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## Technology, Trade, and Security Issues Between the United States and the People's Republic of China: A Trip Report, August 1997

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(name redacted)

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### **ABSTRACT**

This is a trip report based on discussions held with both Chinese and U.S. officials and business leaders in China during 1997. The CRS representative was part of a U.S. congressional staff delegation which visited Beijing, Xi'an, Shanghai, and Hong Kong. Discussions during the two weeks in China covered three major policy areas: technology, trade, and security. Developments since August 1997 indicate that these three areas continue to be subjects of great interest between the two nations. This report provides an analysis of both U.S. and Chinese perspectives on these issues at the time of the visit, and a brief update regarding issues since August 1997. It is part of a series of trip reports written by CRS analysts on southeast Asia. It will not be updated.

# Technology, Trade, and Security Issues Between the United States and the People's Republic of China: A Trip Report, August 1997

## Summary

From August 12<sup>th</sup> through August 20<sup>th</sup>, 1997, a congressional staff delegation visited the People's Republic of China. This report provides the research findings of this group, which was sponsored by the U.S.-Asia Institute, and was the 37<sup>th</sup> such trip undertaken since 1979 to increase the understanding between the two nations. The U.S. group was comprised of seven congressional staff from the House of Representatives, the U.S. Senate, and the Congressional Research Service. The delegation met with Chinese industry and business leaders in Beijing, Xi'an, Shanghai, and Hong Kong. The group also met with several U.S. State Department officials and representatives of U.S. industry doing business in China.

The meetings focused on many policy issues. However, three themes emerged during the two weeks of discussions: technology, trade, and security issues between the two countries. Since August 1997, technology, trade, and security issues have become more prominent and perhaps more contentious. Several of the specific issues discussed, such as the trade imbalance between the United States and China (and the composition of that trade), China's membership in the World Trade Organization (WTO) and Most Favored Nation (MFN) status with the United States, and human rights issues as a form of international diplomacy and relations, are still important concerns between the two nations

In Beijing, discussions with Chinese officials, U.S. business representatives, and U.S. Department of State staff focused on overall technology, trade, and security issues between the two countries. These included the merchandise trade deficit that the United States has with China, the growth and trend of the deficit, China's Membership in the World Trade Organization, Most Favored Nation status with the United States, and linking trade policy to non-trade issues, such as human rights. Discussions in Beijing also concerned technology transfer and proliferation issues between the two countries. In Xi'an, the political and cultural history of China put many of the PRC's current issues into perspective. High technology development and agricultural trade issues were also discussed. In Shanghai, technology and capital formation, the roles of state-owned enterprises and multinational enterprises, and telecommunications and the growth of the Internet were topics of discussion. In Hong Kong, the turnover of the island from British to Chinese rule, political freedom, and territorial sovereignty issues were discussed.

Technology, trade, and security issues continue to be important components of the relationship between the two countries. Important issues and developments since August 1997 have included President Jiang's visit to the United States, an economic slowdown in Asia, a worsening trade balance between the two nations, technology transfer and proliferation issues, and President Clinton's visit to China in June 1998.

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# Technology, Trade, and Security Issues Between the United States and the People's Republic of China: A Trip Report, August 1997

## Background

This report provides research findings from a two week trip to the People's Republic of China (PRC), August 12 to August 20, 1997.<sup>1</sup> This trip was sponsored by the U.S.-Asia Institute, and was the 37<sup>th</sup> such trip undertaken as part of that organization's efforts to expand the knowledge and understanding between the United States and China. The U.S. group was comprised of seven staff members from the House of Representatives, the U.S. Senate, and the Congressional Research Service. The delegation met with Chinese industry and business leaders in Beijing, Xi'an, Shanghai, and Hong Kong.<sup>2</sup> The group also met with several U.S. State Department officials and representatives of U.S. industry doing business in China, to obtain their perspectives. The views and opinions expressed by members of the U.S. delegation reflected either their own perspectives or the perspectives of the Members of Congress they represented, and did not necessarily reflect official U.S. government policy.

The meetings focused on many policy issues. However, three themes emerged during the two weeks of discussions: technology, trade, and security issues between the two countries. Since August 1997, technology, trade, and security issues have become more prominent and some more contentious. Several of the specific issues discussed included the trade imbalance between the United States and China (and the composition of that trade), China's membership in the World Trade Organization (WTO) and Most Favored Nation (MFN) status with the United States, and linking human rights issues to trade policy.

Other issues touched on during the two weeks of meetings last summer have since emerged as critical in Sino-American relations. These include technology transfer and U.S. export control policies, the financial health and economic growth of China and Hong Kong, and the delicate issue of foreign influence on domestic politics and policies. On several of these issues, concerns raised on both sides during the two weeks of meetings were addressed. As a result, a greater understanding of national policies was achieved on both sides. In other areas, concerns remained and issues were left unresolved.

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<sup>1</sup>In this report, China and PRC are used interchangeably.

<sup>2</sup>The chapters in this report are organized chronologically by itinerary. For a complete listing of people the delegation met, see References.

Despite differences that may exist between the two nations, the meetings also reflected the deep desire for American congressional staff and Chinese policymakers to learn more about each other, to exchange ideas, and to find common ground. The Chinese hosts at every meeting in every city extended a gracious hospitality. The Chinese sponsors of this trip also ensured that the delegation had the chance to enjoy the great cultural heritage that China has, and in this way provided a context of China's history, politics, and economic growth. Members of the group were impressed by the broad size and scope of the Chinese nation, from the Great Wall outside of Beijing to the dynamism in Hong Kong, and from the rural expanses of the Shaanxi province to the growth of development in Shanghai.

## **Beijing (August 12<sup>th</sup> - 16<sup>th</sup>)**

Most of the meetings that took place in Beijing concerned broad trade and political issues between the United States and China. The congressional staff delegation met with senior Chinese government officials, former members of the government (both civilian and military), officials in the U.S. embassy, and with representatives from the Boeing Corporation.

### **An Overview of Technology, Trade, and Security Issues**

It became apparent during two weeks of discussions that China's national technology policy is viewed by many policymakers, business leaders, academics, and others as the engine for China's future economic growth and development.<sup>3</sup> Invigorating scientific research and access to technology innovation are at the core of China's economic plan for the 21<sup>st</sup> century. Part of this strategy is a domestic policy targeted at strengthening internal science and technology (S&T) resources. This strategy is also global. China seeks to obtain a wide range of scientific and technological resources to hasten its development. Its relationship with the United States, both in cooperation and competition, is viewed by many as critical to nurturing and improving its technological capacity.

Chinese national technology policy is a complex mix of centralized industrialization, state-run technology parks, and economic development zones. While there is a coordinated national policy from Beijing, pockets of local entrepreneurial high technology have sprouted all over the country. There also continues to be a reluctance to openly exchange many forms of scientific research and technology innovation with foreign entities. Yet China appears eager to embrace the best and the brightest that foreign research and development sources have to offer. This ambivalence was not surprising. It is a country that at once appears to be coming into 21<sup>st</sup> century as an advanced, developed nation, while parts of the country

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<sup>3</sup>Discussions with Yang Jiechi, Assistant Foreign Minister, Ministry of Foreign Affairs Beijing, 14 August 1997; Chong Wang, Senior Manager of Public Relations and Advertising, China International Economic Consultants Co., Ltd. Beijing, 13 August 1997; Cheng Zhen-deng, Senior Engineer, The State Science and Technology Commission, Beijing; and Sun Dejiang, Deputy Division Chief Engineer, Department of Planning, The State Science and Technology Commission, Beijing, 13 August 1997.

struggle to move beyond a largely agrarian past. Therefore, China's national policies at once embrace foreign sources of technology while at the same time reflect some suspicion of the outside world.<sup>4</sup>

Like many other newly industrializing economies, China's policies are heavily focused on applied research and technology commercialization. Several areas of scientific research and technology development stood out as priorities for China: telecommunications, information technology, aerospace, biotechnology, agricultural, and energy. In all of these areas, the Chinese consistently expressed a strong desire to improve scientific cooperation and technology transfer between the two nations.

