

CATO HANDBOOK FOR CONGRESS

POLICY RECOMMENDATIONS FOR THE 108TH CONGRESS

CATO
INSTITUTE

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57. Relations with China

Congress should

- treat China as a normal great power, not as a “strategic partner” or a probable adversary;
- continue to liberalize U.S.-Chinese relations and hold China to its World Trade Organization commitments;
- avoid imposing economic sanctions against China even for narrowly defined objectives, since such measures will undermine permanent normal trade relations (PNTR);
- reject the proposed Taiwan Security Enhancement Act but support Taiwan’s requests to purchase defensive weapons systems; and
- recognize that advancing economic freedom in China has had positive effects on civil society and personal freedom for the Chinese people.

Constructive Partner or Emerging Threat?

U.S.-Chinese relations have become increasingly unpredictable. Only a short time ago, both governments spoke of a “strategic partnership” and sought ways to enhance already substantial economic and political ties. The bombing of the Chinese embassy in Belgrade, the release of the Cox report alleging systematic nuclear espionage by the People’s Republic of China, and the forced landing of a U.S. spy plane on Hainan Island produced a new round of tensions. Those have been offset, somewhat, by China’s accession to the World Trade Organization and by cooperation between Beijing and Washington in the war against terrorism. But, as the 2002 reports by the U.S.-China Security Review Commission and the

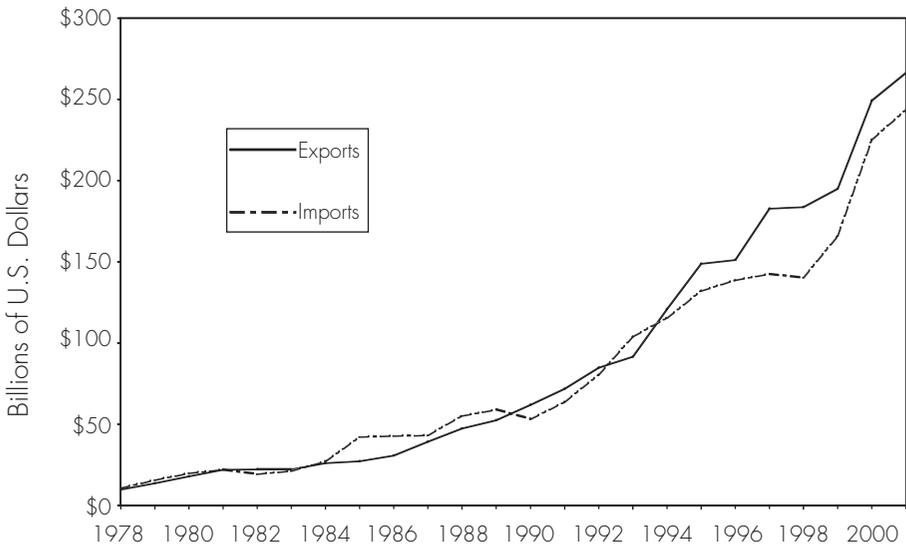
Pentagon illustrate, there is deep concern that China will be an increasing threat to U.S. global economic and military power.

It would be a major mistake, however, to backslide from a policy of engagement into one of containment and to treat China as an adversary rather than as a normal great power. Managing relations with China and avoiding the extremes of confrontation or wishful thinking will be one of the key challenges facing U.S. policymakers in the next decade.

China's economy has grown precisely because Beijing has allowed greater economic freedom. The rapid growth of trade has increased per capita incomes in China and provided the Chinese people with new opportunities. In 1978 the total value of Chinese imports and exports amounted to only \$20.6 billion. By the end of 2001, their value had increased to \$509.8 billion (Figure 57.1). China's desire to compete in world markets is good for consumers and poses no threat to U.S. security.

Protectionists in the United States who point to large and growing trade deficits with China and to increased U.S. investment in China should not be allowed to block trade liberalization by injudicious use of national security and human rights arguments. Further liberalization of U.S.-

Figure 57.1
China's Opening to the Outside World



SOURCE: PRC General Administration of Customs, *China's Customs Statistics*.

