

Remarks by
The Honorable Barbara Hackman Franklin
Former US Secretary of Commerce
The U.S.-China Relationship – Where Do We Go from Here?
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Good evening. I am delighted to be here to discuss the all-important subject of U.S.-China relations. But first, let me commend the World Affairs Council for doing a splendid job of bringing to our community a variety of perspectives about the global arena. We appreciate that very much.

Turning to China. Let me state at the outset that I believe the U.S.-China relationship is the most important bilateral relationship in the world and that China and the U.S. will continue to be the world's most formidable economic powers. And so, it follows that the relationships which are built and nurtured between our two governments, our two business communities, and our two peoples will take on added significance in the years to come.

My engagement with China

My personal involvement with China dates back more than 15 years when I was honored to serve as Commerce Secretary in the Administration of President George H. W. Bush. Serving in the cabinet of this great and visionary president remains the highest honor of my life. In late 1992, President Bush, after he lost the election, he asked me to undertake a special mission to China to normalize business relations. I was to reconvene the U.S.-China Joint Commission on Commerce and Trade (JCCT). The JCCT had been started by then Commerce Secretary Malcolm Baldrige and his counterpart in the mid-1980's. After the unfortunate events at Tiananmen Square in June, 1989, the U.S. had placed eight sanctions on China, one of which was a ban on ministerial contact, which meant that high level officials could not talk. And so the JCCT had not met. We put this mission together in just a couple of weeks, and set out for Beijing in December, 1992, not knowing how we would be received. I reconvened the JCCT with my counterpart, Minister Li Lanqing, and that removed the sanction. Our discussions were productive, and we then returned home with more than \$1 billion worth of signed contracts for American companies. Mission accomplished.

But more importantly, this mission gave a green light to U.S. companies eager to explore business in China, but holding off because they did not want to run counter to their government's policies. By normalizing business relations at that time, just before he would leave the White House, President Bush presented his successor with a better atmosphere in which to build closer ties with China. Had there been a crisis with China in the new Clinton Administration, it would have been much more difficult to solve with that sanction still in place.

The mushrooming of China-U.S. trade and investment

Since then, trade and investment have grown dramatically. From just \$40 billion in 1993, two-way trade between the United States and China grew to \$321 billion in 2007, an eightfold increase, with a huge surplus on the Chinese side. Foreign Direct Investment has grown dramatically as well. Today, China is the United States' 3rd largest trading partner and the fastest growing market for U.S. exports. China's admission to the WTO in 2001 officially confirmed its arrival on the global economic stage. As China's market opening continues and its economy becomes more consumption-oriented, its economic influence will grow greater. Indeed, China is fast becoming an anchor for the global economy. In the decades ahead, I hope that an expanded appetite for a wide range of consumer and agricultural products will drive up U.S. imports to China and enable it to work off the large trade imbalance, now at \$256 billion.

Today the economic ties between our two countries are the very foundation for the relationship. There are tensions, of course, but the ties of business and trade bind us together and make possible better cooperation on a host of other issues - health, energy, environment, and a solution to the North Korea threat, to name a few.

China's Transformation and Governing Structure

China's astonishing growth and development in such a short time is virtually without parallel in human history. GDP, in this nation of 1.3 billion people, has been growing at an average of 10-11% a year. At that rate China's GDP could outstrip U.S. GDP by 2035 or 2040. Inflation, however, is at a twelve year high, and the central government is trying to cool down the economy, with not much success so far. GDP per capita is still low -- \$5,300—and that highlights one of the country's greatest challenges: the disparity between the "haves", in the more developed coastal and urban areas and "have-nots", in the rural areas to the west. Unemployment is a problem, as some farmers move to the cities for work. China must create 25 million new jobs a year to tamp down unemployment and there are plans to increase urbanization to make available housing and services for those who migrate. There are many other challenges, having to do with health, a safety net (there really isn't one now), water, and the environment to name a few. Nonetheless, it is remarkable that millions have been lifted out of poverty during the past 25 years.