**Trade Issues.** U.S.-PRC trade issues were consistently discussed during the two weeks the delegation was in China. However, during the time in Beijing, when most of the discussions were with Chinese political and policy leaders, trade issues dominated. The four major U.S.-PRC trade issues were:

- ! The worsening U.S. trade deficit with China. In 1987, the United States had a \$2.8 billion merchandise trade deficit with China. By 1996, the merchandise trade deficit surged to \$39.5 billion, and in 1997, it was \$49.7 billion.<sup>5</sup> From 1991 to 1996, U.S. exports to China increased by 90.5%, while U.S. imports from China increased by 171.4%.<sup>6</sup>
- ! The composition of goods and services traded between the two countries, and why this composition is important to U.S. policymakers. According to the U.S. Department of Commerce, in 1997 small and medium-sized electrical machinery, toys and sports equipment, and footwear accounted for almost all of the imports from China to the United States. In terms of U.S. exports to China, large-scale machinery, aircraft and spacecraft technologies, electrical machinery, and fertilizers constituted the majority of merchandise exported in 1997. Talks between Chinese officials and the U.S. delegation revolved around whether this trade composition is a reflection of real market demand, or whether tariff and non-tariff barriers are causing distortions in trade composition.
- ! China's Most Favored Nation (MFN) trading status with the United States is not permanent but conditional. U.S. policy has been that certain issues need to be addressed by the Chinese before MFN status becomes permanent. Chinese officials contended that this is a serious issue for the Chinese people; some in the U.S. delegation contended that trade, security, and human rights issues must be addressed in China before MFN can be approved.

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<sup>4</sup>Discussions with Cheng Zhen-deng, Senior Engineer, The State Science and Technology Commission, Beijing and Sun Dejiang, Deputy Division Chief Engineer, Department of Planning, The State Science and Technology Commission, Beijing, 13 August 1997.

<sup>5</sup>Department of Commerce, Bureau of the Census, *The World Trade Atlas*, 28 May 1998.

<sup>6</sup>Congressional Research Service, *China-U.S. Trade Issues*, by (name redacted), IB9112 [updated regularly], p. 1.

- ! China's acceptance as a member of the World Trade Organization (WTO). The Chinese consider WTO membership as an important step which would indicate recognition of China's importance in the global economy. Some U.S. policymakers have economic and non-economic concerns regarding China's WTO membership. Among the issues discussed were those linking WTO membership to ensuring U.S. access to Chinese markets, greater democratization in China, improvement in PRC human rights issues, greater access to information through the Internet and telecommunications technologies, and improving U.S. export control policies to China.<sup>7</sup>

Major points of contention between several members of the U.S. delegation and Chinese officials during meetings in Beijing were the size of the trade deficit (which is large), the direction the deficit is taking (growing larger each year), and the composition of the trade (small manufactured goods from China, advanced technologies and value-added services from the United States). Several members of the U.S. group expressed the opinion that it was likely that any improvement in the U.S.-PRC relationship would have to start with a change in the trading relationship between the two nations.

***Chinese Position.*** In response to U.S. concerns about the size, structure, and composition of the trade deficit, Chinese policymakers emphasized their view that:

- ! The current merchandise trade deficit with the United States, and particularly a significant reduction in U.S. exports to China, is a temporary aberration and will be brought to equilibrium by free market forces.
- ! While the trade imbalance with the United States may create tensions, the Chinese policymakers contend that it is the result of market forces at work, and not central government planning.
- ! The U.S. government has not accurately taken into account Hong Kong trade as part of the PRC trade equation with the United States, nor accurately accounted for U.S. firms manufacturing goods in China for sale in the United States.
- ! The United States harms itself by maintaining complicated and unwise export control policies, particularly for dual-use technologies and atomic energy. These technology exports to China could greatly improve relations between the two countries as well as helping redress the trade imbalance issue.

***U.S. Delegation Position.*** On each of these points, several members of the U.S. group sought to clarify the U.S. position as well as address Chinese concerns. The U.S. groups' views, while not always unanimous, are summarized in the following points.

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<sup>7</sup>While these were issues raised by the U.S. group during this trip, it should be noted that the U.S. Trade Representative does not link specific trade issues with non-trade issues in discussions with Chinese officials.



- ! The trade deficit trend line between the United States and China can be traced over several years, and is neither a one year aberration nor a short term development.
- ! While honest disagreements can exist regarding trade policies between nations, much more can be done to eliminate Chinese tariff and non-tariff barriers on U.S. imports.
- ! While there may be some accounting discrepancies between the two nations, U.S. officials do not view this as a major contributing factor to the trade deficit between the United States and China.
- ! U.S. export control policies are of concern to many U.S. policymakers, yet reflect a balance between national security and economic opportunities for U.S. firms.

**Linking Trade to Other Issues.** Two very contentious policy issues—MFN status and membership in the WTO — led to a broader policy question often discussed between the U.S. delegation and their Chinese hosts (as well as debated within the U.S. delegation). Should the United States link trade and non-trade political issues—such as human rights—when dealing with China?

**MFN Status.** MFN treatment is conferred when one country extends to another any trade concessions, privileges, and immunities which that country has granted or will grant to any trading partner. In other words, trade between the two nations is conducted with tariffs that are set at the rate lowest among common trading partners, rather than at higher full rates. The United States has extended MFN status to all but a few nations, but never extended permanent MFN status to China. It had suspended MFN status with China between 1951 and 1980, but then revoked the suspension when diplomatic relations between the two nations were restored. From 1980 through 1989, annual renewal of China's MFN status was generally uncontroversial, with some congressional disapproval.<sup>8</sup>

The incident in Tiananmen Square in June 1989 caused a strong congressional reaction. In 1990, Congress undertook a series of legislative initiatives tying China's MFN status with progress in the PRC's human rights conditions. Several bills passed the 102<sup>nd</sup> and 103<sup>rd</sup> Congress making renewal of China's MFN status conditional on progress in human rights. Yet President Bush was opposed to linking MFN to human rights issues and vetoed the legislation. No legislation withdrawing or imposing further conditions on China's MFN status has passed Congress during the Clinton Administration.<sup>9</sup>

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<sup>8</sup>Congressional Research Service, *Most-Favored-Nation Status and China: History and Alternative Approaches to Current Law*, by (name redacted), CRS Report 96-992, 10 December 1996, p. 1-3.

<sup>9</sup>*Ibid.*, p. 3, President Clinton announced in 1993 that the U.S. would provide conditions on renewing China's MFN status; however, in 1994 the President announced support for its MFN status without conditions linked to human rights issues.

Several Chinese policymakers expressed frustration that the United States has considered linking MFN status to China's domestic issues. They contended that China has made great progress since 1989 in providing democratic initiatives to the Chinese populace. They also contended that the conditional MFN policy "stick" is no longer effective in trying to make China comply with U.S. ideals. Not renewing China's MFN status would seriously impair the current trade relations with the United States as well as cause significant trade disruptions.<sup>10</sup>

There was a range of opinion on this issue within the U.S. group. Some members flatly rejected a policy linking human rights and other democratic ideals to trade relations with China. They contended that to link human rights issues to trade policy unfairly imposes an American viewpoint on the current Chinese political system. America must view China through a prism that reflects China's culture, history, and political development—not U.S. ideals and aspirations for the PRC.

Others in the U.S. delegation represented the view that MFN for China should be opposed based on the continuing structural trade deficit with the United States. From this point of view, the deficit is not a short-term phenomenon but a longer-term problem. Before permanent MFN status is bestowed on China, the structural imbalance of the trade deficit must be addressed. This viewpoint articulated the concern that once China's MFN status becomes permanent, there will be no incentive for China to redress the long-term trade deficit with the United States.

Yet others in the delegation supported MFN status but believe it should be linked to progress on human rights issues. This viewpoint contended that it is perfectly within the political and philosophical framework of the United States to insist that basic conditions of freedom and democracy are in place before a permanent business and trading relationship is ratified by Congress. In particular, there was concern that Chinese dissidents continue to be imprisoned without fair trials and that free speech and other forms of expression are routinely suppressed. Advocates of this position in the U.S. group called for the United States and China to exchange information on political prisoners, and hold leadership summits in Beijing and Washington to discuss both nations' humanitarian concerns.

