Chapter-V

Negotiating Trade and Non-Trade Issues in Sino-U.S. Diplomacy
Overview

Trade and business diplomacy, generally less contentious than its political or strategic cousins, could serve as a leading edge to stabilise U.S. bilateral relations with China. To do so, however, the different issues showering in U.S.-China commercial relations must first be managed. These issues are driven by the uniquely American practice of linking noncommercial objectives to trade and business objectives and to trade and business policies and by the age-old Chinese tactic of holding business to political interests. It is indeed in the interest of both the countries to manage the relationship effectively in order to gain steadily from the ongoing bilateral trade and business.

The United States’ approach has been to comprehensively engage China for its own economic and security interests. Matrice R. Greenberg, Chairman and CEO of American International Group, while testifying before congress was of the opinion that, “Even at the height of Cold War with the Soviet Union, we had a functional framework designed to support a workable relationship. While we had frequent disagreements, they were contained, and not allowed to define the entire relationship and prevent constructive interaction. We should engage China on a broad strategic basis, and not let our differences on individual issues distort the opportunity to accomplish our broad strategic objectives.” On the other side, China is also increasingly engaging herself bilaterally with United States for furtherance of its’ trade and economic interests.

It is being viewed that, despite the differences and disagreements over many issues between the United States and China, there are areas in which the two countries have cooperated. There is one thing that stands out with stunning

clarity: the mutual interest in preserving and expanding the bilateral economic relationship. The bedrock of the U.S.-China relationship in today's new globalised era is economic. It is quite unlike the way the U.S.-China normalisation began in the early 1970's.

It has become nearly a truism to say that in the 1970s and 1980s, the United States and the PRC developed cooperative relationships in order to enhance their security against the threat to both from the erstwhile Soviet Union. Initiating and sustaining cooperation is never easy, because it not only requires that both sides have common interests but also requires that their conflicts of interests be either insignificant or manageable. More often than not, there are significant preexisting and ongoing bilateral conflicts, so that establishing and sustaining cooperation requires mutual adjustment and extensive negotiations. Cooperation is neither spontaneous nor self-perpetuating. Maintaining cooperative relations requires considerable effort by both parties. Establishing and maintaining cooperation entails a cost, insofar as coping with an immediate and significant threat upon requires that other objectives go unrealised. In these circumstances, the underlying issue requiring negotiation in all operative relationships is how to distribute the burden of cooperation. Throughout these years of U.S.-PRC relationship, the burden of cooperation gradually and significantly shifted. Despite Washington's effort to maintain the status quo, Chinese leaders managed to consolidate various aspects of U.S.-PRC relations and have succeeded in imposing upon the United States a larger share of burden of cooperation.

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5 Robert S. Ross, op. cit. no. 3, p. 2
In the beginning of United States and PRC rapprochement in the early 1970, there was no way to predict what compromises the US would have to make, and what costs Beijing would have to endure in order for the two sides to develop cooperative relations over the ensuing almost three decades. Similarly, there was no way to predict in 1970 how much cooperation would develop, it was not inevitable that the two sides would be able to manage their conflicts well enough to develop cooperative military, economic and educational ties by the 1980s. Instead, the course of U.S.-PRC negotiations was shaped by a number of factors that interacted in different ways at different times to produce various periods during the era of cooperation, each characterised by distinct negotiating dynamics, and to create the ultimate distribution of the cost of cooperation at the end of three decades.

Issues, which are plaguing the bilateral relationship, are of different nature and measures. These can be broadly categorised into trade and non-trade issues. Trade and business issues encompass most-favoured-nation (MFN)/permanent normal trade relations (PNTR) status, intellectual property rights, trade barriers, China’s accession to WTO, China’s economy etc. Whereas the non-trade issue covers the sovereignty, human rights, environmental as well as the security aspects of the bilateral relationship.

5.1 Trade and Business Issues

5.1.1 Bilateral Trade Imbalance

The growing Sino-U.S. trade has brought one discomforting feature into their bilateral trade relations. The growing trade deficit of U.S. with China since

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6 ibid.
late 1980s has become an increasingly important issue for both nations. Although initially trivial in size, the deficit has grown rapidly during these years. The US Department of Commerce data in the following figure 5.1 shows the growing bilateral trade imbalance.

**Figure 5.1**

**United States-China Trade Balance (1978-1999)**

Source: U.S. Department of Commerce

From the above figure it shows that, in 1999, the US merchandise trade deficit with China was $68.7 billion, an increase of $29.2 billion from 1996, and an approximate 60% increase since 1996, when the merchandise trade deficit with China stood at $39.5 billion. China has marked 12th straight annual increase in the deficit with the US.

The US Department of Commerce reported that the floods of Chinese clothing, shoes, and toys are main contributors to this growing trade gap.

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7 Source: U.S. Department of Commerce.
8 Ibid.
However, at present the US FDI flows to China as well as the service trade with China continue to increase.

**US Reactions**

US industry continues to express concerns over China's significant trade barriers. These barriers pertain to the high tariffs, non-trade barriers, non-transparent rules and regulations, ownership and distribution rights, lack of intellectual property rights protection, restrictions on services and investment restrictions. US parties assert that China is seeking to build international competitiveness by protecting various sectors.

The US government had been complaining that China's lack of market access and transparency hurts the US and was doing very little to change the situation. For these reasons, the United States continued to block China's entry into the WTO, and to impose trade sanctions on some Chinese products. These Chinese trade and investment barriers have been negotiated between the two countries in the bilateral WTO accession agreement of November 1999.

On the other hand, China maintained restrictive import policies, such as high tariffs and taxes. Although China reduced tariffs several times in 1990s most of the tariff reductions have been on low volume imports. The Chinese government determines the level of import flows through licenses, quotas, and other non-tariff measures, such as the "automatic" registration requirements, electromechanical product import control measures, regulations on the administration of medical equipment, and camera import control measures.

However, China has increasingly strengthened the protection of foreign business under its legal system, and steadily improved its trade and investment
policy environment. It has negotiated a number of concessional measures with the United States in the bilateral WTO Accession Agreement of 1999.

**China Reactions**

China is aware of US concerns regarding the trade imbalance. This has been highlighted through commercial and diplomatic channels especially through the long-lasting negotiation process of its WTO entry. However, China is focusing on further reforms in several fields, such as state-owned enterprises (SOEs), and banking system reform. The process of more fully opening the Chinese economy will take a relatively long period. The Chinese government still has a long way to go to build the domestic economic and political basis for major liberalisation of its trade regime\(^9\).

With respect to the trade deficit issue, China argues that the US exaggerated the deficit figure and the US statistics are faulty. The US Department of Commerce figures overstates the trade deficit due to the ever-expanding role of Hong Kong as an entrepot in China trade\(^10\). For example, the average rate of value-adding of Chinese exports to the US via Hong Kong was around 50% in 1999, which was calculated as imports from China, and thus greatly over-calculated the US’s real import value from China. Therefore, the size of US trade deficit with China has been largely exaggerated. Meanwhile, China argues that US export controls against China are a major obstacle for US exports. For these reasons, China has tried to improve trade relations with other countries in the event of possible US trade sanctions.

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At the same time, it can be argued that, the trade deficit with China primarily reflects its openness to foreign investment, not unfair trading practices\(^{11}\). As a result of the liberalisation of its domestic economy, in recent years China has attracted about 40% of all foreign direct investment flowing to emerging markets. Foreign investors have moved facilities that produce footwear, garments, toys, sporting goods and other labor-intensive products to China to take advantage of cheap labor. These products also account for a large share of US imports from China. The growing deficit the United States has experienced in its trade with China, not surprisingly, has been accompanied by sharply declining deficits with Hong Kong, Taiwan, and Korea\(^{12}\). Thus, the argument that the growing deficit with China has caused a large loss of manufacturing jobs in the United States is inaccurate.

5.1.2 Most-Favored-Nation (MFN)/"Normal Trade Relations" (PNTR) Status

The most-favoured-nation status has long been used as the tool to monitor communist countries' economic activators in the world economy. In 1951, The Trade Agreements Suspension Act of the U.S. prohibited the MFN status to former Soviet Union and China\(^{13}\). In 1974, the Act was amended under the Jackson-Vanik amendment. Under the Jackson-Vanik Amendment to the Trade Act of 1974, most favored nation (MFN) status can be extended to nonmarket economies only if the President grants a waiver certifying that the country does not impede emigration policy\(^{14}\).

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\(^{11}\) Zhang, op.cit., no.9

\(^{12}\) Ibid.