Chinese trade is a win-win strategy and can play an important role in promoting peace and prosperity. Containment would do the opposite.

The U.S.-China Commission report “The National Security Implications of the Economic Relationship between the United States and China” offered more than 40 recommendations, many of which implicitly assume that China is a threat to U.S. economic and military power. Congress should not enact any recommendation that would endanger our policy of engagement. In particular, Congress should strongly oppose the creation of a “federally mandated corporate reporting system.” That system is designed to force U.S. firms doing business in China to provide extensive data on all their business activities, even those that have no significant impact on national security.

U.S. firms investing in China would be strictly monitored and have to account for their investments in China and how those might affect jobs in the United States. Enactment of such a recommendation would impose a heavy burden on U.S. firms and put them at a competitive disadvantage in the Chinese market. Reduced investment in that market would have a negative impact on the U.S. market, because subsidiaries in China would import fewer U.S.-made components.

The USCC report also calls for Congress to “renew the Super 301 provision of U.S. trade law and request the Administration to identify and report on other tools that would be most effective in opening China’s market to U.S. exports if China fails to comply with its WTO commitments.” Such a step would be unwise. China should be given ample time to meet its obligations to the WTO and to the United States under the 1999 bilateral market access agreement. The United States should work through the WTO dispute resolution mechanism and target specific cases that are *significant* rather than try to prosecute *every* infraction of the trade agreement. It is in the interests of both Washington and Beijing to open China’s markets. China will be undergoing important changes in its leadership, and the reformers need to have congressional support.

Likewise, Congress should not follow the commission’s advice to “amend the CVD [countervailing duty] law to specifically state that it applies to NMEs [nonmarket economies].” The purpose of that recommendation is “to protect U.S. industries from unfair competition from the imports of these economies.” In fact, China is unfairly treated by the use of NME methodology in determining production costs in antidumping cases. The methodology is grossly defective and prevents China from realizing its comparative cost advantage. Moreover, China has a higher

economic freedom rating than Russia, yet the European Union has dropped the NME label for Russia. The United States should do the same for China. U.S. consumers would gain as a result.

Congress should not let protectionist interests dominate future U.S.-Chinese relations. The USCC report sends the wrong signal to Congress and to China. Instead of seeing China as a threat, Congress needs to cooperate with China in ways that are mutually beneficial. As Joseph Borich, executive director of the Washington State China Relations Council, noted in his July 2002 *CRC Update*:

The draconian system the commission would create will do little or nothing to promote the long-term security of the U.S. Conversely, it would undermine shared Sino-U.S. interests, create a whole new layer of federal bureaucracy and bureaucratic requirements to bedevil U.S. business, and lay the basis for a self-fulfilling prophecy that could actually diminish our security.

Continued trade liberalization and engagement on a number of fronts, including a more liberal visa policy that permits Chinese students to study in the United States, especially law, economics, and the humanities, will have positive long-term benefits. Visa procedures should be reexamined. So long as individuals pose no threat to our national security, they should be encouraged to learn about our free society firsthand. Free trade can help normalize China and transform it into a modern economy and a civil society under the rule of law. Backsliding into protectionism cannot.

Both the USCC and Pentagon reports imply that as China grows wealthier its military spending will increase to the detriment of the United States and our Asian allies. That danger cannot be overlooked, but the probability is small compared with the likelihood that, as the nonstate sector in China grows, the Chinese Communist Party will lose power and political reform will ensue.

China is a normal, albeit sometimes difficult, rising great power. China's behavior can sometimes pose challenges, but the country is not a dangerous threat to U.S. security. China's military spending is a tiny fraction of U.S. defense spending. It will take decades before China can even come close to *current* U.S. spending levels. (China officially spends \$19 billion on defense, but the actual figure is somewhere between \$40 billion and \$60 billion. In contrast, U.S. defense spending for fiscal year 2003 is \$397 billion.) China's weapons systems are no match for those of the United States—although China is making a serious effort to modernize its armed forces.