The CPC Ruling Elite

The Communist Party is the sole ruling party and has been since the revolution in 1949. Today its legitimacy as the ruling party is largely dependent on its ability to continue to deliver prosperity to the people. The Party has complete control of the PRC government and fosters capitalism and "opening up". They call the governing philosophy "socialism with Chinese characteristics." Some people around the world call it "authoritarian capitalism". Today the Party has about 73 million members, roughly 5-1/2 % of the total population. An individual cannot just voluntarily sign up; he or she has to be invited. The process is quite selective; individuals are well vetted. So, the Party is selecting the best and the brightest, and has developed a cadre of very bright, well educated, increasingly worldly people. Starting several years ago, business people and entrepreneurs have been invited to join. Karl Marx would not have approved.

Last October, the 17th Party congress occurred – this happens every 5 years – and there are changes in personnel, which generally signal succession at the highest levels. A bit of background about the Party hierarchy: The Central Committee of the Communist Party of China is the paramount decision-making body of the Party, with a membership of 150. The Political Bureau – or Politburo -of the Central Committee has 25 members and the Politburo Standing Committee has 9 members. The Politburo Standing Committee is China's most powerful governing body. Mr. Hu Jintao is the Party general secretary; he is also President of the People's Republic of China and head of the Central Military Commission, the highest military body. We should note that Mr. Hu as Party secretary and as President does not have dictatorial power. In decision-making, he must forge consensus among the top officials. It is a collective leadership.

The Party is committed to promoting more coordinated development and economic expansion based on social harmony, environmental protection and energy conservation. This is a refinement of the earlier economic agenda and is called the Scientific Outlook on Development.

China has a congress – the National People's Congress (NPC) – which is populated by Party members. It has nearly 3,000 members. However, this year, for the first time, some non-Party members were invited to participate; among them were migrant workers and a few business tycoons. In March the NPC Congress met and ratified what the Party Congress did. As expected, Mr. Hu Jintao was elected to another 5-year term as President of the Peoples Republic of China and Mr. Wen Jiabao was elected to another 5-year term as Premier. There were no other candidates. We should also note that there are term limits in these roles, both Party and Government. Seventy is the retirement age at the top levels. These men are known as the 4th generation of leaders, meaning the 4th generation since the revolution.

Now the 5th generation, who are in their 50's, is getting into position. At this moment, first among that generation is Mr. Xi Jinping, age 54. He became a Politburo member in October, Vice President of the Peoples Republic in March, and the betting is that he is in line to succeed Hu Jintao as President in 5 years. He has recently cleaned up a corruption scandal in Shanghai and now, among other things, has leadership of the Olympics in his portfolio. He has good lineage – his father was a revolutionary hero and vice premier. There are new Vice Premiers, the next level of leaders after the President, Vice President, and Premier. They are 5th generation. The first among Vice Premiers is Li Keqiang, who is expected to succeed Wen Jiabao as Premier in 5 years. He has the macroeconomic portfolio. The portfolios of the other Vice Premiers are just now becoming clear.

Some speculate that the 5th generation of leaders – 5 years away – might make some changes. The 4th generation leadership is populated by engineers. Hu Jintao is an engineer; Wen Jiabao is a geologist. The new generation is more a law and liberal arts educated group. (Examples: Xi Jinping graduated from Tsinghua University in

humanities and social sciences, studied chemical engineering and has a law degree. Li Keqiang has a doctorate in economics.) Some people think that this group might move toward more transparency and more democratic processes. On that, we'll have to wait and see. I hasten to add that the succession process is quite opaque and not entirely predictable. So, we never know for sure who is doing what until we know.

Another notable development is the decision to reorganize the central government once again, for the 5th time since 1982. There will be 5 super ministries, impacting 15 of the 27 ministries and agencies. They are: industry and information, human resources and social security, environmental protection, housing and urban-rural construction, and transportation. This seems to make good sense -- I would especially note the elevation of environmental protection -- but how it will work remains to be seen. What is not yet clear is where certain decisions and approvals for various projects will lodge. What is clear is that when new people take new jobs in newly created government bodies, there will be delays in decision making. For U.S. businesses needing approvals for projects or licenses, expect delays. A footnote: Some ministries are not affected by the changes -- for example, the Commerce Ministry and central bank.