\(^{14}\) Ibid,9
The annual renewal of China's MFN status had been a controversial irritant in U.S.-China relations. Each year by June 3, the President may recommend that Congress renew his authority to waive restrictions on China's MFN eligibility, thus effectively extending MFN status to China for another year. If recommended by the President, the renewal is automatic, and Congress need not act. The renewal can be blocked, however, by enactment of a joint resolution of disapproval within a specified time frame. Joint resolutions of disapproval have been introduced for China each year since 1990. Although none has passed both houses, the House has voted on joint resolutions each year, a total of eleven times. (The Senate has never had a recorded vote on a joint resolution of disapproval for China's trade status.) In fact, most of the debate about China's MFN eligibility since 1990 has involved separate legislation which would either place new conditions on China's MFN eligibility, or legislation addressing a range of contentious issues other than MFN.  

China was first awarded MFN status in 1980 under the U.S.-China Trade Agreement as a result of the 1979 formal normalisation agreement, and its annual renewal under Jackson-Vanik was routine until the Tiananmen Square incident of 1989. Sino-American trade and business relations suddenly burst into an all-round cooperation. According to a congressional hearing held in 1982, in 1981, Chinese representatives from the Shanghai Investment and Trust Corporation (SITCO) visited the U.S. Department of Commerce and the Chinese representatives of the International Trade Research Institute of the Ministry of

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16 Deng Xiaoping graciously offered to permit 10 million Chinese to emigrate to the United States, in order to prove there was no restriction on emigration. (As a point of reference, the Immigration and Naturalisation Service only allows 20,000 immigrants from any given country each year, although family members, political refugees, and some others may be exempted from this restriction.)
Foreign Trade paid a visit to study market research techniques. In essence, the national interests of the United States justified the grant of MFN status to those non-market economies. The hearing remarked:

"MFN status for Hungary, Romania, and China have served U.S. economic interests well and should continue to do so in future. Extension of the waiver authority under section 402 of the Trade Act for these countries is in our national interest. It will continue the development of our economic and commercial relations with these countries and support the expansion of our economic cooperation on a firm and enduring basis."

Since then the annual renewal has been a point of contention with a bipartisan Congressional coalition of anti-Communists, human rights proponents, and protectionists, attempting to use the threat of non-renewal as leverage to encourage human rights, discourage nuclear proliferation, promote open markets, and reduce the bilateral trade imbalance. President Clinton exacerbated this tendency, first by criticizing then-President Bush during the 1992 campaign, and then in 1993 by tying renewal of MFN explicitly to immediate improvements in human rights in China. The Executive Order signed by President Clinton in 1993 to extend MFN until 1994 included a list of human rights objectives as conditions for future renewal.

Renewal became highly controversial since Tiananmen because many congressmen and even the executive branch had come to view the threat of withdrawing China's MFN status in the US market as a major lever to encourage the Chinese government to improve human rights, to limit the spread

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18 Ibid., p. 97
of nuclear weapons, and to further open China’s market to US goods in order to reduce the large and growing bilateral trade imbalance\textsuperscript{19}.

In June 1991, a special hearing was organised by the Committee of Foreign Affairs on the issue of MFN status for China\textsuperscript{20}. Commercial as well as political policy, the MFN status with China, however, was strongly characterised by the facilitation of its influence to China to abide by the international rules. MFN, as “a key instrument of leverage with China” was embodied in the general framework of this policy\textsuperscript{21}.

Relations between the two countries continued to be rocky in most parts of the early 1990s. There were various cases of human rights violation by the Chinese government during this period. The U.S. congress as well as the media also well pointed such cases. Despite this, economists and business leaders successfully argued that revoking China’s MFN and the ensuing retaliation would only hurt American exports while doing little or nothing for human rights. The Chinese, for their part, made a number of concessions on human rights while cultivating the support of US business. Despite an outcry from many Congressmen, human rights activists and the press, the Administration decided to announce that China had met the minimum requirements necessary for renewal\textsuperscript{22}. It also declared that in the future it would delink MFN and non-trade issues. The Administration’s adopted the new line that encouraging China’s economic liberalisation and integration into the world economy would be the best way to

\textsuperscript{21} Ibid,p.8
pursue US foreign policy objectives of democratisation, development and economic reforms in China.

In addition to intellectual property rights infringement and market openness, the facilitation of MFN as an instrument to induce China to recognise universal human rights was further confirmed in another hearing held on 24 March 1994. These subcommittees were looking for resolutions by using the MFN in monitoring the degree to which China abides by universal human rights. They were focusing on the following five conditions:

- taking steps to begin adhering to the universal declaration of human rights;
- releasing and providing an acceptable account for Chinese citizens imprisoned or detained for the nonviolent expression of their political and religious beliefs, including such expression of their political and religious beliefs, including such expression of beliefs in connection with the Democracy wall and Tiananmen square movements;
- ensuring humane treatment of prisoners, such as by allowing access to prisons by international humanitarian and human rights organisations;
- protecting Tibet’s distinctive religious and cultural heritage; and
- permitting international radio and television broadcasts into China.

The above mentioned problems were exactly the major concerns of the United States. In fact, more human rights related problems such as the abuse of orphans in Shanghai, high death rate in orphanages, the debate over Asian values

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22 President Clinton did impose one minor sanction, a ban on $200 million worth of Chinese weapons and ammunition, a cursory nod capable of pleasing everyone from the gun industry to opponents of trading with the military enterprises who produce the weapons.
versus the universality of human rights and the imprisonment of Wei Jiangsheng have been brought to the attention of the United States too\textsuperscript{26}. Nevertheless, in deciding to withdraw China's MFN status, the White House had always considered the huge possible economic losses it would bear caused by Chinese retaliation\textsuperscript{27}.

In addition, it seemed that the facilitation of human rights recognition was not correctly maintained by using the MFN status as a monitoring measure. Eventually, the MFN ceased to be the leverage to monitor human rights in China when the linkage between human rights and MFN was dropped. The crux of the problem, as mentioned by the U.S. Department of State Human Rights Report in February 1995 was due to the fact that "The People's Republic of China is an authoritarian state in which the Chinese Communist Party monopolises decision-making authority\textsuperscript{28}.”

The most important of all, nevertheless, is that the MFN issue provides a useful tool to facilitate U.S. foreign policy in shaping China toward a more market-oriented system. The China specialists have pointed out that, the failure to grant MFN status to China, "could have proved not only ineffective, but counterproductive. It would have imposed substantial economic costs on the United States while jeopardising China's peaceful transition to a more market-oriented, open society that respects the rule of law."\textsuperscript{29}

Soon after the 1994 MFN renewal, the US designated China as a priority foreign country under the Special 301 intellectual property rights protection

\textsuperscript{26} China Rights Forum (Spring 1996): 4-31; China Rights Forum (Fall 1996):32-35 and China Rights Forum (Spring 1997):10-13
\textsuperscript{27} Lardy, op.cit, no.19, p.102.
\textsuperscript{28} U.S. Department of State, Human Rights Report, China, February 1995, p.1
provision. In May 1995, the US Congress voted overwhelmingly to support the admittance into the US of Taiwan's President Lee Teng-hui to receive an honorary degree at his alma mater, Cornell University. The vote to admit Lee was a reflection of both fundamental American values and the fact that while the US public regards China as important; this is not translated into warm feelings.

Over the next year relations between the two countries plunged to their lowest level in recent memory. Several reports were released criticizing China's human rights policy; the American public was particularly outraged when China imprisoned human rights activist Harry Wu, a US citizen. China also conducted large-scale military exercises off the coast of Taiwan in an effort to intimidate voters before the island's first democratic elections in which Lee Teng-hui scored a resounding victory. Evidence was uncovered that Chinese firms had sold Pakistan magnetic rings that could be used to enrich nuclear fuel which could be then used in the production of nuclear weapons, and were involved in smuggling illegal weaponry into the US. And just as the intellectual property rights (IPR) dispute was reemerging as a hot political issue, it was time to renew China's MFN status for another year.