***Membership in the WTO.*** Chinese membership in the WTO also was discussed at great length by Americans and Chinese on this trip. In 1995, the WTO succeeded the General Agreement on Tariffs and Trade (GATT) as the major forum for discussion of global trade issues. Since the inception of the WTO, China has sought membership, in part to have a forum to voice its trade policy and in part as a sign of its growing importance and stature in the global community. However, many WTO countries contend that China's trade policies are incompatible with the WTO system of what are accepted as standard and fair trading practices. Critics cite China's

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<sup>10</sup>Discussions with Ambassador Jiang Chengzong, Chinese People's Institute of Foreign Affairs, Beijing, 12 August 1997; Mme. Zhang Yuejiao, Director General, Department of Treaty and Law, Ministry of Foreign Trade and Economic Cooperation; William C. McCahill, Jr. Deputy Chief of Mission, Department of State, Beijing, 16 August 1997; Robert Ludan, Minister-Counsellor, Economic Affairs, Department of State, Beijing, 16 August 1997.

continued centralized trade practices, a lack of movement towards complete privatization of enterprises, inadequate protection of intellectual property rights (IPR), and evidence of continued non-tariff barriers as some of the issues still unreconciled for Chinese membership in the WTO.<sup>11</sup>

In response, several Chinese officials contended that it is critical for the global community to include a major nation like China in the multilateral trading system. China is the eleventh largest trading nation in the world, and by some measures, the third largest economy in the world.<sup>12</sup> Chinese officials contended that WTO membership will further open its economy to technology imports, creating a greater market for high technology firms seeking to do business abroad. Chinese officials also stated that other nations without open economies or completely free market trade policies, such as India, Malaysia, and Thailand, are members of the WTO. They asked: is there a double standard for China?<sup>13</sup>

MFN status with the United States and China's WTO membership are important issues for both China and the United States. The Chinese position consistently emphasized the importance of resolving both issues in a satisfactory manner. Members of the U.S. delegation stressed that the U.S. government understands the importance of both issues to the PRC, and that a stable trading position with the United States and other global partners is a desired outcome.

**Technology and Security.** During discussions on trade issues, concerns were raised about technology transfer between the two nations. Chinese officials uniformly stated that one way to significantly alter the trade imbalance between the two nations was to change U.S. export control policy and allow more high technology components to be sold to China. In particular, Chinese officials stressed the importance of U.S. high technologies and advanced research and development to the Chinese economy. Several Chinese government and business leaders called for greater U.S. exports of telecommunications and computer technologies, aircraft and aerospace industry components, capital equipment and manufacturing technologies, and advanced materials and composites. They argued that these technologies would continue to spur economic growth and lead to greater domestic stability in China, the region, and globally.<sup>14</sup>

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<sup>11</sup>George Holliday, *China's Application to the World Trade Organization: Are Chinese Economic Reforms Sufficient?* CRS Report 96-857, p. 2-3.

<sup>12</sup>*Ibid.*, p. 1.

<sup>13</sup>Discussions with Ambassador Jiang Chengzong, Chinese People's Institute of Foreign Affairs, Beijing, 12 August 1997; Mme. Zhang Yuejiao, Director General, Department of Treaty and Law, Ministry of Foreign Trade and Economic Cooperation, Beijing, 13 August 1997; and Yang Jiechi, Assistant Foreign Minister, Ministry of Foreign Affairs, Beijing, 14 August 1997.

<sup>14</sup>*Ibid.*, China's policy was summarized very concisely by William C. McCahill, Deputy Chief of Mission, Department of State, Beijing, and Robert Ludan, Minister-Counsellor of Economic Affairs, Department of State, 16 August 1997.

Discussions between members of the U.S. delegation and Chinese policymakers during this trip explored whether there may be increased opportunities for technology transfer between the two nations. Common ground was found in those areas where U.S. technological expertise can directly contribute to improving the quality of life for the Chinese people (e.g., telephone and telecommunications infrastructure). It was also recognized that there continues to be tension between China's desire for U.S. commercial technology transfers and U.S. concerns regarding Chinese use of dual-use technology for military applications, as well as proliferation of such technologies to other countries. These tensions appear to have increased since August 1997.

***Technology Transfer and Economic Growth.*** The importance of technology transfer to the PRC was raised often by Chinese officials. Technology was cited as the catalyst by which China would fully develop as a nation. Some American observers of China believe no long-term relationship is more important to the Chinese than the relationship with the United States, because of the need for U.S. technologies leading to China's advancement. These observers view China as poised to make an historic political, economic, and social transformation, shedding many antiquated aspects of an older system as a new society emerges.<sup>15</sup>

Chinese officials emphasized the importance of technology transfer as part of China's self-image among other developed nations. In this respect, U.S. policies that deny technologies to China were described as an affront to the Chinese people. Some officials often expressed frustration with U.S. views which they believe "demonize" or "chastise" Chinese attempts to obtain advanced commercial technologies. Chinese officials contended that any developing country would seek out the most advanced and appropriate technology for economic growth. Several officials were of the opinion that there is a double standard in U.S. policy towards technology transfer to developing countries, in which other developing nations receive appropriate technology denied to the Chinese. Some officials appeared perplexed and angered by U.S. technology transfer policies.<sup>16</sup>

***Export Controls.*** Chinese officials consistently raised two concerns with U.S. technology transfer policy. The first was over U.S. export control laws and regulations. The Chinese position seemed to reflect confusion and irritation over the direction and intent of U.S. export control policies. They expressed concern that certain technologies, such as basic memory semiconductor chips, can be exported to China while more advanced semiconductor chip technologies can be blocked under U.S. military control lists. Similarly, while U.S. policies restrict certain types of supercomputer technologies for sale to China, Chinese officials stated that they can obtain identical technologies from other countries (e.g., France or Japan). Or, the Chinese can buy "off the shelf" workstations and other commercial technologies

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<sup>15</sup>William C. McCahill, Deputy Chief of Mission, Department of State, Beijing, and Robert Ludan, Minister-Counsellor of Economic Affairs, Department of State, 16 August 1997.

<sup>16</sup>Discussions with General Xu Xin, President, China Institute for International Strategic Studies, Beijing, 13 August 1997; Yang Jiechi, Assistant Foreign Minister, Ministry of Foreign Affairs, Beijing, 14 August 1997; and Ambassador Jiang Chengzong, Chinese People's Institute of Foreign Affairs, Beijing, 12 August 1997.

from U.S. vendors and “bundle” these technologies for advanced high-performance computing.<sup>17</sup>

Many U.S. policymakers and some business leaders also have questioned U.S. export controls, believing they are antiquated and at cross-purposes. Basic export control policies were established during the Cold War, when U.S. national security interests were clearer and well-defined. Some now argue that current export restrictions toward China may be attempts by some to create a national security threat for the United States where none may now exist.<sup>18</sup> However, numerous Members of Congress and several private analysts have recently suggested that the post Cold War deregulation of exports (and particularly the liberalization of export controls by the Clinton Administration) may be contributing to the strategic capabilities of potential adversaries. In particular, Congress is currently examining the implications of U.S. exports to China of dual-use commodities, licensed by the Department of Commerce. Another issue is the transfer of several items from the U.S. Munitions List, where they were licensed for export by the Department of State, to Commerce Department’s Commodity List, the effect of these transfers on export control decisions, and the national security, nonproliferation, and foreign policy implications.

Critics in the United States and China also point to conflicting licensing policies and jurisdictions among the Departments of Commerce, State, and Defense. According to the General Accounting Office (GAO), the Department of Commerce can justify the license of commercial technology for export using economic and trade interests, and it controls items to achieve specific national security and foreign policy objectives. The Department of State has a broader authority to deny export, and must take national security interests into account before providing export licenses. The Department of Defense advises both Departments of Commerce and State on their license cases and emphasizes military applications of technology transfer. The GAO contends that differing statutory authority among these three agencies has caused jurisdictional and procedural uncertainty for U.S. export control policies.<sup>19</sup>

However, the GAO, upon examining specific technology transfer policies and actions between the United States and China, also has determined that the Chinese government’s role—particularly the military—in technology transfer has complicated this issue. The GAO found that in the transfer of both telecommunications and machine tool equipment to China, the Chinese military’s role in obtaining and

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<sup>17</sup>This perspective is discussed in: Seymour Goodman, Peter Walcott, and Patrick Homer, *High-performance Computing, National Security Applications and Export Control Policy at the Close of the 20<sup>th</sup> Century* [Working paper], Department of Commerce, Washington, 4 May 1998, 200 pages..

