more important cases have been:

- **Color televisions.** On June 16, 2003, the ITC ruled that Chinese producers of color televisions were dumping their products into the U.S. market. Based on a preliminary finding by the Commerce Department on November 24, 2003, tough provisional anti-dumping duties of 28 to 40 percent were placed on color television sets imported from China. The ITC's final ruling in late May 2004 will finalize the duties set by the Commerce Department.
- **Wooden bedroom furniture.** On January 9, 2004, in the largest anti-dumping case China has faced, with 52 American manufacturers taking part in the complaint, the ITC determined that these producers are injured by imports of wooden bedroom furniture

from China. The ITC ruling paved the way for the Commerce Department to set preliminary anti-dumping duties sometime between late April and early June 2004.

- **Shrimp imports.** On February 19, 2004, the ITC in a preliminary finding determined that U.S. industries are negatively affected by Chinese shrimp producers (shrimp imports from India and Vietnam are also targeted). A ruling of proposed remedies will be made by the ITC in June 2004.

At a hearing on China's WTO compliance on Capitol Hill in early February 2004, a senior Commerce Department official acknowledged that in the last three years, the Commerce Department had initiated more anti-dumping investigations and imposed more anti-dumping orders covering products from China than any other country, more than twice as many as the next leading country. In 2003 alone, more than 50 percent of all new anti-dumping orders put in place have involved China.[15] With the Import Administration bureau in the process of establishing a new China Enforcement Office specifically to focus on anti-dumping cases against China, it appears U.S.-China trade disputes will not abate any time soon.

Unlike criticisms over China's currency or its WTO obligations, the threat of applying safeguard mechanisms and levying anti-dumping duties against Chinese imports constitute a direct and concrete trade action against China, which has prompted hostile responses from Beijing. For example, following the CITA ruling on textile products in November 2003, the Chinese warned they would seriously consider joining the Europeans and Japanese to impose tariffs in retaliation for non-WTO-compliant U.S. steel safeguards, though Beijing had thus far not taken that step. In another example, when the ITC ruled against Chinese color television imports in November 2003, Beijing cancelled a trade mission to the United States to sign contracts for soybeans and other agricultural products. China continues to threaten action when cases are submitted to the ITC and when the ITC rules in favor of the U.S. petitioners.

China resents what it sees as "creeping protectionism" in the increased use of the special safeguard clause and dumping charges by American industries and other interest groups. Looking ahead into the election year, different groups will likely feel more empowered to bring such cases in hopes of leveraging support from political incumbents and aspirants alike. For example, the American Federation of Labor-Congress of Industrial Organizations (AFL-CIO) submitted a petition on March 16, 2004 to pressure the Chinese government to improve China's poor labor practices, which the AFL-CIO claims are not only an unreasonable trade practice but violate U.S. law under Section 301. The petition claims that the United States lost 700,000 jobs as a direct result of workers' rights violations by the Chinese government. The Bush administration must decide by April 30, 2004 whether to accept the petition and launch an investigation. While the President rejected ITC-recommended remedies against China in two cases thus far, he might feel greater political pressure to approve remediation as the presidential election draws nearer.

One indicator of the Administration's greater concern was the announcement in April 2004 establishing a new Office of China Affairs within the USTR to focus more intensely on Chinese

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[15] Comments made by Assistant Secretary of Commerce James Jochum, before a hearing of the U.S-China Economic and Security Review Commission on "China and the WTO: Compliance and Monitoring", February 5, 2004.

intellectual property rights violations and on China's manufacturing and export policies. In any event, this will be an area for interested analysts to watch carefully. The more China perceives these measures as injudicious and discriminatory, the more likely progress would be slowed in meeting its WTO commitments and implementing other fair business and trading practices.

U.S.-China competition in the international setting

While much attention is focused on U.S.-China bilateral economic differences, the two countries also often find themselves on opposite sides as competitors on the regional and global economic scene. For example, Asia will be an increasingly competitive arena for U.S and Chinese economic interests in the years ahead. With U.S. strategic attention diverted in the war on terror, China is positioning itself as a more proactive and significant economic (and political) player in Asia.