MFN renewal in 1995 passed with little fanfare, but as tension on the trade, human rights, IPR and proliferation fronts increased, the debate over renewal in 1996 became yet another forum for addressing American concerns. As could be expected, the President announced that he would certify China's

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30 The vote in the House of Representatives was 396 to 0, and the tally in the Senate was 97 to 1. The sole Senator voting against the resolution had previously announced that he would not stand for reelection, and reportedly has two sons doing business in Shanghai.
31 A public opinion survey found that both elite's and the general public believe by substantial majorities that the US has vital national interests at stake in China (Rielly, 1995). However, China's ranking was in the lowest quartile of countries, below the EU, Japan, and Russia, and just above the Cedras dictatorship in power in Haiti at the time of the poll.
MFN status for another year, and the Administration has strenuously resisted Congressional efforts to link the 1996 MFN debate with human rights, the IPR issue, and proliferation concerns. The USTR has made it clear that it will deal with the IPR issue independently of the MFN renewal. Specialists in this field have long argued that China's MFN status should only be dependent on substantive progress in meeting criteria of trade liberalisation, transparency, and other preconditions in China's effort to join the WTO. Even South Carolina Senator Ernest Hollings, a long-time opponent of China's MFN status, announced that he would switch his vote and support MFN extension on the grounds that the yearly Washington debate serves only to increase tension and harm US-China relations without accomplishing anything positive. Indeed, what is truly striking about the trade politics in the US is how MFN policy has been driven by exporters and investors, not import-competing interests.

On July 9, 1998, Congress cleared for the President's signature on the Internal Revenue Service Restructuring and Reform Act. That Act contained a provision replacing the term "most-favored-nation" status (MFN) with the term "normal trade relations" (NTR). The intent of the provision, (enacted as P.L. 105-206) was to reinforce that this trade status was not a special or preferential trade status, but simply the normal status that the United States gives to all but a handful of its trading partners.

H.R.4444 as introduced by Representative Bill Archer on May 15, 2000, would have extended PNTR status to China upon its accession to the WTO. On May 17, 2000, the House Ways and Means Committee passed an amended version of the bill, which included an anti-import surge provision (essentially

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32 For a detailed history of congressional action on China's MFN status, see CRS Report 98-603, China's MFN Status: Congressional Consideration, 1989-1998
codifying the U.S.-China import safeguard provisions and establishing procedures for U.S. firms to seek relief from import surges from China. On May 23, 2000, the House Rules Committee added several new provisions to H.R. 4444; mainly those contained in a proposal made by Representatives Sander Levin and Doug Bereuter. These provisions among other things suggests to establish a special Congressional-Executive commission to monitor, and report on, China's policies on human rights and labor practices; require the USTR to annually issue a report assessing China's compliance with its WTO trade obligations (and to seek to establish, within the WTO, a special mechanism to monitor China's compliance); expand funding for various U.S. government agencies to monitor and enforce China's compliance with its WTO trade agreements; set up a special government task force to halt U.S. imports from China of products suspected of using prison labour; provide technical assistance to promote the development of the rule of law in China; and urge the WTO to immediately consider Taiwan's admission to the WTO after it approves China's membership. On May 24, 2000, the House passed H.R. 4444 by a vote of 237 to 197.

A motion to proceed with the consideration of H.R. 4444 was passed in the Senate on September 7, 2000. Several Senators offered amendments to the bill, dealing with such issues as weapons proliferation and human rights, although none were approved, due in part to concerns by many Senators that an amended bill would have required another vote on the issue in both Houses and might have doomed its chances for passage. H.R. 4444 passed the Senate on September 19, 2000 by a vote of 83 to 15.

34 Ibid.
5.1.3 China's accession to World Trade Organisation

The November 15th U.S.-China agreement on the terms for China to join the World Trade Organisation (WTO) is the most significant deal between the two countries since diplomatic relations were established more than two decades ago. The Clinton administration paved the way for Congress to vote permanent Normal Trade Relations (NTR) (also known as Most Favored Nation), thereby giving China the same trading privileges now enjoyed without annual review by almost every other U.S. trading partner. The only other nations denied NTR statuses by the U.S. are Afghanistan, Cambodia, Cuba, Laos, North Korea, and Yugoslavia. China has enjoyed NTR since 1980, but only by an annual vote of Congress. WTO membership for China and permanent NTR status will clear the way for Taiwan to join the WTO. China and Taiwan are the only two major U.S. trading partners those are not members. When these two join, all significant U.S. trading partners will be governed by the same rules and dispute-resolution procedures\(^{35}\).

China's membership of the trade body is, however, not yet assured. In any case, even if China does join the WTO, accession will by no means resolve all underlying tensions between the US and China—entry to the trade body will not even end bilateral bickering over trade issues. This is particularly so as, given the nationalistic and interventionist economic tendencies of officials, China's markets will not be opened to the extent suggested by the government's pre-accession pledges\(^{36}\).

\(^{35}\)James H. Holt, “China in the WTO: The Debate”, *Foreign Policy In Focus*, Volume 4, Number 38December 1999, p.1

5.1.3.1 The long-march to WTO entry

The World Trade Organisation -- usually known by its acronym WTO -- is the latest incarnation of the world trading system. Despite some institutional and coverage weaknesses, the WTO is an impressive organisation that has the potential to liberalize global trade and bring the rule of law to international trade. The WTO is still in its infancy, however, and it faces a number of challenges. Probably the most difficult of these challenges is integrating a number of reforming non-market economies, most notably China and Russia, into the WTO.

The WTO is the legal and institutional foundation of the multilateral trading system. It provides the principal contractual obligations determining how governments frame and implement domestic trade legislation and regulations. The WTO requires members to do the following:

- Provide market access to the products of other WTO members by lowering import tariffs on industrial and agriculture products
- Provide trade with all member countries on a nondiscriminatory basis
- Open up service markets to foreign competition
- Provide effective intellectual property protection through international specified domestic procedures
- Institute policies for foreign investment
- Ensure transparency of the trade regime

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• Ensure uniform application of trade policies in the entire country
• Place restrictions on state-operated trading corporations

The Chinese Communist Party (CCP) first signaled a real interest in world trade institutions in July 1986, when it lodged an application to join the General Agreement on Tariffs and Trade (GATT), which was replaced by the WTO in 1995. Membership of the GATT was a logical part of the post-1978 policy of economic reform and opening up China to the outside world. Joining the world trade body was also viewed by the leadership in Beijing as essential if China was to assume its rightful place as a major power on the international stage.

Despite these motivations, by early 1999 China had made only limited progress in its WTO accession bid. To join the trade body, a country must conclude bilateral market-opening negotiations with all existing members of the WTO which request such talks. Yet by late 1998 China had concluded market-opening agreements with just a few WTO members. Negotiations with the US and EU were particularly difficult. Authorities in both Washington DC and Brussels were eager to secure a significant opening of China's domestic markets before allowing China into the trade body. The government in Beijing, on the other hand, long accustomed to managing the economy through direct means and to protecting local companies, was reluctant to allow greater foreign participation in China's economy.

The U.S. has negotiated many liberalizing trade reforms with China. In March 1998, China made far-ranging concessions to liberalize its economy. In April 1999, President Clinton and Chinese Premier Zhu Rongji met to discuss an U.S.-China comprehensive trade package of economic reforms, which they pledged to conclude by the end of 1999. An agreement was presented at that time
that addressed some important issues, including steps China would take to open its market for goods, agricultural products, as well as a wide range of service sectors, an agreement on trading rights, technology transfer and offsets, state enterprises, and subsidies. In each case, the U.S. has achieved commitments that address the principal barriers to American products. These commitments include the following 39:

- A number of market access benefits effective immediately on China's accession
- Tariff reductions effective immediately upon accession, with further phase-ins over specific periods of time, including bindings for all tariffs
- Elimination of quantitative restrictions
- Resolution of outstanding problems with sanitary and phytosanitary standards for key agricultural products, effective immediately
- Participation in the three major multilateral agreements negotiated since the Uruguay Round: the Information Technology Agreement; the Agreement on Basic Telecommunications; and the Financial Services Agreement
- Resolution to open service sectors

5.1.3.2 The U.S.-China WTO Accession Agreement

The November 1999 US-China bilateral accession agreement produced an extensive package of Chinese commitments covering the full range of

39 ibid.2
commercial issues addressed in the WTO\textsuperscript{40}. Included are tariff and nontariff commitments that will be "multilateralised" in the process of China's accession. This means that the bilateral agreements reached by every other country will be merged, along with the US-China agreement, to produce a consolidated Protocol of Accession. Concessions are ratcheted-up, so that every WTO member gets the most favorable terms any single country secured with China. The six key pieces are:

1. **Tariffs**: A complete schedule of tariff reductions covering traded goods, including industrial and agricultural products. Chinese tariffs fall on average from 24.6 percent to 9.4 percent overall, and they drop to 7.1 percent on US priority products.

2. **Non-tariff barriers (NTBs)**: Extensive coverage of NTBs, for example, the phase-out of import quotas, phytosanitary standards, and licensing requirements. Most quotas are phased out by 2002, and the rest by 2005.

3. **Services**: The full schedule of service sector commitments includes import-export trading rights, distribution rights, banking, insurance, telecom, professional services (accountancy and legal), consulting, business and computer related services, motion pictures and sound recording services. China will join the WTO Basic Telecommunications and Financial Services Agreements.