<sup>18</sup>Henry A. Kissinger, “No Room for Nostalgia,” *Newsweek*, 29 June 1998: 50-52.

<sup>19</sup>General Accounting Office, *Export Controls: Change in Licensing Jurisdiction for Two Sensitive Dual-Use Items*, GAO/NSIAD-07-24, January 1997, p. 3-4.

diverting technology from the United States has raised additional questions about the purpose and objective of China's technology transfer from the United States.<sup>20</sup>

Most members of the U.S. delegation acknowledged that more can be done to streamline U.S. export licensing procedures, clarifying jurisdictional problems between U.S. agencies, and making procedural decisions more transparent. However, most believed that serious technology transfer problems between the United States and China still exist. Some members expressed doubt that the United States would change its export control policies towards China, unless the PRC first made very transparent its policies of obtaining and using certain foreign technologies. This was underscored by the position that until these issues are discussed more openly and frankly between both countries, changes in U.S. export control policies which might benefit the PRC are unlikely.

**Proliferation.** Several Chinese officials protested that the United States has unfairly and incorrectly portrayed China as an agent of proliferation of military weapons and nuclear technologies to rogue nations. During every discussion with Chinese officials, this portrayal was denied. Chinese officials consistently spoke of a U.S. government report which purportedly cleared China of this portrayal,<sup>21</sup> as well as the absence of proof from the international community at large that China was supplying Iraq, Iran, Pakistan, or any other country with military weapons or nuclear technology.<sup>22</sup>

This claim was countered by official U.S. representatives in Beijing. They stated that there has been evidence of China's proliferation activities for several years. However, U.S. officials indicated that China appeared to be curtailing some of its proliferation activities to other nations. According to the U.S. view in Beijing, in 1997 Chinese officials recognized that proliferation was a serious impediment to U.S.-Chinese relations. U.S. officials also commented that when the United States raises proliferation concerns with Chinese officials, China raises concerns about weapon sales to Taiwan.<sup>23</sup>

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<sup>20</sup>General Accounting Office, *Export Controls: Sale of Telecommunications Equipment to China*, GAO/NSIAD-97-5, November 1996, p. 4; General Accounting Office, *Export Controls: Sensitive Machine Tool Exports to China*, GAO/NSIAD-97-4, November 1996, p. 1-4.

<sup>21</sup>It is unclear which U.S. government report the Chinese were referring to. Several officials mentioned a Central Intelligence Agency (CIA) report; a 1997 CIA report addressing this issue, covering the last half of 1996, described China as "the most significant supplier" of goods related to weapons of mass destruction to Pakistan, Syria, and Iran. "China: Certifiably What?" *The Economist*, 25 October 1997: 41.

<sup>22</sup>Discussions with General Xu Xin, President, China Institute for International Strategic Studies, Beijing, 13 August 1997; Yang Jiechi, Assistant Foreign Minister, Ministry of Foreign Affairs, Beijing, 14 August 1997; and Ambassador Jiang Chengzong, Chinese People's Institute of Foreign Affairs, Beijing, 12 August 1997.

<sup>23</sup>Discussions with William C. McCahill, Deputy Chief of Mission, Department of State, Beijing, and Robert Ludan, Minister-Counsellor of Economic Affairs, Department of State, 16 August 1997.

Proliferation of specific technologies and their uses also was raised during discussions. During one such meeting, the Chinese position stressed the importance of the nascent national space program, and how China and the United States could cooperate in this field.<sup>24</sup> Members of the U.S. group asked Chinese officials about China's national policies for containment of launch vehicle and related satellite technologies, and the use of these technologies within national boundaries. The U.S. delegation was assured that China's Long March satellite launch program was purely commercial in nature, and that there was no intent to pass along vital launch and satellite technologies to other nations that could be used for launching missiles. The delegation found this Chinese position to be highly suspect.<sup>25</sup>

**National Interests.** According to one source, one-third to one-half of all economic growth comes from technology progress, and that it is the principal driving force for long-term economic growth and increased standards of living for modern industrial societies.<sup>26</sup> Therefore, it is understandable why China's national policy for obtaining and utilizing the best foreign technologies is vital to its goals of economic growth. However, China's national interest in obtaining technologies may not be consistent with those nations that are the source of technology. Those nations often restrict or control technologies that they view as inimical to their national economic security.

The importance of technology transfer to national economic security policies was the focus of an animated discussion during a luncheon at the Boeing Corporation's Beijing offices. Officials from Boeing described what it is like to do business in China, and cited two key elements for undertaking business in the PRC. The first is that it is never "just business" in China, but that personal and political relations are key for any foreign firm trying to do business. Boeing officials acknowledged that meeting certain host country concessions, such as technology transfer, required a balancing of business interests and objectives. If certain technology transfer concessions would have to be made to capture Chinese market share, Boeing likely would consider this as a good long-term tradeoff.<sup>27</sup>

The second key was to balance Boeing's corporate global perspective with U.S. national economic and security interests. For Boeing officials, U.S. export control policies can hinder the company as it competes against companies from countries

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<sup>24</sup>For background, see: Congressional Research Service, *China's Space Program: A Brief Overview Including Commercial Launches of U.S.-Built Satellites*, by (name redacted), CRS Report 98-575 23 June 1998, 15 pages.

<sup>25</sup>Discussion with General Xu Xin, President, China Institute for International Strategic Studies, Beijing, 13 August 1997; proliferation issues were more broadly discussed with Yang Jiechi, Assistant Foreign Minister, Ministry of Foreign Affairs, Beijing, 14 August 1997; and Ambassador Jiang Chengzong, Chinese People's Institute of Foreign Affairs, Beijing, August 1997.

<sup>26</sup>Ralph Landau and Dale Jorgenson, editors, *Technology and Economic Policy*. Cambridge, Mass.: Ballinger Publishing Company, 1986, p. 2.

<sup>27</sup>Discussions with Timothy B. Premelaar, Vice President of Customer Service, Boeing China Inc., Beijing, and Jane Chen, Ph.D., Director of Public Affairs, Boeing Commercial Airplane Group, Beijing, 14 August 1997.

with less restrictive policies. The Boeing officials cautioned members of the delegation that, as staff for U.S. policymakers, they should recognize that export control policies do not just affect the United States domestically, but have a wider impact outside of U.S. borders, which may significantly affect U.S. business interests.<sup>28</sup>

But several members of the U.S. delegation countered that what may be best for U.S. multinational corporations may not always be best for U.S. national interests. While recognizing the challenges of doing business in a country like China, they contended that every country has export controls that would extend to important commercial technologies and dual-use commodities. Nor, some in the delegation argued, should the United States encourage technology transfer while serious trade, employment, and security issues between the two nations have not been resolved.

### **Xi'an (August 15<sup>th</sup> - 17<sup>th</sup>)**

The congressional group spent several days in the city of Xi'an in the Shaanxi province. This part of the trip provided members of the group the opportunity to visit a high technology center, engage in discussions on current agricultural standards issues, and visit many cultural and historical sites in the region.

#### **High Technology Center**

The U.S. group made a brief visit to the Xi'an High-Technology Center. The high technology center, formed in 1991, is a complex of buildings that serves many purposes. Office and research space are rented out to entrepreneurs who are seeking to develop new innovative ideas or to commercialize scientific inventions. It is also a site for joint ventures and direct foreign investment. Since 1991, nearly 300 high technology joint ventures have begun at the Xi'an high technology center.<sup>29</sup> Upon completion of the entire high technology center early in the next century, supporters of the center expect 2,000 high technology enterprises to be housed in over a dozen buildings.<sup>30</sup>

The high technology center is also part of a larger high technology development plan to establish a high technology zone in the Shaanxi province. According to the managers of this high technology center, China now has 52 state-level high technology zones. The Xi'an high technology zone is intended to become the Chinese high technology version of Silicon Valley or Research Triangle (in North Carolina). To that end, the provincial government has established strong ties with local universities and colleges to draw upon students with backgrounds in science,

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<sup>28</sup>Ibid.