Even though the United States remains the largest foreign investor in the region, China is rapidly catching up in terms of investor influence as East Asian and Southeast Asian businesses become increasingly tied into and dependent upon the Asian network of imports, exports, production, and investment which has China at its core. As noted earlier in this report, China is also becoming a major importer of goods, services, and resources from the region, further solidifying its place as a key regional economic player. In recent years, Chinese companies have begun to expand their investments in parts of Southeast Asia, a trend that will undoubtedly continue. The United States may also find that Free Trade Agreements (FTAs) negotiated in the region – such as with Singapore and possibly with Thailand – could be eclipsed should the FTA between China and the Association of Southeast Asian Nations (ASEAN) succeed in achieving a formidable trading bloc in the next decade.

China has also been active in courting stronger economic relations with other major economic powers, especially with the European Union (EU). Total EU-China trade will surpass U.S.-China trade in 2004, and will surpass Japan-China trade in 2005, making the EU China's largest trading partner. This will give China even greater room to maneuver in both business and politics, and, as circumstances warrant, play the EU and United States off one another.

With 10 more countries joining the EU in May 2004, Europeans and China view each other as very attractive and promising markets. Recent years have seen a real solidification of that attraction. EU-China summitry, in place since the mid-1990s, has led to deeply institutionalized dialogue channels across a range of issues. The sixth EU-China summit, held in October 2003, concluded two major agreements on satellite navigation cooperation and tourism facilitation, as well as the establishment of a new mechanism for industrial policy dialogue. One of the most important linchpins for improved EU-China cooperation is the fact that Europe does not regard China as a security threat or potential rival, leaving the field open for the development of strong mutual economic interests.

U.S.-China competition on the international scene is also reflected in certain multilateral settings. The WTO talks in Cancun in September 2003 are a case in point. U.S. officials hoped to gain Chinese cooperation on a range of multilaterally agreed-upon agricultural questions. China initially signaled its intention to line up with the United States during the Doha Round in November 2001 and as part of the Cairns Group, a coalition of 18 large agricultural exporting countries. Beijing apparently aimed to export more agricultural products by lowering high agricultural tariffs amongst its Asian neighbors.

However, on the eve of the Cancun meeting, China joined the Group of 22, a coalition of developing countries opposing U.S. and EU positions on agriculture issues. These countries felt the agricultural agenda did not go far enough in cutting agricultural subsidies in developed countries while demanding tariff reductions for developing countries. Although China was not a leader within the Group of 22, its willingness to join the developing countries lent weight to their positions and resulted in generating a greater hearing of developing world concerns within the WTO agenda. As a result of the stalemate between the two blocs, the Cancun meetings failed to produce an agreement on modalities for further agricultural negotiations. Not only did China gain political prestige within the developing world for its stand, but it also demonstrated that Beijing could support measures for its own interest in a multilateral economic setting while at the same time undermining U.S. positions.[16]

[16] Drawn in part from remarks by Margaret Pearson during the conference organized by the CSIS Freeman Chair in China Studies on January 13, 2004 entitled, *Partners or Competitors?: Economics, Trade, and Finance in U.S.-China Relations*.

PART THREE

Conclusions and Recommendations

The United States and China are entering an entirely new and complex era in their economic relationship. In a nutshell, China is *both* partner and competitor, and simplistic efforts to cast the complexity of U.S.-China economic relations as *either* one of partnership *or* competition are unhelpful to the development of effective policy.

If managed correctly, the increasingly complex U.S.-China economic, trade, and financial relationship should result in benefits for the United States, positive changes in China, and a strengthening of stable U.S.-China relations over the longer-term. But as the United States and China become increasingly intertwined economically, the complexities of this relationship will only become more challenging in the years ahead. The United States needs nuanced, resourceful and multifaceted economic, trade, and financial policies that reflect those complex economic realities.