The U.S.-China Government to Government Relationship

The government-to-government relationship has expanded exponentially. There are today 50 bilateral strands of it. Most of these bilateral strands are in the economic area. But there are others in diplomacy and the military. I am concentrating here on the economic arena because it is the one I know best and because it forms and colors the business environment.

The economic strands of the relationship are now coordinated under the Strategic Economic Dialogue (SED). I believe the SED -- initiated by President Hu and President George W. Bush two years ago -- is the most important development in the U.S.-China relationship in years. It is a way to bring all these various strands together, push the most sensitive and urgent issues to the top, prioritize them and work toward solutions. U.S. Treasury Secretary Paulson and Chinese Vice Premier Wu Yi deserve our gratitude for their good and diligent work in getting the SED started and keeping the momentum going.

How to keep the U.S.-China economic relationship going strong

But now we are moving into an era of great change. We have already mentioned the changes taking place in China's government now and we are very much aware that a new Administration will take over in our country in 2009. So, looking ahead, I offer six recommended actions which I think are key to ensuring that the relationship continues to thrive.

- **First, the new U.S. president must establish and maintain a close diplomatic and personal relationship with China's president and keep the hot line going between them regularly.** I am saying the same thing to my Chinese friends. That's the way to address issues before they become crises.

■ **Second, we should let nothing disrupt the SED and other dialogues.**

Given the large volume of trade and business activity, some disputes are inevitable. The crucial thing is to manage those disputes intelligently so that they do not provoke a major confrontation. The SED and other dialogues – such as the JCCT and those in energy, health, environment, and safety among others –continue to bring problems to the surface so we can deal with them, not sweep them under the rug. Issues that are allowed to fester unattended are the ones that usually lead to big blowups. But we should not expect big pronouncements each time the SED meets. That is not the major purpose of the dialogue. The real value is in the relationships and trust that are built and the steady progress that is made toward agreed upon objectives.

My greatest concern is that a new Administration might decide the SED didn't really produce much after all and might decide to abandon it. That would be a mistake. I think we need the SED, or something like it, to manage the relationship. So even if it were to be abandoned, it would have to be reestablished again. Worse case: that it is abandoned and then reinstated after a time, leaving a gap in continuing the engagement and highlighting problem issues. This relationship is too important to both sides to allow that to happen. In fact, I believe the SED can become ever more important in the years to come as it becomes more embedded in each country's governmental processes.

The big question, given the changes in China's government, is: who would be Secretary Paulson's counterpart since Vice Premier Wu Yi has retired? Secretary Paulson was in Beijing last week and now we know – it is Vice Premier Wang Qishan, the former mayor of Beijing and earlier head of the China Construction Bank. Hank Paulson has known him for years, and I'm told the atmospherics of their meeting were good. That is a positive sign. The next SED is scheduled for late June in Washington.

Let me digress a moment and talk about Wu Yi. She was in the Commerce ministry during my trip in 1992, became Commerce minister, and then Vice Premier. She negotiated China's entry into the WTO and is well known and well regarded in China and around the world. We knew her to be tough but fair, and when she promised action on the Chinese side, we could count on it. So, we will be watching closely how her successor will handle the relationship.

■ **Third, both sides should be proactively seeking ways to work together to solve problems as they arise and before they become full blown crises.** A collaborative, win-win solution should be the objective.

One current test of our relationship is food and product safety and the recalls of various Chinese imports, from toys to heparin to toothpaste. According to polls by Zogby International, American consumers have grown dubious about the quality and safety of Chinese products. A strong majority of respondents say Chinese products are "non-beneficial" to U.S. consumers -- a significant reversal from just two years

ago. An equally strong majority think the United States should consider restrictions on the import of Chinese products. Having said that, however, it does not appear that American consumers have stopped buying Chinese goods, even though they admit to more wariness.