<sup>29</sup>Discussions with Zhang Dongfan, Vice Executive Director, The Administrative Committee on Xi'an High-Tech Industries Zone, Xi'an, 15 August 1997.

<sup>30</sup>Ibid. While construction of the high technology center began shortly after its creation in 1991, only approximately one-third of its facilities were completed by August 1997.



engineering, and related technical education. The provincial government also provides preferential treatment for newly formed firms at the center.<sup>31</sup>

The Xi'an high technology center appears to have potential in a region where there has been little high technology development and economic growth. The center and zone are both intended to attract companies in telecommunications, electronics, advanced materials and other high growth fields. However, it was unclear whether any new products or commercial innovations had come out of the Xi'an high technology center by August 1997. It is also unclear whether this type of state-directed high technology program will provide the type of innovative and entrepreneurial technology development and commercialization its leaders have set as the region's goal.

## **Agriculture Exports and Sanitary Standards**

The issue of agriculture trade between the United States and China was discussed several times during this trip. Because the Shaanxi province is a farming region, Sino-American discussions on this part of the trip often addressed both opportunities and problems of agricultural trade between the two countries.<sup>32</sup>

According to the Foreign Agricultural Service (FAS) of the U.S. Department of Agriculture, China's large and growing population is driving a greater need for wheat, coarse grain, corn, and other agricultural goods. Domestic production of agricultural products, while expanding rapidly, cannot meet the needs of a population now at 1.2 billion. For example, for corn, production is being used to meet increased domestic consumption and is not exported.<sup>33</sup>

China is an important market for U.S. agricultural exports. In 1996, the United States exported \$2.092 billion in agricultural goods to China. (In the same year, the United States imported \$597 million in agricultural goods from China). Through 1997, the United States had a surplus in agricultural trade with China for nine of ten years. The most important agricultural exports to China are wheat and cotton, which in 1996 together accounted for 56% of U.S. agricultural exports to China. However, these export levels for specific commodities can vary greatly from year to year. For example, the United States exported \$1.1 billion in wheat to China in 1989; in 1990, exports of U.S. wheat to China was \$497 million.<sup>34</sup>

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<sup>31</sup>Ibid.

<sup>32</sup>Shaanxi is not the largest farming region in China, however. The Shandong province is a leading producer of wheat and corn, and other provinces with large agricultural interests include Henan, Hebei, and Sichuan.

<sup>33</sup>William Brant, Minister-Counselor, Office of Agricultural Affairs, "The Chinese Market for U.S. Agriculture," [Overview], Department of Agriculture: Foreign Agricultural Service, 1997.

<sup>34</sup>Congressional Research Service, *The Market in China for U.S. Agricultural Exports*, by (name redacted) and (name redacted), CRS 97-807, 27 August 1997, p. 1-2.

An important part of the U.S.-PRC relationship is a 1992 Memorandum of Understanding (MOU) that included terms to standardize import-export policies and to reduce tariff and non-tariff barriers. Part of the MOU included an agreement that China would use more rigorous scientific measurements for evaluating the sanitary and phytosanitary standards of imported agricultural commodities. However, the U.S. Trade Representative has concluded that China's phytosanitary standards are "often overly strict, unevenly applied, and not backed by modern laboratory techniques."<sup>35</sup>

China's use of sanitary and phytosanitary standards<sup>36</sup> to restrict U.S. imports, particularly that of wheat, was discussed. Some Chinese and Americans expressed a belief that China and the United States can find a common ground in their bilateral agricultural policy. Some members of the U.S. delegation, especially those from rural states, stressed the importance of increasing U.S. agricultural exports to China as a way of improving relations between the two nations. China continues to indicate that it is receptive to increasing its agricultural trade with the United States, but has linked that action with obtaining MFN status with the United States, and eventual membership into the WTO.<sup>37</sup>

## Political and Cultural History

The visit to Xi'an included several visits to museums, ancient burial grounds, temples, and other historical sites. It provided members of the delegation an opportunity to better understand the political and cultural history of China, and to better comprehend the enormous size, scope, and diversity of the nation.

One of the most important cultural and historical lessons learned during this part of the trip was that China's long history has been marked by periods of unity and disunity, in which imperialism and autocracy brought together disparate groups interspersed by periods of separatism and provincial discord. For some Chinese policymakers and foreign Sinologists, this history provides a cautionary note that political, cultural, and ethnic ties which appear to unite China today may be more tenuous than viewed from the outside.<sup>38</sup>

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<sup>35</sup>Office of the U.S. Trade Representative, *1998 National Trade Estimates Report*, p. 50.

<sup>36</sup>Sanitary (human and animal health) and phytosanitary (plant health) measures are laws, decrees, standards, regulations, guidelines, and procedures that protect human, animal, or plant life and health primarily from risks arising from additives, contaminants, toxins, pests, or diseases in foods, animals, or plants. See: Congressional Research Service, *Sanitary and Phytosanitary Safety Standards for Foods in the GATT Uruguay Round Accords*, by (name redacted), CRS Report 94-512, 21 June 1994, 30 pages.

<sup>37</sup>William Brant, Minister-Counselor, Office of Agricultural Affairs, "The Chinese Market for U.S. Agriculture," [Overview], Department of Agriculture, Foreign Agricultural Service, 1997. The problem of differing U.S. and Chinese sanitary and phytosanitary policies also was discussed by William C. McCahill, Jr. Deputy Chief of Mission. Department of State, Beijing, 16 August 1997.

<sup>38</sup>Emily MacFarquhar, "Back to the Future in China," *U.S. News and World Report*, 12 March 1990, p. 40-48.

The city of Xi'an figures prominently in the earliest history of what is now China.<sup>39</sup> It was Qin Shi Huang Di (259-210 B.C.) who established the first unified imperial dynasty in China at Xi'an and ordered the creation of 6,000 life-sized terra cotta soldiers. Xi'an served as China's capital over 11 dynasties, from the Qin Dynasty and its successor, the Han Dynasty (206 B.C.-A.D. 220), to the Tang Dynasty (618-907).<sup>40</sup>

The region around Xi'an also became the crossroads for the development of several religious and philosophical tenets during the era of "The Hundred Schools of Thought" (approximately 400-200 B.C.). Among the first of the philosophies developed was Confucianism, a philosophy adapted by a scholar who sought to create a social and political ideal unifying the Chinese people. This system prescribed a series of orderly relationships within a society ("Let the ruler be a ruler and the subject a subject") based on ethical relationships and moral good.<sup>41</sup>

Chinese Legalism, also known as the School of Law, was diametrically opposed to Confucian thought, and vied for followers during this period. It was a philosophy based on authoritarian control of government, not ethical or moral persuasion. Legalists exalted the state and sought prosperity and marital prowess above the welfare of the common people. During the Han Dynasty, the tenets of Confucianism and Legalism were combined to create a working imperial form of government. The tension inherent in these two philosophies of the "Rule of Man" versus the "Rule of Law" approach to government is still evident in modern China.<sup>42</sup>

## **Shanghai (August 18<sup>th</sup> - 21<sup>st</sup>)**

Shanghai is one of the most rapidly growing cities in China, with a 1997 population of 14.7 million, the fifth largest in the world.<sup>43</sup> It was the first Chinese city opened to western trade (1842), and at the beginning of the 20<sup>th</sup> century became China's largest industrial center. Although closed off from western interaction after 1949, it retained its lead as China's center for industrial, scientific, and technological development for nearly fifty years. Since normalization of relations with most of the West since the late 1970s, issues involving Shanghai's development are technology and capital formation, the role of state-owned-enterprises (SOEs) and multinational enterprises (MNEs), and telecommunications and Internet development.<sup>44</sup>

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<sup>39</sup>Library of Congress, Federal Research Division, *China: A Country Study*, by Robert L. Worden, Andrea Matles Savada, and Robert E. Dolan, editors, July 1987, p. 5.