The complexities abound. On the one hand, China's attractiveness as an investment and export platform has become more about growing productivity and less about cheap labor. China itself is becoming a rewarding market with massive future potential for U.S. exports. China will likely continue to be a huge economic opportunity for American businesses and investors.

On the other hand, the economic relationship poses a number of difficult questions. The United States has been affected by China's economic emergence: market competition and frustration and wariness with China's business practices. The issues of job losses, revaluing the *yuan*, China's WTO compliance record, and the growing list of trade disputes point to increased difficulties ahead. Issues of trade, economics and finance – traditionally considered among the most positive and beneficial aspects of the relationship – have increasingly become matters of dispute and friction.

The growing economic relationship with China also raises new and difficult political- and security-related issues as well. For the first time since before World War II, the United States finds in China a major trading partner which is not a close friend or ally. Indeed, for many, the principle underlying concerns about U.S.-China economic and trade relations are not associated with traditional questions of jobs, profits and trade deficits, but the questions of how U.S.-China economic relations might contribute to China burgeoning political and economic strength, and its ability to threaten U.S. security interests in the future.[17]

Concerns also persist over China's human rights record and the nature of its political system, and whether it is in U.S. interests to "reward" China with the economic benefit of doing business with the United States. For the most part, however, the goodwill and stability that has been

[17] U.S.-China Security Review Commission, *Report to Congress of the U.S-China Security Review Commission: The National Security Implications of the Economic Relationship between the United States and China* (Washington, D.C.: Government Printing Office, July 2002).

generated between the United States and China in recent years has helped alleviate some of those concerns and place the relationship on a sturdier footing with regard to political and security issues.

The increasingly complex U.S.-China relationship is also unfolding in the context of a U.S. election year, further complicating matters. Questions of job creation and losses, outsourcing of manufacturing and service positions abroad, economic policies, and trade competition will be central aspects of the presidential contest this year. It is likely U.S.-China economic relations will be a target of much of that discussion.

During this transition toward a new and more complex era in U.S.-China economic, trade, and financial relations, clearer policy directions are needed on both sides to further consolidate mutual economic interests and sustain a more stable comprehensive relationship over the long-term. Importantly, the currently favorable political and security conditions between the two countries offer a relatively rare opportunity to work through contentious economic and trade issues. If both sides are unable to realize the potential gains of smooth and steadily improving economic relations, a tremendous opportunity to shape a new era in U.S.-China relations will be lost.

With these considerations in mind, some broad policy guidelines are provided below.

♦ **Grasp the complexities of U.S.-China economic relations, place them in their broader context, and avoid politicizing economic and trade disputes**

Political leaders need to look beyond black-and-white understandings of the U.S.-China economic relationship and place them in a broader strategic context. To begin, it is important to recognize that competition need not take on a negative connotation. After all, the United States' biggest trading partners have often been competitors with which it had conflicting economic interests. The key has been to assure that competition took place on a level playing field, and that China continues to embrace market principles and moves toward true market economy status. China has already come a long way in that direction, and should be expected to do more in the months and years ahead.

On the matter of the trade deficit with China, political and policy leaders in Washington should recognize that in and of itself, it is a simplistic measurement to gauge the real value of U.S.-China economic and trade relations. Moreover, measures aimed at curbing Chinese exports to the United States, such as Chinese currency revaluation, could have a negative impact on U.S.-invested enterprises based in China. Rather than considering traditional trade flows alone to make the case for *yuan* revaluation, analysts and politicians alike ought to also look into the value of repatriated profits to better understand the increasingly complex nature of U.S.-China trade and economic relations. It is also worth keeping in mind that the dynamic of the Chinese economy is such that it is becoming an increasingly important importer and consumer of goods, technology, and services, and is not simply an export platform.

In an election year, trying to keep an eye on the larger strategic picture will prove difficult. Both industry and labor are looking to lend support to politicians who might advocate tougher economic and trade policies toward China. China can and should take more steps to open its economy, improve its labor, safety, and environmental standards, strengthen its domestic financial system, and assure an even more fair, competitive, and transparent trade and investment environment. But the greatest gains thus far in seeing China move in this direction have occurred largely outside the glare of the political spotlight. In addition, blatantly political actions against China, especially in an election year, only strengthens the view among Chinese that our interest in their compliance is largely a matter of our own domestic politics, rather than a serious structural concern about the way China conducts itself in economic and trade matters.