This polling also indicates that consumers do not believe the Chinese government has taken a strong enough position on correcting the problems. I do not think that is quite accurate. I believe China's State Council (the Cabinet) and the Administration for Quality Supervision, Inspection and Quarantine (AQSIQ) has taken a number of very meaningful steps to address the problems. These include, among others drafting of the first product recall system, review and revision of 4,000 PRC standards, and stiffer enforcement.

But, frankly, most U.S. consumers and most members of Congress do not know very much about the depth of the Chinese response. It would help if the Chinese government would assemble a comprehensive list of all the steps that it has taken and then aggressively communicate them to opinion leaders and the public. And, of course, we anticipate that China would fully and faithfully implement every one of the actions.

But we must also understand that the Chinese are playing catch up here, particularly with respect to safety standards and the enforcement. This affects products for export as well as those for sale in their home market. It's in our interest to help them catch up.

The other side of the coin is that American companies whose products are being manufactured in China have a responsibility, too. Toys are a case in point. Some 20 billion toys are made in China, in 10,000 factories, for a variety of U.S. companies. Those U.S. companies must make sure that the design of their products is safe. They also must ensure that products are properly tested for safety before they reach retailers' shelves.

What both sides must resist is the desire to retaliate when there is a product recall or some other problem. There has been a bit of tit for tat going on. For example, following some product safety recalls here, the Chinese found ants in U.S. exported pistachios and fungus in U.S. soybeans. It's in our collective interest to reduce this sort of retaliation.

The second Product Safety Summit held last September in Washington is a good example of effective government-to-government collaboration on product safety. I have a special interest in this because I was an original commissioner of The Consumer Product Safety Commission (CPSC) in the 1970's. We promulgated the first safety standards for toys. At that time most toys were made in the U.S. or Europe, not in China. The CPSC and AQSIQ reached a new set of agreements regarding products with lead-based paint, used in many products such as jewelry and toys. China's standards are less strict than ours. AQSIQ pledged to increase

inspections of factories that export to the United States; and both sides agreed to joint work plans focused on toys, fireworks, lighters, and electrical products.

U.S. businesses have highlighted other areas of concern that could lend themselves to collaborative solutions. The U.S.-China Business Council's annual survey of its more than 200 members makes clear why addressing concerns pre-emptively is so important. Last year, 83% of companies report profitable operations in China, and a majority say doing business in China is an important part of their future. Those are astounding numbers that we don't want to put at risk. There are three challenges that I will mention briefly, challenges which impact many industry sectors, and on which collaborative efforts should have priority.

- The first is the enforcement of **intellectual property rights (IPR)**. No company wants its patented or confidential designs stolen. We compliment the Chinese for putting into place the structure to deal with IPR violations, but enforcement is the real issue. Enforcement must be more vigilant, particularly when it comes to the determination about when prosecutions should be criminal.
- Another concern is **transparency**. In the United States, we have grown up with transparency and we accept it as a fact of life that is almost as natural as breathing. Our governmental processes are very much open.

But, China has a very different tradition; a tradition reflected in the Chinese saying that "if one fishes in clear water, he cannot catch any fish." That heritage is why China's governmental processes are opaque and why transparency is a new idea.

We appreciate the steps the Chinese government is taking to make regulatory and other processes more transparent. Greater transparency is absolutely essential to the long-term well being of U.S.-Chinese trade relations. Our businesses need to know what regulatory actions are being contemplated before they become final. Over time, the Chinese side will be convinced that transparency has benefits for Chinese businesses and consumers as well.

- The third challenge is **standards**. When goods are entering a market, any market, around the world they must meet the standards of that market. This means that it is in our collective interest to have global standards that are followed by all businesses no matter where they are based and no matter where they sell their products. That way consumers everywhere can benefit from an agreed upon level of quality and safety. Although we are a long way from this vision, working to harmonize standards between China and the U.S. – lead-in-paint, for example -- is a good avenue to pursue. What we want to avoid is the use of standards to establish de facto trade barriers that a government may use to keep foreign competition out of a market.