<sup>40</sup>J.D. Brown, "Chinese City in Transition," *The New York Times*, 14 March 1994.

<sup>41</sup>Library of Congress, Federal Research Division, *China: A Country Study*, by Robert L. Worden, Andrea Matles Savada, and Robert E. Dolan, editors, July 1987, p.7-10..

<sup>42</sup>Ibid.

<sup>43</sup>Its population by 2015 is expected to be 23.4 million.

<sup>44</sup>*The World Almanac and Book of Facts*, World Almanac Books, 1997, p. 838, and *The New Encyclopaedia Britannica*, v. 27, 1997, p. 284-288.

## Technology and Capital Formation

Shanghai has three major districts: central Shanghai, which consists of the oldest part of the city; the large agricultural areas of the rural hinterlands forming the edge of the metropolitan area; and the transitional zones in between the two. The Pudong district is one such transitional zone, and is home to a science and technology park as well as several public and private research and development centers.

The Shanghai (Z.J.) Hi-Tech Park was created in 1992 as the first step of a larger “technopolis” encompassing most of the Pudong district of Shanghai. As with its counterpart in Xi’an, the Shanghai (Z.J.) Hi-Tech Park, when completed, will be impressive in size and scope. It will cover 17 square kilometers and employ over 10,000 scientists, engineers and researchers.<sup>45</sup> The main purpose of the park is to encourage foreign investment and joint ventures in research and development (R&D). A preferential tax policy for foreign firms locating in this park was outlined by officials at the park. This includes tax moratoria and holidays for long-term R&D investment by foreign firms.<sup>46</sup>

While the official emphasis at Shanghai (Z.J.) Hi-Tech Park is to encourage domestic and foreign private sector investment, it was clear that American and Chinese interpretations of how to implement this policy differed. Chinese officials at the park were asked by members of the U.S. delegation what could be done to further encourage U.S. high technology firms to consider Shanghai (Z.J.) Hi-Tech Park for R&D joint ventures. The Chinese officials responded that the U.S. government should lead companies to Shanghai, and it should be U.S. public policy to interest U.S. firms in relocating to the park. Even when members of the delegation explained that this is not an appropriate role for government in the American context, the Chinese position remained unchanged.<sup>47</sup>

The issue of attracting foreign investment for technology development also was central to discussions with representatives of the U.S. insurance firm American International Group/American International Assurance Co., Ltd. (AIG/AIA). Representatives from this company stated how difficult it is to sell insurance and other forms of financial instruments in Shanghai and the rest of China. They contended that many Chinese still have a strong suspicion of foreign financial companies, and that life and property insurance are new concepts for most Chinese. For many Chinese, the risk/reward for investment resides only with savings accounts in Chinese banks that pay very low interest rates. Representatives from AIG/AIA indicated that further industrialization and technology development and commercialization may be hindered if Chinese capital is not invested more constructively.<sup>48</sup>

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<sup>45</sup>*Investment Guide*, Shanghai (J.Z.) Hi-Tech Park, [English version] 1997, 19 pages.

<sup>46</sup>Discussions with Honglian Hu, Vice President, Z.J. Hi-Tech Park, and Shirley Zhao, Sales and Marketing, Z.J. Hi-Tech Park Development, Shanghai, 19 August 1997.

<sup>47</sup>*Ibid.*

<sup>48</sup>Of course, their view of “more constructive” capital investments would be through their  
(continued...)

One source of investment capital for technology development and commercialization may be the Shanghai Stock Exchange. Created in 1990 with just eight companies publicly traded, the Shanghai Stock Exchange had 628 members by August 1997, with over half of those firms issuing two forms of stock.<sup>49</sup> However, it was unclear from discussions how much of the investment in the Shanghai Exchange was used for capital investment in Shanghai as opposed to being secondary market transactions among buyers and sellers. When asked about this, Chinese officials contended that while there will always be some speculative money, most of the investment was sound. As proof, they indicated that as of August 1997 neither the Shanghai Exchange nor China as a whole was affected by the economic downturn which had begun in Indonesia, Korea, and Japan.<sup>50</sup>

## SOEs and MNEs

State-owned-enterprises (SOEs) are those companies started, managed, and supported by the Chinese government. Multinational enterprises (MNEs) are mostly foreign firms, independent of government control, that have established production, sales, and/or R&D in China. In Shanghai, the congressional staff delegation met representatives from General Motors (GM) and Nike Sports Company, Ltd., two U.S. MNEs. The delegation found:

- ! At GM China Inc., there is a complex relationship between GM, the central government in Beijing, the Shanghai provincial government, Chinese suppliers, several Chinese SOE auto manufacturers, and other foreign auto firms competing in China. For GM, having to work with so many disparate interests was inefficient and uneconomical. To address this problem, GM provides 50% funding for the Shanghai Automotive Industry Group (SAIG), a joint venture automobile manufacturing facility with the Shanghai provincial government. This provides GM with a single Chinese-affiliated entity with which to do business.<sup>51</sup>
- ! Nike's Shanghai branch office represents the company's sales and marketing interests in China. This operation began in 1984, and every year since, Nike

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<sup>48</sup>(...continued)

company's investment instruments. Discussions with Bethy Wu, Assistant Manager, Human Resources Department, AIG/AIA; Jacob N.K. Wong, Deputy General Manager, Administration, AIG/AIA; Daniel C. Zhou, Accident and Health Manager, AIG/AIA, Shanghai, 19 August 1997.

<sup>49</sup>These are "A" shares, which are primary shares in a company, and "B" shares, which are somewhat like convertible stock in the United States. Discussions with Dr. Hio Rio Yin, Vice Director, Development and Research Centre, Shanghai Stock Exchange and Li Qian, Director of Public Relations, President's Office, Shanghai Stock Exchange, Shanghai, 20 August 1997.

<sup>50</sup>Ibid.

<sup>51</sup>Discussions with John Wilson, Attorney, General Motors Overseas Corporation; William J. Barclay, Executive Director of Finance, GM China Inc., Shanghai Automotive Operations, and Sherrie Childers, Manager, Public affairs, GM China Inc., Shanghai Automotive Operations, Shanghai, 19 August 1997.

has lost money, including \$9 million in 1996. However, company representatives stated that Nike is committed to long-term business growth in the PRC. The biggest problem facing this U.S. company is protection of intellectual property rights against piracy, and what they described as the PRC's bureaucratic and often corrupt distribution system for their goods.<sup>52</sup>

In Shanghai, as elsewhere on this trip, there were indications that China is going through a difficult era of privatization as it tries to reduce or eliminate its SOEs. However, if the Chinese government removes all support for these firms, most will not be able to compete. The potential for large scale unemployment if workers from Chinese SOEs cannot find work elsewhere is a major concern for China. As of August 1997, there already was some indication of worker displacement and massive shifts of population as China tries to address issues of privatization and free enterprise.<sup>53</sup>

### **Telecommunications and the Internet**

Shanghai also was representative of the great growth in telecommunications infrastructure, applications, and services in China. There was evidence in central Shanghai and Pudong of long lines of fiber optic cable, new satellite dishes on buildings, and construction of terrestrial communications relay towers. The Shanghai Stock Exchange had just recently been completely rewired for global trading.

In the rest of China, there has been an explosion of telecommunications technologies and applications. This has been most evident in the growth of the Internet in China. In 1993, only about 20,000 Chinese had access to the Internet. By the time of the delegation's trip, that figure was about 250,000. In 1998, it is over 600,000. Chinese officials forecast that the number of Internet users in China will be two million by 2000, and seven million by 2001.<sup>54</sup>

One of the impacts of this growth in Internet use is its effect on the global economy. From discussions with U.S. business representatives in Shanghai, education and training of Chinese students in computer science and related fields represents one of the most popular areas of academic study.<sup>55</sup> These students are just beginning to enter the workforce. One expert describes many of the new information technology and service workers as "virtual aliens." Instead of making high-level professional wages as they would in the United States, these information technology

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<sup>52</sup>Discussions with Harry Johnson, General Manager, Nike Sports Company Ltd., Shanghai Branch Office; Frank Chen, Marketing Director, Nike Sports Company Ltd; and Martha Benson, Director of Communications/Asia Pacific, Nike International Ltd., Shanghai, 20 August 1997.