4. **Investment and Intellectual Property**: China will comply with the WTO Agreements on Trade Related Intellectual Property Rights (TRIPs) and Trade Related Investment Measures (TRIMs). This means foreign exchange balancing requirements, local content requirements, and technology transfer requirements will all be eliminated. China will not condition investment approvals or import

\textsuperscript{40} The full text of the U.S.-China Bilateral WTO Accession Agreement (November 15, 1999)
licenses on local content requirements, offsets, transfer of technology, or requirements to conduct local R&D.

5. Safeguards: The US Bilateral Agreement contains China-specific provisions that rely on a nonmarket methodology for safeguard and dumping cases, plus special safeguards for the US textile and clothing industries.

6. State Firms: Anti-competitive behavior by state-owned enterprises (SOEs) becomes an actionable offense in many cases. SOE purchases are not to be treated as government procurement, which means they are subject to normal WTO rules.

The conclusion of the U.S.-China bilateral WTO trade agreement appears to have given new momentum towards China's eventual accession to the WTO, due in part to the important role the United States plays in the WTO, and since Chinese officials in the past complained that the United States' position on China's WTO accession was the main obstacle to China's admission. However, China must still conclude bilateral agreements with Mexico and Switzerland and complete talks with the WTO Working Party over the nature of its trade regime, before a final vote can be taken in the WTO on China's accession.

The WTO Working Party handling China's WTO application formally met in late July 2000. Press reports indicate that, while China made progress in addressing many of the concerns of WTO members over the nature of China's trade regime once it joins the WTO, a number of difficult outstanding issues appear to remain. For example, Inside U.S. Trade reported that China was seeking to insert a provision in the WTO working party report on China's WTO accession that would imply that the WTO supported China's position that Taiwan

was part of China. In addition it was reported that China continued to demand it be afforded treatment as a developing country in the WTO, which would give China longer transitional periods for implementing various WTO agreements, such as those covering agriculture and industrial export subsidies. The International Trade Reporter stated that "a number of countries have raised questions about China's commitments in areas such as agricultural export subsidies, trade-related investment measures, and the application of sanitary/phytosanitary (SPS) measures," and that several WTO members insisted that China afford to them the same safeguard provisions on import surges that were agreed to in an agreement with the United States. Finally, Inside U.S. Trade reported that China had strongly opposed an U.S. and Canadian proposal to establish a biennial review mechanism of China's compliance with its WTO trade commitments.⁴¹

5.1.4 Intellectual Property Rights (IPRs)

Intellectual property rights (IPR) are a serious problem with long term consequences for global trade and commerce. An important, possibly preeminent, source of conflict has been over the lack of intellectual property rights (IPR) protection in China. It is not a problem solely with China, however; the United States and other Western nations have similar concerns with most of the newly industrialised countries.⁴² China, in fact, is a latecomer to the game, following the third world practice of duplicating computer software without paying royalties, copying and exporting legally protected hardware, infringing trademarks, copying and distributing chemicals and pharmaceuticals without

paying for them, exploiting access to trade secrets—in other words, taking full advantage of these products without paying the companies that own them.43

China's original commitment to provide mutual protection of intellectual property rights i.e. copyright, patent and trademark protection for foreign goods was embodied in the United States-China Bilateral Trade Agreement of 1979.44 However, efforts to get China to comply with the agreement did not really get under way until the mid-1980s, when the United States raised the issue in meetings of the bilateral Joint Commission on Commerce and Trade in 1985. Similar concerns were also raised in market access negotiations begun in 1987. Although some progress was made—China enacted new trademark and patent laws and joined Paris Convention for the Protection of Intellectual Property Rights, still some serious shortcomings remained.45 Concerns over Chinese IPR protection led the United States Trade Representative (USTR) to place China on its Special 301 "priority watch list" in the beginning of 1990s.46

The USTR annually issues a three-tier list of countries which are considered to maintain inadequate regimes for the protection of U.S. IPR or deny market access: (1) priority foreign countries which are considered to be the worst violators of U.S. IPR and are subject to Section 301 investigations and possible U.S. trade sanctions; (2) priority watch list countries which are considered to have serious deficiencies in their IPR regime, but do not currently warrant a Section 301 investigation; and (3) watch list countries which have been identified because they maintain IPR practices or barriers to market access that

43 ibid, p.198
44 Nicholas Lardy, op.cit, no.19, p.79.
45 Ibid., p.80
are of particular concern, but do not yet warrant higher level designations.\textsuperscript{47} In addition, the USTR has made "out-of-cycle" decisions throughout the year concerning the IPR regimes of particular countries, including the designation of countries as priority foreign countries and the imposition of trade sanctions for IPR violations.

In May 1991 the United States government initiated a special 301 investigation of protection of US intellectual property rights (IPR) in China. Under the Special 301 provision of the Omnibus Trade and Competitiveness Act of 1988, the United States reserves the ability to conduct Special 301 investigations and right to unilaterally impose tariffs on countries found to be violating intellectual property.

Additional measures followed in the 1990s, including the “Special 301” investigation of IPR protection by the United States in 1991. After a series of negotiations aimed at heading off retaliatory tariffs, the two countries signed a memorandum of understanding in 1992 under which China agreed to strengthen its IPR laws. It pledged to treat computer software as literary works: subject to copyright protection for 50 years. It also promised to expand the definition of and increase the protection for pharmaceutical patents, an issue that had proved to be a major sticking point in the negotiations\textsuperscript{48}.

According to Article 5 of the Memorandum of Understanding (Annex 3.3) between the Government of the United States and the PRC on the Protection of Intellectual Property, “Both Governments will provide procedures and remedies to prevent and stop, internally and at their borders, infringement of intellectual

\textsuperscript{47} ibid. p.14-15.

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property rights and to deter further infringement." Under these circumstances, China and the United States have mutually agreed to respect and observe the rules and binding forces underpinning their bilateral trade relations. Moreover, China also agreed to accede to the Berne Convention for the Protection of literary and artistic works and the Convention for the Protection of the producers of Phonograms against Unauthorised Duplication of Their Phonograms. As a signing party, China's commitment and the enforcement of IPR protection has thus become a substantial issue.

5.1.4.1 The 1995 IPR Agreement

In June 1994, the USTR again designated China as a Special 301 "priority foreign country," because it determined that China had met most of the conditions of the 1992 agreement, namely the establishment of new laws and regulations protecting IPR, but failed to enforce such laws. A January 1995 General Accounting Office (GAO) report noted that China had amended its patent law, issued copyright regulations, joined international copyright conventions and enacted protection for trade secrets. However, China made little progress in establishing the legal and administrative framework that would provide effective procedures and remedies to address IPR infringement and to deter further infringement.

The USTR cited the establishment of several factories in China producing pirated compact and laser disks, as an example of China's "flagrant" violation of U.S. IPR. In addition, the USTR stated that trade barriers had restricted access to

50 Ibid,p.6
China's market for U.S. movies, videos, and sound recordings, and that such restrictions encouraged piracy of such products in China\textsuperscript{52}. US Trade Representative Mickey Kantor threatened a 100 percent tariff on $1.08 billion worth of Chinese imports\textsuperscript{53}. In February 1995, after a flurry of consultations, negotiators reached an agreement on the day before the tariffs were to be imposed. The new agreement pledged China to substantially beef up its IPR enforcement regime and to remove various import and investment barriers to IPR-related products. Specifically, China agreed to:

- **Take immediate steps to stem IPR piracy in China over the course of the next three months** by taking action against large-scale producers and distributors of pirated materials, and prohibiting the export of pirated products.

- **Establish mechanisms to ensure long-term enforcement of IPR laws**, such as banning the use of pirated materials by the Chinese government, establishing a coordinated IPR enforcement policy among each level of government, beefing up IPR enforcement agencies, creating an effective customs enforcement system, establishing a title verification system in China to ensure that U.S. audio visual works are protected against unauthorised use, reforming China's judicial system to ensure that U.S. firms can obtain access to effective judicial relief, establishing a system of maintaining statistics concerning China's enforcement efforts and meeting with U.S. officials on a regular basis to discuss those efforts, improving transparency in Chinese laws concerning IPR, and strictly enforcing IPR laws.

\textsuperscript{52} Wayne Morrision, IB91121: "China-U.S. Trade Issues," September 2000 p.8

\textsuperscript{53} Noland, op.cit, no.48
• Provide greater market access to U.S. products by removing import quotas on U.S. audio visual products, allowing U.S. record companies to market their entire works in China (subject to Chinese censorship concerns), and allowing U.S. intellectual property-related industries to enter into joint production arrangements with Chinese firms in certain cities.