Now back to my recommended actions for a continued thriving relationship.

■ **Fourth, we should focus more attention on investment and promote understanding of the rules that pertain on both sides.**

The United States has an open investment policy. However, by law, the President has the authority to suspend or prohibit any foreign acquisition, merger, or takeover of a U.S. company that is determined to threaten U.S. national security. There is an interagency process, the Committee on Foreign Investments in the U.S. (CFIUS), which reviews acquisitions and makes determinations about national security implications. It is chaired by the Secretary of the Treasury, includes 12 departments and agencies, and can turn down an acquisition of an American company by a foreign buyer. Quite simply, the concern is that an acquisition of a U.S. company by foreign entity could give that foreign entity (or foreign government) access to technology which could be turned to military uses, and then be turned against the U.S. directly or indirectly. In the case of China, there are some in the U.S. who distrust China's motives, and those views can impact the review process.

This CFIUS process is not meant as a trade barrier or as a device to preclude foreign investment in the United States. It is a sincere effort to protect U.S. national security, a concern that has been heightened since the 9/11 attacks. However, this is not well understood by our Chinese colleagues.

At times, our review process seems too political or unfair. The Chinese side thought the furor created when CNOOC attempted to buy Unocal was unfair. More recently the CIFIUS process caused China's Huawei Technologies to back off in its effort to acquire an interest in 3Com, a U.S. network equipment manufacturer, which supplies the U.S. military. Similarly, on the U.S. side, there is concern about China's mergers and acquisition regulation under which an acquisition by a foreign company can be declined for reasons of "national economic security". There are differences in thinking on each side about what constitutes "national security" We must air and overcome those differences.

■ **Fifth, we should work to combat protectionism in both our countries.**

The cross border investment issues and the food and product safety concerns earlier described can lead to outright protectionism -- an outcome I believe we must resist with all our might.

Some in our Congress already have concerns about trade, about China taking U.S. jobs, about China's currency being undervalued, and about the large U.S. trade deficit with China. Those concerns have led to the introduction in Congress of numerous bills that would interrupt or curtail Sino-U.S. trade. So far, wiser heads have prevailed and no restrictive legislation has been adopted. But continued engagement around the troublesome issues is crucial if we are to head off restrictive legislation.

It is true that protectionism is broader than U.S.-China relations. There is a negative reaction in many places around the world today against globalization and free trade. Quite frankly, I am concerned about the anti-free trade rhetoric, which has characterized the debate in the presidential campaign. It is too easy, especially when the economy is soft, to blame trade. That's much too simple. And in the case of U.S.-China trade, we risk hurting us all if we make China the scapegoat.

- **Sixth, we need to build more trust between the U.S. and China, people to people. Trust is something intangible but crucial. It is built through relationships and it takes time.** Relationships are built in many ways -- through educational endeavors, cultural activities, sports, and business. They help us get to know and understand each other better. Our Chinese friends greatly value relationships. I always encourage young people to visit China and learn the language.

Finally, a word about the upcoming Olympics, China's "coming out" in the world community. They are working very hard on this, to clean up the pollution, planting many trees and flowers in Beijing, training those who will be working at the games, and preparing to win more "golds" than any other country. But the eruption in Tibet is causing consternation. The timing of these protests so close to the Olympics seems rather calculated, but this irritation has festered for years. Tibetans believe China has extracted too much from Tibet and has too much control of its economy, religion, and culture. The Chinese government is dealing with the protesters, but Beijing has to rethink how it handles things like this because the entire world is watching.

Conclusion

Let me conclude where I began. I believe the U.S.-China relationship is the most important bilateral relationship in the world and the most important economic relationship. Therefore, we must engage with China, and both sides must skillfully manage this complex relationship. We must work to build trust between our peoples. China and the U.S. can be an enormous positive force for economic growth and stability around the world as well as for peace. In the words of Confucius, "Wheresoever you go, go with all your heart." That is how I hope both sides will pursue the U.S.-China relationship.

Thank you.