♦ **Recognize and respond to the global and regional impact of China's economic policies**

There is a tendency in Washington to view relations with China through a narrow bilateral lens. But the United States needs to spend more time examining the opportunities and challenges of China's economic growth in its regional and global context. For example, it is useful to recall that China played a constructive role following the 1997 Asian financial crisis, and has since helped pull the region forward as an economic engine. The region's largest economy, Japan, has benefited from its exports to the dynamic Chinese economy, helping Japan enjoy a modest recovery in the past year.

At the same time, Washington policymakers need to also recognize that China has parlayed its economic importance into political weight in the region. In response, Washington should see beyond a strictly bilateral context in considering China's economic growth, and solidify American economic positions and influence in the vital Asia-Pacific region. This can be done by bolstering economic and trade ties with longstanding partners in the region, including the conclusion of Free Trade Agreements among key partners. It can also be achieved in the multilateral context through more robust support for pursuing the free-trade goals of the Asia-Pacific Economic Forum (APEC) and other regional multilateral organizations which complement and play to U.S. competitive strengths.

♦ **Exhibit sharper instincts about each other's domestic concerns**

Both the United States and China should pay much greater attention to the domestic political, social, and economic environment faced by the other side. Integrating this kind of understanding into the policy process would result in approaches which would be more acceptable to the other party.

For example, U.S. China policy tends to focus on the external aspects of growing Chinese power – such as China's growing military strength, Chinese policies toward Taiwan, Chinese proliferation activities, China's increasing economic power and competitiveness, and the rise of China's influence in Asia. However, much of Chinese diplomacy, economic policy, and security strategy is shaped by Beijing's perceptions of its domestic challenges and goals. Chinese economic decision-making is largely concerned with maintaining domestic stability at a time of considerable socioeconomic convulsion and change at home. The new "Fourth Generation" leadership is China is ostensibly more concerned with addressing the many social and economic weaknesses the country faces, including narrowing the prosperity divide between rich and poor and across regions in China, cleaning up the liabilities of the state-owned sector, and strengthening the fragile financial sector.

By understanding the strengths and weaknesses of China's economy, and the many challenges on its domestic agenda, U.S. policymakers should be in a better position to craft policies which reflect and respond to the realities of this increasingly important trading partner while at the same time achieving American interests.

Beijing too would benefit by doing more homework on the domestic political and economic situation in the United States. Beijing should understand that economic relations with the United States, long a firm foundation for the broader U.S.-China relationship, cannot be taken for granted, even when other aspects of U.S.-China relations, such as political and security affairs, have seen modest improvement.

The Chinese practice of conducting high-profile trade missions and buying sprees, or threatening to withhold certain lucrative contracts, can only at best generate short-term flexibility from the United States in the absence of even more fundamental structural change toward the market in the Chinese economy. Similarly, China's public insistence that the United States lift export controls on high-technology goods as a way to resolve the trade deficit could be more effectively framed. The Chinese side should have a keener sense of the political and security concerns surrounding trade in high-technology, often dual-use, goods such as satellites and nuclear energy, and take further measures at home to reassure Washington with regard to export controls, nonproliferation, end-use inspections, and the separation of the military from ostensibly civilian activities. Agreements reached between the two sides during the April 2004 JCCT meetings aimed at improving end-user inspections are a step in the right direction, but more reassurance will need to be done by the Chinese side.

♦ **Sustain and deepen senior- and sub-cabinet level exchanges, upgrade the level of exchanges and press hard on key issues**

The growing frequency of senior-level engagement between the two countries indicates the importance both sides attach to the economic relationship. Since last fall, President Bush has met with President Hu Jintao at the Asia Pacific Economic Cooperation (APEC) meeting in October 2003 and received Premier Wen Jiabao when he visited the United States in December 2003. Trade matters were central to those discussions. The Treasury Secretary, Commerce Secretary, and United States Trade Representative and their Chinese counterparts regularly exchange visits, with even more frequent exchanges conducted at working levels across these agencies.