Several U.S. firms charged that IPR piracy in China worsened in 1995, despite the 1995 IPR agreement, and pressed the USTR to take tougher action against China. The International Intellectual Property Alliance (IIPA), an association of U.S. copyright-based industries, called on the USTR to impose sanctions against China unless it agreed to fully implement the 1995 IPR agreement. A February 1996 IIPA press release stated: "Illegal CD and other factories continue to produce and export pirate product, and China has not opened its markets to U.S. copyright industries as promised."54 IPR-related industries estimated that IPR piracy by Chinese firms cost U.S. firms $2.2 billion in lost trade during 1995.55 The USTR's 1996 Foreign Trade Barriers Report stated: "By early 1996, it was clear that China made significant and, in some localities, effective efforts in the retail sector within China to begin to reduce piracy and counterfeiting. However, effective action against producers and major distributors of pirated audiovisual and computer software products has been lacking." The USTR report further stated that exports of pirated products in third markets continued at the same or even higher levels than before the 1995 IPR agreement.56

56 Ibid
In a U.S.-China Business Council survey, one-third of the participants reported experiencing some form of IPR infringement in China, whether patent, trademark, or copyright problems. Of those who had registered their intellectual property with China, only 11 percent reported infringement, but one-third still reported trademark problems. Most typically, companies “on the ground” seek negotiation or an administrative solution, and apparently these efforts have been largely successful, with most reporting satisfaction with the outcome.

From the Chinese perspective, the concept of intellectual property is new, and incorporating Western capitalist concepts of ownership into Chinese socialist law is a complex process. As a signatory of the 1992 MOU and 1995 joint agreement, China has essentially accepted the West’s definition of intellectual property, agreeing to very broad protection of copyrights, patents and trade secrets. This puts China in the vanguard of the Third World in intellectual property rights. Taiwan, for example, still refuses to accept such sweeping agreements.

However, in this sense, the 1996 U.S.-China IPR agreement is of great importance for the concerned issue. Under this, the US needs to hold China to its commitments, and China needs to enforce those commitments more vigorously. The conflict over intellectual property is about theft and how to establish a legal framework, in which companies can trade and invest with confidence. What is at stake is whether China, already one of the largest trading nations, will agree to abide by the basic rules that govern the international order.

5.1.4.2 The 1996 Chinese Action Plan

On April 30, 1996, the USTR again designated China as a Special 301 "priority foreign country" for not fully complying with the February 1995 IPR
agreement. According to the USTR, while China had cracked down on piracy at the retail level (launching raids and destroying millions of pirated CDs and hundreds of thousands of pirated books, sound recordings, and computer software), it had failed to take effective action against an estimated 34 or so factories in China that were mass-producing and exporting pirated products. U.S. officials called on the Chinese government to close such factories, prosecute violators, and destroy equipment used in the production of pirated products. Further, the USTR stated that China had failed to establish an effective border enforcement mechanism within its customs service to prevent the export of pirated products. Finally, the USTR indicated that China had failed to provide sufficient market access to U.S. firms, due to high tariffs, quotas, and regulatory restrictions. Shortly after, the USTR indicated it would impose U.S. sanctions on $2 billion worth of Chinese products by June 17, 1996, unless China took more effective action to fully implement the IPR agreement.

On June 17, 1996, (then acting) USTR Charlene Barshefsky announced that the United States and China had reached an accord on China's implementation of the 1995 agreement. The accord outlined steps that China had recently taken to enforce the IPR agreement (such as the closing of 15 plants producing illegal CDs, several seizures of pirate CDs, VCDs, and LDs by Chinese customs officials, and the issuance of new regulations directing government agencies to seek out and close illegal plants) and China's pledge to extend a period of focused enforcement of anti-piracy regulations against regions of particularly rampant piracy, such as Guangdong Province (Annex 3.3). The Chinese government also promised to improve border enforcement to halt exports of pirated products as well as illegal imports of presses used to manufacture CDs, open up its market to imports of IPR-related products, and improve monitoring and verification efforts to ensure that products made by
Chinese CD plants and publishing houses were properly licensed. Finally, the Chinese government reaffirmed that public and private sector entities would use only legitimate software.\(^{57}\)

In April 1997, the USTR reported that, following the June 1996 accord, China had "made significant progress in combating IPR violations," including the closure of nine factories and 28 illegal production facilities, and confiscation of millions of unauthorised LDs, CDs, and VCDs and other publications, increased checks on IPR-related cases, significantly strengthened border enforcement against IPR-related smuggling, and improved market access for certain U.S. IPR-related industries. The USTR stated: "The Administration commends China for taking these promising steps on effectively enforcing intellectual property rights (IPRs)."\(^{58}\)

In February 2000, the USTR stated that over the past couple of years China has made great strides in improving its IPR protection regime, noting that it has passed several new IPR-related laws, closed 80 assembly operations for illegal production lines, seized millions of illegal audio-visual products, curtailed exports of pirated products, improved customs enforcement, expanded training of judges and law enforcement officials on IPR protection and established special IPR courts, and has expanded legitimate licensing of film and music production in China.\(^{59}\) In April 1999, the USTR announced that the Chinese government had issued a new high-level directive to all Chinese government entities directing that they use only legitimate computer software, a move described by the USTR as a "milestone in China's efforts to increase intellectual property protection."\(^{60}\)

\(^{57}\) USTR IPR Piracy Fact Sheet, June 17, 1996.  
\(^{60}\) USTR Press Release, April 7, 1999.
According to the USTR's 2000 *Foreign Trade Barriers Report*, prior to the U.S.-China agreements on IPR, China was one of the world's IPR pirates and a major exporter of pirated products. Since then, China has improved its legal framework for IPR enforcement and has "virtually shut down the illegal production and export of pirated music and video CDs and CD ROMs." In addition, China has made enforcement of IPR part of its anti-crime campaign and has been conducting a nationwide anti-piracy campaign. However, the USTR noted that resistance from the provincial and local level has undermined central government efforts to implement IPR reforms.

In April 2000, the U.S. Interactive Digital Software Association (IDSA), a trade body representing U.S. video and computer game software companies, stated that the Chinese government, over the past two years, has "mostly lived up to their obligations under the 1995 agreement and the 1996 action plan to close down pirate optical media production and halt exports." However, IDSA noted that IPR piracy in China's domestic markets remains a serious problem, estimating the rate of IPR piracy for computer and video games at 95% and costing U.S. firms $1.3 billion annually. Of particular concern to IDSA has been a massive increase in imports into China (from such sources as Hong Kong and Taiwan) of pirate products, which has acted to offset many of the gains made in closing illegal plants in China. The IDSA has also stated that China uses vague cultural standards to restrict certain imports. The IDSA noted that IPR enforcement remained a serious problem. However, the IDSA states: "the fact that enormous piracy and market access problems in China persist does not mean that China is not taking the problem more seriously, or that no progress has been made, or that there is not an improved attitude in China toward addressing the
issue. To the contrary, we believe there has been progress and there are signs China recognizes additional steps are required.\(^{61}\)

The IIPA estimates that IPR piracy in China cost U.S. firms $1.7 billion in lost sales in 1999—an improvement over 1998 losses which were estimated at $2.6 billion. However, while China has continued to maintain significant enforcement actions against IPR piracy, the IIPA states that such enforcement is hampered by the failure of the government to take sufficient action against criminal, followed by deterrent penalties against well organised pirates. IIPA notes that China has largely ceased exporting pirated products but has developed a major domestic piracy problem along with an increase in pirated imports. In addition, the piracy rate for music and sound recordings rose from 56% in 1998 to 90% in 1999.\(^{62}\)

In 1999, the U.S. Embassy in Beijing reported that China's IPR efforts had produced mixed results:

China has made significant progress in protecting intellectual property rights (IPR), but still faces major problems. On the one hand, a respectable (but not perfect) IPR legal system is in place, along with government agencies handling copyright, patent, trademark, and enforcement matters. At the same time, fueled by unemployed workers, and boosted by a lack of market access for legitimate products, smuggling and counterfeiting continue at a high rate, often swamping enforcement efforts.\(^{63}\)

\(^{61}\)Testimony of Douglas Lowenstein, Interactive Digital Software Association on Permanent Normal Trade Relations with China before the Senate Finance Committee, April 6, 2000.
The U.S. Embassy observed that, despite improvements in IPR protection in China, "IPR violations continue on a massive scale." It was noted that effective enforcement action is often hampered by local protectionism, lack of training of judicial officials, and corruption.64

In reaction to continued IPR problems, over 20 U.S. companies in China recently formed an informal coalition to draw the attention of Chinese and U.S. government authorities to the counterfeiting problem in China and to propose ways of strengthening enforcement. These companies estimate their annual losses due to counterfeiting at over $1 billion. Limited market access for products such as foreign movies and computer software, and relatively small fines for persons convicted of piracy are viewed as major incentives for smugglers and counterfeiters. Some U.S. companies have devoted considerable on-the-ground resources to combating IPR violations, with mixed results65

The tit-for-tat threats of sanctions and retaliation, orchestrated for domestic political consumption, titillated observers, belaying the gravity of the negotiations. Although there is wide agreement that the Chinese have improved certain aspects of IPR protection, notably at the retail level, enforcement at the production level remains limited. China has at least nominally complied with all aspects of the IPR agreement, including establishing a legal and judicial framework for IPR enforcement. Despite these efforts, however, piracy of U.S. software, videos and sound recordings remains a serious problem.