The Taiwan Question

The most serious potential flashpoint in relations between the United States and China involves the status of Taiwan. China is primarily concerned with its domestic stability and with Taiwan's ultimate return to the motherland. The United States should insist that China use peaceful means to settle the Taiwan question. Despite Beijing's objections, the United States should be more willing to sell Taiwan the weapons it needs for its own defense. However, Congress should reject the proposed Taiwan Security Enhancement Act, which would create extensive military ties between Washington and Taipei and put the United States in the middle of the dangerous PRC-Taiwan dispute. The best way to bring about a peaceful resolution to the Taiwan issue is to further liberalize trade relations between the mainland and Taiwan.

During the past 10 years, Taiwanese investors have committed more than \$70 billion to Chinese projects. Those investors have a strong incentive to maintain peace in order to increase their own prosperity. Likewise, they have an incentive to have direct trade, transport, and postal links with the mainland. The sooner those links are established, the better the chance for a cooperative solution to the Taiwan question. Congress should recognize that reality.

As a free country, Taiwan obviously has no incentive to become part of the PRC at this time. But if liberal economic policies on both sides of the strait continue, then China may undergo the quiet revolution that has occurred on the island. In that case, a peaceful solution to the Taiwan question could be realized. Congress should foster that process. Taiwan's recent accession to the WTO, following in China's footsteps, is a positive development that offers hope for the future.

Forging a Constructive Relationship

The dark side of the Chinese communist state is disturbing and must not be ignored. But that unsavory record should not be allowed to hide the progress that the Chinese people have made since economic reforms began in 1978. Increased trade has promoted the growth of markets relative to state planning, given millions of people new opportunities, and substantially raised living standards, especially in the coastal cities where economic liberalization has advanced the most. The primary goal of U.S. foreign policy should be to further the liberalization trend in China by maintaining

a cooperative, constructive relationship. The most direct means of achieving that goal is through closer trade ties.

China has benefited most not from Western aid but from trade. As Ma Yu, a senior research fellow of the Chinese Academy of International Trade and Economic Cooperation, recently wrote in *China Daily's Business Weekly*, “The root cause of China’s high-speed economic growth . . . is the policy of reform and opening-up.” Congress should not take any actions that would stall that process.

The challenge for the United States is to exploit opportunities for further gains from trade and move closer to a constructive partnership with the PRC—but at the same time protect vital U.S. interests. Unfortunately, U.S. policy is drifting toward confrontation, as witnessed, in particular, by the USCC and Pentagon reports. That strategy risks creating a self-fulfilling prophecy that China will become an enemy. Indeed, a growing chorus in Congress and the U.S. foreign policy community argues that the PRC is a belligerent dictatorship and an implacable future enemy of the United States.

Painting China as an economic and military adversary is dangerous and misguided. Free trade is mutually beneficial—both China and other countries gain from trade liberalization. There is no doubt that, as the Chinese economy grows, so will the Chinese military budget. But that is not unusual for a large nation-state, and thus far China’s military spending and its military modernization effort have been relatively modest.

It is true that no one can be certain how the PRC will behave on security issues in the future. Unlike Nazi Germany or the Soviet Union, however, the PRC is not a messianic, expansionist power; it is a normal rising (or reawakening) great power. At times, that can be difficult for other countries to deal with, but such a country does not pose a malignant security threat.

Proceed with Caution

The best course is to treat China as a normal (albeit sometimes repressive and prickly) great power and avoid the extremes of viewing the PRC as either an enemy or a strategic partner. The United States would also be wise to encourage other major countries in Asia to think more seriously about how they intend to deal with a rising China. A collection of diffident, militarily weak neighbors, wholly dependent on the United States for protection, is not likely to cause Beijing to behave cautiously.