<sup>53</sup>Discussions with Yang Guoqiang, Deputy Director-General, Foreign Affairs Office, Shanghai Municipality, Shanghai, 19 August 1997.

<sup>54</sup>"China and the Internet," *Reuters*, <http://www.nuia.ie/surveys/index.cgi?service>.

<sup>55</sup>Discussions with Bethy Wu, Assistant Manager, Human Resources Department, AIG/AIA.; Jacob N.K. Wong, Deputy General Manager, Administration, AIG/AIA; Daniel C. Zhou, Accident and Health Manager, AIG/AIA, Shanghai, 19 August 1997.

workers are employed by U.S. companies at a much lower wage than comparable U.S. workers. They have been characterized as “virtually” U.S. employees for a U.S. company; “fully networked and employed as members of the U.S. economy, they don’t pay U.S. taxes and may never even have visited the United States.”<sup>56</sup>

But the Internet does not yet represent a total communications revolution in China. In a country of 1.2 billion people, 0.4% of households reportedly have personal computers.<sup>57</sup> Most Chinese citizens are unlikely to have access to computers and global communications networks well into the next century. Even telephones, while becoming more common, reach about 6% of the population.<sup>58</sup> It also is unclear whether China’s official policies toward Internet use and communications will permit this growth or have to change because of it. In 1996, a law was passed requiring all Chinese who use the Internet to register with Beijing. China’s official policy on the Internet continues to restrict its access and use by ordinary citizens.

## **Hong Kong (August 22<sup>nd</sup> and 23<sup>rd</sup>)**

The last part of the trip consisted of one full day of meetings in Hong Kong. Discussions focused mainly on the impact of the turnover of Hong Kong from British to Chinese rule. Other points of discussion included political freedom and territorial sovereignty.

### **Hong Kong After July 1, 1997**

At midnight, June 30, 1997 Hong Kong reverted to Chinese sovereignty, after 150 years of British rule. The transfer of power was the result of a 1984 Sino-British Joint Declaration which established a “one country, two systems” principle of transfer. The PRC has pledged to leave in place Hong Kong’s open capitalist system for at least fifty more years.

On the surface, little seemed to have changed in Hong Kong in the nearly sixty days between the transfer and the delegation’s visit. Hong Kong has a population of 5.5 million, with a population density per square mile of 15,158.<sup>59</sup> It gave the appearance of continuing to be a thriving mercantile center and there was no civil disruption or interference with activities after the turnover. Most of the discussions

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<sup>56</sup>Dan Tapscott, *The Digital Economy: Promise and Peril in the Age of Networked Intelligence*, New York: McGraw-Hill, 1997, p. 5.

<sup>57</sup>In the United States, it is 40%. Mark Landler, “Hong Kong Tycoon Seeks Internet Success,” *The New York Times*, 13 April 1998, <http://www.nytimes.com>.

<sup>58</sup>Karl Gude and Silvio da Silva, “China by the Numbers: Portrait of a Nation,” *Newsweek*, 29 June 1998, p. 24. In the United States, about 94% of the population has direct access to telephones.

<sup>59</sup>In the United States, population per square mile is 75; in the rest of the PRC, it is 327, Anna Kuchment, “For Richer or Poorer. . .” *Newsweek*, 19 May 1997, p. 40.

we had with both Hong Kong natives and American business leaders expressed continued confidence in Hong Kong's growth and prosperity.<sup>60</sup>

## Political Freedom<sup>61</sup>

Many leaders in Hong Kong acknowledged that a very important question will be answered over the next several years: can the Hong Kong which they have known survive as a part of China? While economic conditions are somewhat guaranteed, can the same be said for political freedom and protection of individual rights?<sup>62</sup>

Interestingly, for many long-time residents of Hong Kong, democratic ideals of political freedom and protection of individual rights have come somewhat late in Hong Kong's history. Many natives of Hong Kong were disenfranchised during most of the British rule, and Chinese resentment over foreign rule was strong even at the time of the turnover. Still, some would argue that real power in Hong Kong resides in the marketplace, and not in legislative bodies.<sup>63</sup>

As of August 1997, most Hong Kong observers with whom we met said that they expected a smooth transition as the Provisional Legislative Council ("Legco"), appointed on July 1, 1997, by Beijing, is replaced by one elected more directly (elections were scheduled for May 28, 1998). Elections for Legco only began to be held in 1985, with the first wholly-elected Legco not occurring until 1995. These elections were based on a "20-30-10" formula of geographic representation (direct elections), functional representation (with elected slots determined by occupation and position in society), and by an appointed election committee.<sup>64</sup>

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<sup>60</sup>One interesting note occurred during a talk with the head of Hong Kong's Futures Commodities Exchange. He was asked what he thought of the possible speculative nature of global financial markets, and with forty years of experience in finance and investing, what would be his advice to U.S. stock investors. His reply: "Get out (of the U.S. stock market) now." Discussion with Ivers Riley, Chief Executive Officer, Hong Kong Futures Exchange Ltd., Hong Kong, 22 August 1997. [The S&P 500 has increased 25% since that time.]

<sup>61</sup>The group did not meet with Martin Lee or with any of the members of the Pro-Democracy movement.

<sup>62</sup>Discussions in individual meetings with Dr. Patrick Leung, Chairman, Vision 2047 Foundation, Hong Kong; Arthur NG Sek-hon, Deputy Secretary for Constitutional Affairs, Hong Kong; and Nellie K.M. Fong, Chairwoman, Executive Committee, Better Hong Kong Foundation, 22 August 1997.

<sup>63</sup>Discussions in individual meetings with Arthur NG Sek-hon, Deputy Secretary for Constitutional Affairs, Hong Kong, and Mr. Richard Margolis, First Vice President, Equity, Merrill Lynch, Member, Vision 2047 Foundation, 22 August 1997.

<sup>64</sup>British officials hoped this 1995 Legco could serve through the 1997 transition — a concept called "through train." But the Chinese government dissolved the 1995 Legco shortly after the turnover and crafted new electoral rules for elections to be held in 1998. However, the new rules still allow for the "20-30-10" formula. See: Congressional Research Service, *Hong Kong's "Provisional Legislature Controversy"* by (name redacted), CRS Report 97-557, 10 pages.



Several Hong Kong legal experts contended that among the many implications of this change in electoral representation Hong Kong's "Rule of Law" will influence or supplant the "Rule of Man" tradition in China. They stated that despite British occupancy—or perhaps because of it—Hong Kong has enjoyed a very clear and concrete legal system. Therefore, China, with its history of autocratic rule in Beijing and interests of provincial party officials, has had a history of "Rule of Man," in which the mandate of an individual or the party may supersede legalisms.<sup>65</sup>

The answer of which system will emerge as Hong Kong is assimilated into China is still unknown. U.S. officials generally viewed the developments post-July 1, 1997 with optimism tinged with realism. Some Hong Kong officials contended that difficult issues, such as protection of foreign intellectual property rights (patents, copyrights, and trademarks), abused in both Hong Kong and China, may be resolved under a unified "Rule of Law." Yet, some in Hong Kong stated that, conversely, freedom of the press and free speech may be curtailed if a Beijing "Rule of Man" is extended to Hong Kong. Chinese and American observers commented that even a third scenario, which involves a compromise of both the "Rule of Law" and "Rule of Man," may create a peaceful, if uneasy, coexistence, between Hong Kong and the rest of China.<sup>66</sup>

### **Territorial Sovereignty<sup>67</sup>**

Many residents and observers in Hong Kong which the delegation met with expressed great confidence (although mixed with some concern) that Hong Kong will essentially retain its unique character. In several meetings, the issue was not whether China will influence, and therefore change, Hong Kong; but how much Hong Kong's unique mix of economic, trade, political, and democratic characteristics may change China.

The future of Hong Kong also involves larger issues of Chinese territorial sovereignty in the Asia Pacific region. Hong Kong has served as a gateway for much of China, and therefore can be seen as an aperture through which technology, trade, and security issues flow. As part of an experiment in "one country, two systems," the Chinese appear anxious to demonstrate that it can successfully and peacefully complete Hong Kong's transition. Still, it was also very clear that many Chinese now view Hong Kong as a domestic issue, and no longer subject to outside interference.