64 Ibid. p. 2.
5.1.5 Market Access

To improve market access in China has also began to emerge as a major trade issue since mid-1980s in the Sino-U.S. bilateral relations. However, as noted, the imbalance in bilateral trade continued to widen, leading the United States to initiate more formal bilateral discussions on market access issues in mid-1991. U.S. officials have held negotiations with China over the past several years regarding U.S. concerns over Chinese restrictive trade and investment barriers. In April 1991, the Bush Administration initiated a Section 301 case against four significant unfair trading practices affecting U.S. exports to China:

- selected product-specific and sector-specific import prohibitions and quantitative restrictions;
- selective restrictions on imports made effective through restrictive import license requirements;
- selected technical barriers to trade, including standards, testing and certification requirements, and policy toward phytosanitary and veterinary standards that create unnecessary obstacles to trade; and
- failure to publish laws, regulations, judicial decisions, and administrative rulings of general application pertaining to customs requirements, restrictions, or prohibitions on imports or affecting their sale or distribution in China.\(^{66}\)

The Section 301 case against China was highly unusual due to its breadth of coverage. Most Section 301 cases involve investigations of certain trade restrictions on specific products. However, the China Section 301 case was the most sweeping market access investigation in the USTR's history. It was essentially aimed at substantially reforming China's entire trade regime. In

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\(^{66}\) Wayne M. Morrison, op.cit, no.46,p.10
addition, the USTR linked U.S. support for China's re-entry into the General Agreement on Tariffs and Trade (GATT) to a successful resolution of the trade dispute.67

On Aug. 21, 1992, the USTR determined that negotiations had failed to resolve the trade dispute and threatened to impose $3.9 billion in U.S. trade sanctions unless an agreement was reached by Oct. 10, 1992. The proposed sanctions were the highest level ever issued by the USTR under a Section 301 case. China in turn threatened retaliation against a comparable level of U.S. products.

On Oct. 10, 1992, the United States and China reached an agreement settling the Section 301 case (See Annex 3.2). Under a Memorandum of Understanding (MOU), China pledged to:

(1) reduce or eliminate a wide variety of trade barriers over the next five years (according to specific timetables), including tariffs, quotas, import restrictions, import licenses (covering over 1,200 products);
(2) take a number of specified steps to make its trade regime more transparent, such as publishing its trade laws and regulations;
(3) eliminate import substitution laws and policies; and
(4) apply sanitary and phytosanitary (SPS) regulations on agricultural products based on sound science (within one year) and remove discriminatory standards and testing requirements on non-agricultural products. For its part, the United States pledged to "staunchly support" China's entry into the GATT and to reduce export controls on computer and telecommunications equipment exports to China.68

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67 The GATT in 1995 became the World Trade Organisation (WTO).
68 Wayne M. Morrison, op.cit;no.46,p.11

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In late 1993, the USTR charged that China had failed to implement the market access agreement and warned that the United States would impose trade sanctions against China unless it took steps to abide by the agreement by the end of the year.\textsuperscript{69} A U.S. State Department report stated that by December 31, 1993, China had lowered tariffs on 2,898 items and had eliminated non-tariff restrictions on 283 items. In addition, in June 1994, China eliminated 208 non-tariff barriers, including a number ahead of, or in addition to, the schedule set in the MOU.\textsuperscript{70}

Failure on the part of China to gain status as a founding member of the WTO at the end of 1994 led China to subsequently announce that it would no longer abide by the market access agreement because of the U.S. position on conditions for China's entry into the WTO. However, following the signing of the U.S.-Chinese agreement on IPR in March 1995 (see below), U.S. and Chinese officials announced that an agreement had been reached in which China would resume its implementation of the 1992 market access MOU by the end of March 1995 and that talks would be held with the United States concerning liberalizing China's markets for telecommunications services and insurance.\textsuperscript{71}

5.1.5.1 Assessments of Chinese Compliance With the 1992 MOU

In January 1994, the USTR determined that, to date, China was "substantially in compliance" with the 1992 market access agreement. In January 1995, General Account Office (GAO) issued a report examining China's compliance with the 1992 agreement. Based on interviews with U.S. government and industry officials, GAO stated that the Chinese government had complied overall with the provisions regarding transparency and tariff and non-tariff

\textsuperscript{69} Inside U.S. Trade, November 3, 1993.
barriers, although a number of significant problems remained in these areas. According to the report, USTR officials told GAO that they believed that China no longer maintained import substitution policies. However, GAO noted the growing pressure from the Chinese government to force foreign firms to increase local content (i.e., the share of the value of the product made locally) for certain operations in China. GAO found that China's implementation of the agricultural standards provisions had been slow and that China continued to use such barriers to restrict U.S. imports. Finally, GAO noted that resistance to central government regulations by provincial and local governments, as well as central government ministries seeking to protect the industries under their jurisdiction, impeded the full implementation of the market access MOU.

In congressional testimony in 1996, (then Acting) USTR Charlene Barshefsky drew similar conclusions over China's compliance with the 1992 MOU on market access. She stated that "to its credit, China has done much to implement the agreement," such as eliminating tariff and non-tariff barriers and making its trade regime more transparent. However, compliance in other areas was lacking:

"While China has removed a substantial number of non-tariff barriers, we are concerned with China's tendency to give with one hand and take away with the other. In some instances, China has substituted new barriers in the place of those removed. For example, quotas have been replaced with "tendering requirements" or "registration requirements." In sectors such as medical equipment and film, new regulations have prevented the market access we anticipated as a result of the 1992 agreement. China

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71 Ibid., p.45
72 GAO noted that despite improvements, transparency in China's trade laws and regulations was still far from perfect, and that non-transparency was one of the most cited problems of doing business in China by U.S. firms survey by GAO. In the case of non-tariff barriers, GAO observed that China removed some barriers but then instituted new ones.
74 Ibid. p. 31.
must live up to its agreement and eliminate those impediments to fair trade.”

The 1992 market access MOU was supposed to have been fully implemented by December 31, 1997. The USTR's 1998 Foreign Trade Barriers Report made the following observations on areas where China's compliance with the market access was lacking:

- **Non-tariff barriers.** China had generally met the requirements of the 1992 MOU to remove various explicit non-tariff barriers on products specified under the MOU. However, China still maintained a large number of non-tariff administrative controls (such as registration requirements) to implement its industrial policies, which tend to act as a new *de facto* licensing requirement. About 400 of the products covered by the 1992 agreement were subject to these registration requirements.

- **Transparency.** While China has significantly improved the transparency of its trade regime since 1992, several problems still remained. For example, the coverage of Chinese trade publications of new regulations was often incomplete and not always timely. U.S. firms often had difficulty learning which regulations apply to their operations in China. The lack of regulatory transparency and few implementing regulations continued to inhibit the entry of foreign goods and services.

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75 Testimony of Ambassador Charlene Barshefsky Before the U.S. House Ways and Means Committee, Subcommittee on Trade, September 19, 1996

76 In April 1999, China agreed to remove SPS restrictions on U.S. exports of Northwest wheat, citrus, and meat exports to China. Other trade policies pertaining to transparency in trade laws, non-tariff barriers, SPS restrictions, and import substitution laws were addressed in the November 1999 U.S.-China WTO agreement and are also being considered in the WTO Working Party handling China's accession application.