Beijing’s behavior toward regional neighbors has been a curious amalgam of conciliation and abrasiveness. Examples of conciliation include

efforts to dampen the border disputes with such important land neighbors as India, Vietnam, Russia, and Kazakhstan and a campaign to build close political and economic ties with South Korea. The PRC has also been helpful in trying to discourage the North Korean regime from pursuing nuclear weapons and ballistic missile programs and has facilitated the recent détente between the two Koreas. At the same time, China's relations with Japan, the Philippines, and some other oceanic neighbors are noticeably more confrontational, and Beijing still aggressively pushes its territorial claims in the South China Sea.

Taiwan remains an especially dangerous flashpoint. Any move toward formal independence by Taipei would surely provoke military action by Beijing. Yet China's economic future depends strongly on Taiwan's prosperity, so military action is likely seen as a last resort. The increasing popularity of Taiwanese president Chen Shui-bian may eventually cause Beijing to open a serious dialogue with the island's leaders.

China's Changing Tide

The domestic tension created by Beijing's strategy of opening China's economy to the outside world while preventing meaningful political change has to be released sooner or later. The question is, How far and how fast will China go toward creating a fully open society based on private property and limited government? Gradualism appears to have worked reasonably well so far, but the inefficiency of China's state sector is apparent and corruption is rampant.

Yet it is undeniable that a significant transformation has occurred in the post-Mao era. Slowly but surely China is moving toward a stronger civil society, with the driving force being the market-oriented reforms initiated by Deng Xiaoping. Chinese intellectuals are now largely free to travel and lecture outside the mainland, and they are more interested in the works of Hayek and Friedman than those of Marx and Engels. Whether China will go all the way to a true free-market system, though, remains highly uncertain.

That uncertainty is why the United States needs a clear, realistic, and prudent foreign policy toward the PRC. Instead of painting China as a serious threat one day and as a de facto strategic ally the next, the United States needs to formulate a balanced view consistent with our own principles—a view that recognizes our long-term interest in engaging China while at the same time protecting our national security. The PRC's claims

to the South China Sea islands and its relations with Japan and Taiwan must be viewed from that perspective.

It is also important to consider the future of economic, political, and social reform in China and how that future may be shaped by the liberal influence of Hong Kong and Taiwan. Will freedom spill over from those more open societies to the mainland, or will Chinese communism slowly corrupt the rule of law and weaken the free market in Hong Kong and seek to absorb and subordinate Taiwan? It seems clear that, unless it privatizes state-owned enterprises, China faces continuing problems of corruption and inefficiency. But wholesale privatization would undermine the last vestiges of party power. So the challenge for China's leadership is stark.

Ultimately, the creation of real as opposed to pseudo markets in China will require the full recognition of private property rights. The recent amendment to Article 11 of the PRC constitution, which places the nonstate sector and private enterprise on a par with state-owned enterprises, is a step in that direction. But without further constitutional and political reform that places rights to life, liberty, and property above the party, and allows for both economic and political freedom, there can be no certainty of ownership.

Article 11 of the PRC Constitution, as Amended March 15, 1999

“Individual, private and other non-public economies that exist within the limits prescribed by law are *major components* of the socialist market economy. The state protects the lawful rights and interests of individual and private economies . . .” (emphasis added).

That is why it is so important for China to face foreign economic competition and to be exposed to new ideas. Every step in the direction of greater economic freedom will provide further opportunities for the Chinese people to enlarge their private space and shrink the relative size of the state. Pressures will then build for greater social and political freedom.

An independent scholar in Beijing gave the best concise answer to the question of whether China will be a constructive partner or an emerging threat in the early 21st century. In his view, the answer will “depend, to a very great extent, on the fate of liberalism in China: a liberal China will be a constructive partner; a nationalistic and authoritarian China will be

an emerging threat.” America must prepare for both possibilities, but its policies should avoid needless snubs and provocations that would undermine the prospect for the emergence of a democratic, peaceful China.

Recommended Readings

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