For many Chinese officials, if Hong Kong can be successfully adopted into China's national political and economic system, then the next goal would be to look

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<sup>65</sup>Discussions with Daniel R. Fung, Solicitor General, Department of Justice, Hong Kong, 22 August 1997, See also: Bruce Einhorn, "Hong Kong: Now the Rule of Law is in Jeopardy," *BusinessWeek*, 20 April 1998.

<sup>66</sup>Discussions in individual meetings with Richard Boucher, Counsel General, American Consulate General, Hong Kong, and Professor Ng Ching Fai, Provisional Legislative Councilor, Hong Kong, and Dr. Wong King Keung, Former Preparatory Committee Member, Hong Kong, 21 August 1997.

<sup>67</sup>The following issues, while described as part of the Hong Kong turnover, were also a part of almost every discussion during the two weeks the delegation was in China.

towards Taiwan and apply the “one country, two systems” policy there as well. To some, Taiwan’s absorption into China is inevitable, and would have already occurred without an American presence. U.S. technology, trade, and security policies toward Taiwan are an irritant to the Chinese. They contend that U.S. support of Taiwan interferes with China’s domestic policy of reunification. The U.S. delegation generally pressed for greater dialogue (and change) in U.S.-PRC technology, trade, and security policies; many Chinese officials in turn addressed U.S. policy towards Taiwan as the major obstacle for improving relations.<sup>68</sup>

## **Epilogue: Developments Since August 1997**

U.S.-Chinese relations since August 1997 appear to follow the old Chinese proverb (both a blessing and a curse): “May you live in interesting times.” A variety of technology, trade, and security, as well as other economic and political issues, remain at the forefront of the U.S.-PRC relationship. The following developments are among the highlights of this changing relationship.

In September 1997, the Chinese People’s Congress met to elect party officials and to set national policies for the next year. President Jiang Zemin was expected by some to emerge from the congress much weaker in power and with his economic reform policies greatly diluted. However, according to some observers, Jiang was able to handle internal party factions and avoided open confrontation from both hard-line conservatives and liberal reformers.<sup>69</sup>

During the fall of 1997, the “Asian contagion” of falling currency valuations in Indonesia and Thailand spread to Korea and affected other nations like Japan and China as well. In China, the economic downturn came at a time when official Chinese policy encouraged the privatization or dismantling of many SOEs considered to be inefficient or inoperative. The impact on unemployment was fairly severe, causing disruptions in the workforce. As currencies in several nations were devalued, many U.S. multinational corporations reported that their earnings, some based in large part on overseas sales, would be adversely affected.<sup>70</sup>

In October, President Jiang Zemin visited the United States to meet with President Clinton. President Jiang signed an order for the Chinese government to buy fifty Boeing aircraft for \$3 billion. Presidents Jiang and Clinton also agreed that in exchange for China’s promise to limit nuclear trade with rogue states, the United States would lift a U.S. ban of non-military nuclear technology. President Clinton described it as a “win, win, win” situation for U.S. technology, trade, and security

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<sup>68</sup>Another territorial issue was Tibet, which came up infrequently during discussions. Most Chinese officials we met consider Tibet to be a purely internal matter. The U.S. delegation did not raise it often, and when the issue of hegemony over Tibet was raised, most Chinese had very little to say about the situation.

<sup>69</sup>“Out of the Shadow of Deng,” *The Economist*, 20 September 1997: 39-40.

<sup>70</sup>“Will the World Slump?” *The Economist*, 15 November 1997: 15; 19-21; 77; and “A Lorry-Load of Trouble in Asia,” *The Economist*, 6 December 1997: 65-66.

objectives; critics contended that there was no enforcement in the agreement for China to honor its commitments.<sup>71</sup>

In December, in Kyoto Japan, a United Nations summit on global climate change focused attention on what could be done to reduce emissions of so-called “greenhouse gasses” that are thought to be warming global climate. The Kyoto Protocol was considered controversial because it failed to set commitments for developing countries — including China — to reduce greenhouse gas emissions that other signatories would have to meet. These commitments had been requested by President Clinton and by the U.S. Senate in S.Res. 98 (approved 95-0 on July 25, 1997).<sup>72</sup>

Also in December, elections were held in Hong Kong. China reported that the voting was direct and open, resulting in the election of 36 deputies to sit in the National People’s Congress. However, others contended that most of the elected deputies were Beijing party faithful, selected by a small core of 424 “qualified” delegates in Hong Kong.<sup>73</sup> Elsewhere, Chinese territorial policies continued to raise western concerns. Tensions between China and Taiwan were heightened after Taiwan reaffirmed its independent status. In the far western province of Xinjiang, over a million troops were dispatched to quell a separatist movement.

For the first quarter of 1998, the Department of Commerce reported that the U.S. trade deficit with China was about \$11.5 billion. This represents an increase of 19% over the first quarter of 1997. At this rate, the U.S. 1998 trade deficit with China would exceed 1997, and could possibly pass the trade deficit the United States currently has with Japan. However, the United States continues to run a surplus in agricultural trade with China, with preliminary figures indicating that most agricultural trade with China is ahead of 1997 trade.<sup>74</sup>

In 1998, proliferation in the Asian region became a global concern. In May, India conducted five nuclear tests and Pakistan responded by detonating nuclear devices of its own. The nuclear tests increased tensions between two nations that have fought three wars in the last fifty years. In announcing his country’s successful nuclear test, Pakistani President Sharif publicly thanked China for making its nuclear technology available.<sup>75</sup>

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<sup>71</sup>“Jian Zemin’s Visit: Trick or Treat?” *The Economist*, 1 November 1997: 26-27.

<sup>72</sup>Given these developments, there is little prospect at present that the Senate will give its advice and consent to ratification; consequently, the Administration is not expected to send the protocol to the Senate in 1998. Congressional Research Service, *Global Climate Change*, (name redacted) and John R. Justus, IB89005 [updated regularly].

<sup>73</sup>“Rotten Boroughs,” *The Economist*, 13 December 1997.

<sup>74</sup>Department of Commerce, Bureau of the Census, *The World Trade Atlas*, (Provided by (name redacted), Congressional Reference Division Library of Congress).

<sup>75</sup>Michael Hirsh and John Barry, “Nuclear Jitters,” *Newsweek*, 8 June 1998: 22-27 and “Asia’s Shockwaves,” *The Economist*, 16 May 1998: 15-16. See also: Congressional Research Service, *India-Pakistan Nuclear Tests and U.S. Response*, by (name redacted),

Tensions between the United States and China over technology transfer also extended to several commercial and dual-use technologies. A series of news stories and government reports in the spring of 1998 indicated that several U.S. firms may have improperly or illegally shared technology and information with Chinese scientists and engineers. The 105<sup>th</sup> Congress began a series of hearings on U.S. export control policies and possible Chinese violations of U.S. national security laws in obtaining satellite, machine tool, and supercomputer technologies.<sup>76</sup>

Against this backdrop, President Clinton visited China in late June 1998. The President visited Xi'an, Beijing, Shanghai, and Hong Kong during his two week visit. Addressing issues of political freedom and freedom of speech, he condemned the Tiananmen Square incident of 1989 and called for more democratic reforms in China. He also vowed to improve trade and other economic ties between the United States and China. President Clinton expressed support of China's "one nation, two systems" approach while in Hong Kong and stated that the United States would not support Taiwan's independence. In turn, the Chinese government announced that it would agree to a framework agreement to better control the unauthorized use of technology exported from the United States to China.

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<sup>75</sup>(...continued)

(name redacted), Jonathan Medalia, and Dianne Rennack.

<sup>76</sup>Congressional Research Service, *Space Launch Vehicles: Government Requirements and Commercial Competition*, by (name redacted), IB93062 [updated regularly]; (name redacted), *China: Possible Missile Technology Transfers from U.S. Satellite Export Policy—Background and Chronology*, CRS Report 98-485, 20 May 1998, 20 pages; and (name redacted), *China's Economic Conditions*, IB98014 [updated regularly].

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