77 Various USTR reports indicate that China removed over 1,000 quotas and licenses. However, in some instances, certain non-tariff barriers were not removed on schedule


79 Ibid. p. 48.
• **Import substitution laws.** China claimed that it no longer utilised import substitution policies. However in 1994, the Chinese government announced an "Auto Industry Policy" that included import substitution requirements. The government policy directed that autos and auto parts should be purchased from Chinese producers and that all automotive and component manufacturers in China should strive for complete localisation of production. The policy required producers to include a minimum amount of local materials and value-added work in their final products. Foreign joint venture vehicle assemblers are required to begin with 40% local content, achieve 60% by the second year of production, and 80% the following year. In 1996, the government issued policies on pharmaceutical pricing that discriminated against foreign producers and embodied an import substitution policy.

• **Sanitary and phytosanitary (SPS) issues.** Since 1992, China had made some progress in removing SPS restrictions on certain U.S. agricultural items through the signing of bilateral protocols for live horses; apples from Washington, Oregon, and Idaho; ostriches, bovine embryos, swine and cattle; cherries from Washington; and grapes from California. However, SPS measures continued to bar imports of U.S. citrus, plums, and Pacific Northwest wheat. In addition, China's standards system often lacks transparency and is unevenly applied (i.e., different standards are used for imports from different countries, and standards for imports differ from those

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80 Ibid. p. 49. The 2000 USTR Foreign Trade Barriers Report stated that China had also developed import substitution policies for generic medicines, telecommunications equipment, and power generating equipment.

81 These issues were reportedly resolved in April 1999 when the United States and China reached an agreement on agricultural cooperation. China agreed to immediately remove import restrictions on U.S. Pacific Northwest wheat, citrus, and meat products. However, according to U.S. officials, China has only recently begun to implement the agreement. See U.S. Department of Agriculture Release, March 22, 2000.
applied to domestically produced products). Finally, many such standards were not based on sound science.  

5.1.6 High-Technology Transfer

Technology transfer has become an important bilateral negotiating issue between the U.S. and China. The United States is apprehending a potentially more serious problem in China's appropriation of proprietary technology. According to them, in the long run this issue is more serious than the pirating of computer software, movies and music. China would like to have more transfer of technology from the United States so as to accelerate China's economic development. The Chinese argue that the export control system mainly inherited from the Cold War period has become anachronistic, increasingly hampering the expansion of trade. China needs to import from the United States high-technology products and services, in which the United States enjoys a potent competitive edge. It is seen that, technology transfer would not only benefit China, but also facilitate U.S. exports to China and help bringing greater balance to the bilateral trade.

For the Americans most technology transfer results from commercial decisions made by firms in the private sector. Where these technologies have no potential security application, the U.S. government plays no role in the technology transfer decision. The U.S. government in various ways restricts the transfer of dual use technologies to China and many other countries. Reflecting the belief that effective business requires that technology be mobile, Beijing is encouraging the United States to be flexible where possible in its

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82 Ibid. pp. 50-51.
83 Vogel, op. cit, no.42, p.201
85 Technologies that potentially have both civilian and military uses.
decisions regarding transfer of dual use technologies, while fully ensuring that pertinent technologies are used solely for authorised civilian purposes. Beijing had welcomed Washington's decision to improve monitoring of technology for demonstration of proper civilian use would help expand technology transfer. Both countries need to make serious and expeditious processing of pertinent applications, keeping in mind both the security considerations and the need to handle things in a way that does not undermine the fundamental commercial rationale for the transaction.

The broad factors, which shapes the United States technology transfer issues with China include:

- **U.S. Trade.** China is a dynamic market, with high rates of growth and real opportunities for foreign firms. The U.S. has a significant advantage in the high value, high tech end of the market, but have serious competition from the European Union and Japan. At the same time, U.S. demand for Chinese goods is high, and it has a significant bilateral trade deficit, which would do well to rectify. While technology transfer restrictions account for only a small portion of the trade deficit, in many cases they have a deterrent effect on trade expansion that goes beyond the United States national security needs.

- **The policies of other countries towards China.** Before 1994, when COCOM ended, the United States major trade partners had a coordinated, multilateral approach to high tech trade with China. Since that time, the US has a growing difference in how itself and its allies treat

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86 *China-U.S. Relations: After Two Summits, Goals for the 21st Century*, op.cit, and no.74.
87 COCOM, the Coordinating Committee on Multilateral Export Controls, was a cold war-era agreement that prohibited the transfer of dual-use technology and conventional weapons to Communist countries. That pact dissolved in March 1994, and diplomatic efforts have been underway since that time to create a successor regime that would address new international realities.
high tech exports to China. A number of its allies no longer appear to regard China as being of strategic concern and have dismantled export restrictions on a range of dual-use technologies. The result is that some U.S. controls have become increasingly unilateral and thus ineffective as restraints on China's ability to acquire advanced technology.

- **Security and Nonproliferation.** Security and nonproliferation has remained central to the United States-Chinese negotiation, and have a profound effect in shaping high tech trade with China. It has serious differences with China on a variety of nonproliferation issues and has consistently engaged China to bring its practices into line with international norm. Washington has made notable progress in the nuclear area and are working to broaden this dialogue and to promote cooperation between the US and China on other security issues.

- **The larger bilateral relationship.** China is in the midst of broad social, economic and political change. The U.S. Administration's goal of engaging China to influence its evolution to an open, market-oriented society shapes their technology transfer policies.  

Export controls are one of the principal tools is being used to manage technology transfer. U.S. dual-use regulations allow for extensive review and denial of license applications in cases where a strategically sensitive item would make a "direct and significant" contribution to China's military capabilities. In addition, Tiananmen Square sanctions prohibit the export of arms, satellites and dual-use items used for crime control unless there is a Presidential waiver. U.S.

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policy since Tiananmen Square is to deny export of controlled dual-use technology to the Chinese military and police.\(^{89}\)

The Clinton Administration had significantly improved the dual-use export control process by, among other things, strengthening the role of other agencies in the review process. The source of this revitalised process was Executive Order 12981, issued in December 1995. E.O. 12981 gave the Departments to Defense, Energy, State and the Arms Control and Disarmament Agency the right to review any license of interest to them. It established a clear system for escalation and resolution of disputes, all the way to the President if necessary, and provided for an appropriate review of technology transfer cases by the intelligence community.\(^{90}\) As a result, dual-use license reviews were more thorough, more complete, and more carefully considered than at any time in the past.

Satellite exports are an example of how effective dual-use export controls allow American exporters to enter into China. The United States controls on satellite exports to China are extensive and involve a number of measures to reduce the risk of unauthorised transfers of technology, including a bilateral technology safeguards agreement and the presence of Department of Defense monitors at Chinese launch sites. Also, sensitive military satellite technology remains on the U.S. Munitions List administered by the Department of State. Allowing China to launch U.S.-made satellites, under these safeguards, has been an important factor in helping U.S. companies dominate the satellite market. Most sales are to U.S. or third country firms who have chosen to purchase Chinese launch services.

\(^{89}\) Ibid.
\(^{90}\) Ibid.
The world satellite market was valued at more than $51 billion in 1997. The U.S. has the major share of this market. Satellite manufacturing alone employed 60,000 people in the U.S. and generated more than $8 billion in revenue for its country. Thirty-five commercial launches took place in 1997, by France, the United States, Russia and China. Commercial satellites are a key industry sector and vital to the health of the American economy as a whole.

Satellites and computers are only one part of U.S. exports to China, which were valued at more than $12 billion in 1997. Commerce received 849 export licenses for China in 1997, valued at one billion dollars. Eighty percent of the licenses the United States received were given permission to export; export was not allowed for the remainder for a variety of reasons including a lack of sufficient information. This eighty-percent approval rate for China is lower than most other countries, including Russia. Applications for China usually take fifty-four days to process, whereas the average for all licenses is twenty-nine days. These figures show that China licenses are subject to extensive scrutiny and review to ensure that U.S. interests are well protected. U.S. exporters face de facto unilateral controls on exports to China in several sectors where they have a demonstrated competitive advantage. For example, it has been reported that U.S. firms lost the contract for a three billion dollar semiconductor project to a Japanese firm largely because of Japan's apparent willingness to transfer advanced technology quickly and without extensive conditions.

China poses a difficult problem for U.S. exports control today, and the integration of China into a stable world order is one of the paramount challenges for American foreign policy. Broadly speaking, technological advances drive the modern world economy, and barriers to the mobility of technology should be reduced wherever possible.
5.2 Human Rights Issues

Profound differences exist between the United States and the PRC on the human rights issue. While Washington emphasizes the rights of individual citizens, such free expression (including political dissidence), Beijing argues that the most important human rights concern survival and security, and that individual rights should not prevail at the expense of collective interests. Moreover, Beijing considers China’s human rights to be within its purview alone, claiming that the criticism of China’s human rights violations by the United States and other Western countries shows an ongoing tendency of Western interference in China’s internal affairs\textsuperscript{91}.