The elevation of the Joint Commission on Commerce and Trade (JCCT) to a higher political level meant it was co-chaired by Commerce Secretary Don Evans, U.S. Trade Representative Robert Zoellick and Chinese Vice Premier Wu Yi. As a result, when the JCCT was convened in April 2004, differences were narrowed and new understandings were achieved.[18] Conducting economic and trade consultations at this senior level increases the likelihood that outstanding

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[18] A summary of the results of the JCCT meetings in April 2004 can be found at the Department of Commerce website: www.ita.doc.gov.

differences can be fully and satisfactorily resolved. Given the importance of U.S.-China economic relations, the U.S. should press harder over outstanding differences in key areas –such over industrial policies, market access, agriculture, textiles, services, intellectual property violations, and export controls – by insisting these discussions take place at a higher political level than has previously been the case.

The USTR and Commerce Department acknowledge the good rapport their teams have had with their negotiating counterparts in China. Through these regular discussions, the U.S. side has achieved greater understanding of the progress and impediments of China's reforms, and how best to formulate U.S. policy responses. The test over time of these intensified exchanges will be their ability to withstand downturns in U.S.-China relations, whether they are economic or political downturns, or both. Washington and China should do their best to define economic and trade matters separate from political differences, and more firmly establish economic and trade relations as a central pillar in U.S.-China relations.

♦ Stress WTO compliance and other international obligations and commitments to the Chinese, avoiding devolution into narrowly bilateral disputes

China will likely respond best to U.S. concerns when they are couched in the language of international obligations and responsibilities rather than in the narrow context of resolving a U.S.-specific dispute. Beijing genuinely wishes to be seen as a responsible international economic player, and will want to avoid international opprobrium on economic and trade matters. For example, by urging China to sign international treaties and agreements related to intellectual property protections, China's obligations become more than simply "doing a favor for the United States" and involve meeting global responsibilities of a major economic power. Similarly, implementation of the Transitional Review Mechanism (TRM) has to be seen by the Chinese as part of its international responsibility flowing from its membership in the WTO, not as a pressure tactic by the United States or others to discriminate solely against China.

Washington should not give Beijing the opportunity to accuse the United States of "selective protectionism", which would only undermine Chinese incentives to comply with trade commitments. Likewise, U.S. actions should not be seen as "targeting China", but as an effort to see that China (and all other trading partners) are meeting to their international obligations.

Overall, encouraging China to take on international free trade commitments and responsibilities will invest it more deeply in a stable and rules-based economic and financial system. This is good for China, good for the United States, and good for the global economic and trade regime.

♦ Enlarge public and private support for "best practices" in China

The United States should give even stronger support to programs in China which strengthen the rule of law, bolster corporate responsibility and accountability, encourage transparent administrative and regulatory procedures, build a stronger and more open financial system, establish a professional and impartial judicial system, and foster the emergence of a successful Chinese entrepreneurial and middle class. For example, greater political and financial support, from both the public and private sector, should go toward rule of law initiatives, entrepreneurial development, and business ethics programs in Chinese business schools, law schools, undergraduate institutions, and in Chinese business and trading associations.

Appendix: Project Participants and Conference Agenda

Partners or Competitors?: Economics, Trade, and Finance in U.S.-China Relations

Center for Strategic and International Studies, Washington D.C., January 13, 2004

Project Direction

Bates Gill, *Freeman Chair in China Studies, CSIS*
Sue Anne Tay, *Project Coordinator & Research Assistant, CSIS*

Conference Speakers

Pieter Bottelier
Adjunct Professor
Johns Hopkins University

Harvey Chen (Chen Zhaohui)
Chairman & Founder
First Light Academy, Shanghai

David Dollar
Head, Macroeconomics and Growth Group,
Research Department, World Bank

Ellen Frost
Visiting Fellow
Institute for International Economics

Susan Lawrence
Washington Correspondent
Far Eastern Economic Review

Robert Kapp
President
U.S.-China Business Council

Sherman Katz
Scholl Chair in International Business
Center for Strategic and International Studies

Nicholas Lardy
Senior Fellow
Institute for International Economics

Jeremy Mark
Deputy Division Chief, External Relations
International Monetary Fund

Laurence H. Meyer
Distinguished Scholar
Center for Strategic and International Studies

Kevin Nealer
Principal & Partner
The Scowcroft Group

Margaret Pearson
Professor of Government and Politics
University of Maryland

Hugh Peyman
President & Founder
Research Works, Shanghai

Daniel Rosen
Visiting Fellow
Institute for International Economics

Conference Agenda

Panel 1: Politics of U.S.-China Economic, Trade and Business Relations

Kevin Nealer, The Scowcroft Group
Politics of U.S. economic and trade engagement with China, past and present

Robert Kapp, U.S.-China Business Council
Overview of current economic and business issues in U.S.-China relations

Susan Lawrence, Far Eastern Economic Review
Watching Beijing from Washington: Domestic politics influencing China policy

Moderator: Laurence H. Meyer, Center for Strategic and International Studies

Panel 2: China's Investment Environment

Daniel Rosen, Institute for International Economics
Problems and prospects of China's evolving marketplace

David Dollar, The World Bank Group
Chinese efforts at macroeconomic reform and their prospects

Hugh Peyman, Research Works, Shanghai
Economic reform and impact on growth and investment environment

Moderator: Jeremy Mark, International Monetary Fund

Keynote speaker
Charles Freeman III*, Deputy Assistant to U.S. Trade Representative, USTR
* C*omments were off the record.*

Panel 3: Key Issues in U.S.-China Bilateral Trade Relations

Nicholas Lardy, Institute for International Economics
Reviewing the U.S.-China trade deficit and assessing China's openness

Harvey Chen (Chen Zhaohui), First Light Academy, Shanghai
Assessment of the RMB valuation issue and U.S.-China trade deficit

Moderator: Sherman Katz, Center for Strategic and International Studies

Panel 4: The United States and China's Interaction in the Global Economy

Pieter Bottelier, Johns Hopkins University, former advisor for East Asia, World Bank
Addressing China's growing economic dominance, its impact on the regional and global economy

Margaret Pearson, University of Maryland
Implications of China's growing economic reach

Ellen Frost, Institute for International Economics
U.S. response to China's emergence as a global economic player

Moderator: Bates Gill, Center for Strategic and International Studies

About the authors

BATES GILL holds the Freeman Chair in China Studies at the Center for Strategic and International Studies in Washington, DC. He previously served as a Senior Fellow in Foreign Policy Studies and inaugural Director of the Center for Northeast Asian Policy Studies at the Brookings Institution, D.C. Prior to that position, he directed East Asia programs at the Center for Nonproliferation Studies at the Monterey Institute, Monterey, California and at the Stockholm International Peace Research Institute, and formerly held the Fei Yiming Chair in Comparative Politics at the Johns Hopkins University Center for Chinese and American Studies, Nanjing, China. A specialist in East Asian foreign policy and politics, Dr. Gill conducts research focusing primarily on Northeast Asian political and security issues, especially with regard to China. His current research examines China's domestic social, economic and political transformation including a focus on the country's looming HIV/AIDS challenge.

SUE ANNE TAY is a Research Assistant for the Freeman Chair in China Studies. She previously worked at the Los Angeles World Trade Center Association helping to co-ordinate an international trade project. Her previous work experience include program assistance with a humanitarian agency in Azerbaijan, research at the Singapore Institute of International Affairs, and founder/lecturer of Singapore's first international relations-based high school program. Ms. Tay also studied abroad at the London School of Economics and in Moscow. She currently works on U.S.-China trade and economic relations. Ms. Tay is from Singapore and graduated with a B.A from the School of International Relations, University of Southern California in 2003.