The differences between American and Chinese approaches toward the human rights issue are substantive. However, it is also important to note that such differences are not always insurmountable and, in reality, have diminished somewhat over the past two decades.

China’s human rights practices have fluctuated in recent years. It has been among the most visible and constant points of contention in U.S.-China relations since the 1989 Tiananmen Square crackdown. China's human rights record since then has presented a mixed picture, with both setbacks and minor improvements providing plenty of ammunition for policy debate. Among the more positive developments in China's human rights record, the Chinese government in recent years signed two key human rights agreements -- the U.N. Covenant on Economic, Social and Cultural Rights (October 27, 1997) and the International Covenant on Civil and Political Rights (March 12, 1998)\textsuperscript{92}. The government also


\textsuperscript{92} Kerry Dumbaugh, op.cit, no.33
has been allowing "local, competitive elections" in rural areas in China, and has implemented legislation to make political and judicial processes more transparent and to hold law enforcement officials more accountable for their actions. On the negative side, the sentencing of political dissidents, crack down on religious freedom of people from time to time has intensified the issue further.

The human rights issue is continued be an integral part of an ongoing U.S.-China dialogue. In dealing with specific cases, Washington has made it clear to Beijing that its human rights violations will substantially reduce public support in the United States for a constructive and cooperative relationship with China. However, Washington also understands that regardless of its efforts, the United States is not in a position to transform China's human rights situation overnight. The successful handling of the human rights issue rests on the overall bilateral cooperative engagement of the two countries in the long run.

5.2.1 Prison Labour Exports:

The Tariff Act of 1930, more commonly known as the Smoot-Hawley tariffs; makes the import into the United States of goods produced or mined by convict labour illegal under most circumstances. In other words, the importation from any country of commodities produced through the use of forced labour is prohibited by U.S. law, although obtaining proof of actual violations for specific imported products is often extremely difficult. Although, this act has been seized upon by critics of China’s human rights practices, it is interesting to note that the prohibition does not cover goods that are judged to be in short supply in the United States. It is evident from the fact that the original intention was not to advance human rights outside the United States but to protect

93 Lardy, op.cit,no.19,p. 98
American workers from competition from foreign goods produced in circumstances in which wages could be artificially depressed.\textsuperscript{94}

For the first time, in the late 1980s it was came to known that some Chinese goods imported into the United States were produced in prison-run factories. Bilateral discussions led to the signing of a memorandum of understanding (MOU) between the United States and China on this issue on 7 August 1992.\textsuperscript{95} According to U.S. officials, China's initial implementation of the agreement was "spotty." Chinese officials were slow to respond to U.S. requests for information and to visit suspected sites.\textsuperscript{96} The United States sought to establish specific guidelines for the implementation of the MOU. This led to the signing of a "statement of cooperation" (SOC) on March 14, 1994 that, among other things, included timetables for responding to requests for information and site visits to production facilities suspected of exporting prison labour products. According to the U.S. State Department, the SOC "fostered a more productive relationship between (U.S.) Customs and the (Chinese) Ministry of Justice."\textsuperscript{97} Between March 1994 and April 1995, Customs was allowed to visit five facilities in China, but China turned down several other requests to visit other sites. President Clinton's report to Congress on renewing China's MFN status in May 1994 stated that China had generally abided by the agreements on prison labour.

However, China's cooperation with the United States on prison labour decreased following the visit of Taiwan President Lee Teng-hui to the United

\textsuperscript{94} Ibid.
\textsuperscript{95} The agreement provided for prompt investigation of suspected prison labor exports, exchanges of information on law enforcement efforts, meetings between officials of the two sides, the furnishing of evidence that can be used in proceedings against violators, and the prompt facilitation of visits to relevant facilities upon the request of either party.  
\textsuperscript{96} Testimony of Jeffrey A. Bader, Deputy Assistant Secretary for East Asian and Pacific Affairs before the Senate Foreign Relations Committee, May 21, 1997, p. 2.  
\textsuperscript{97} Ibid.
States in the Spring of 1995; the Chinese government refused all U.S. requests for site visits throughout the rest of 1995. In 1996 Chinese authorities granted access to one prison labour facility requested by U.S. Customs, and to two sites in 1997. The U.S. Department of State's 1998 China Country Report on Human Rights Practices states that: "Although the signing of the SOC initially helped foster a more productive relationship between the U.S. Customs and Chinese authorities, cooperation overall has been inadequate."

According to the 1999 China Country Report on Human Rights, during 1999, U.S. Customs unsuccessfully pursued several standing requests to visit eight sites suspected of exporting prison labour products (one of which dated back to 1992, and several dating back to 1994), and renewed requests (several dating back to 1994) for the Chinese Ministry of Justice to investigate seven factories and three penal facilities for evidence of prison labour exports; none of these requests have been granted.

5.2.2 Religious Freedom:

The issue of religious freedom of the Chinese people and American concern over it has made this another irritant in the bilateral relationship. The growth of religion reflects the general weakening of the state's monolithic control over culture, due to the worldwide failure of Marxism, past years of Chinese interaction with other societies, the exposure to global information technology, and the global weakening of the nation-state in the post-Cold War era. In China as elsewhere this has fueled a shift of loyalty and identity to local communities and international communities. In the ideological vacuum in China, there is a search within the intellectual elite for a new social philosophy to guide the nation.

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into the next century, a societal search for daily support systems and community, and the perennial universal search by individuals for moral purpose beyond material survival. For many, there are answers in religion; for others, in more secular values. 100

Membership data on religious organisations in China suggests that the practice of religion continues to increase and the number of religious adherents continues to grow. Nevertheless, Chinese officials decided in 1994 to tighten restrictions on religious practices, and one result has been a marked increase in American criticism. Among other things, new restrictions prohibit evangelical activities and require all religious groups to register with the Religious Affairs Bureau (RAB). The RAB, charged with policing and regulating religious activities, is part of China's State Council and reports to the Communist Party's United Front Work Department.

The United States has also shown concerns over the crackdowns against political dissidents and the Falun Gong group. On July 22, 1999, the government outlawed Falun Gong, a spiritual movement in China said to combine Buddhist and Taoist meditation practices with a series of exercises. Chinese officials have accused the group of being a cult and fostering superstitious teachings.

It is acknowledged that while state registration and selective repression have had some chilling effects, in reality religious practices are flourishing as never before in 20th century China. While Americans support religious freedom - a freedom fundamental to core human rights values. Where as, China still regard religion as "potentially threatening" to Chinese social stability and that the Chinese government maintains intrusive controls over most if not all religious activity. Within the past year, two U.S. government reports - the Department of

100 Ibid

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State's Annual Report on International Religious Freedom for 1999, and the report issued on May 1, 2000, by the U.S. Commission on International Religious Freedom - have criticised Chinese government policies on religious practices.\(^{101}\)

Washington's effort has been to pursue the Chinese leaders through persistent and extensive discussion to understand that persecution of people of faith turns loyal citizens into opponents of the regime. Americans both in the private and public sectors have stressed to China's leaders a universal lesson that suppression is rarely effective when increasing numbers of a country's citizens are becoming people of faith\(^ {102}\).

### 5.3 Environmental Issues

Economic development, population growth, and increasing purchasing power and consumption combined impose a tremendous burden on China's environment and natural resources.\(^ {103}\) China is now regarded as a key player in global environmental challenges. China's participation in global solutions is critical to preventing climate change, controlling the production and transport of toxic chemicals and pesticides, endangered species and repairing the ozone layer. Environmental issues, however, have the potential to serve not only as a building block for U.S.-PRC cooperation but also as a model for how the United States will engage other developing nations with similar environmental problems.\(^ {104}\)

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\(^{101}\) See CRS Report 97-882, *China's Treatment of Religious Practices*

\(^{102}\) *The Atlanta Communiqué on China*, opcit; p.7.


While U.S. engagement with China is multifaceted, environmental issues have become a core component of improved relations. As demonstrated by a multitude of cooperative agreements between the United States and China on science and technology issues, the environment has developed into an area of flourishing success in U.S.-China relations.\textsuperscript{105}

The United States has shown concern over China's environmental difficulties, which continues to grow at alarming rates. China is the second largest emitter of greenhouse gases (the United States is first and has much higher per capita emissions than any other country), and its emissions are growing while those of most developed countries are either stabilizing or decreasing. Inefficient and "dirty" coal accounts for 75 percent of Chinese energy production, contributing to serious urban air pollution throughout China. According to the World Bank, at least five of the nine most polluted cities in the world are Chinese and 500 major cities in China do not meet World Health Organisation (WHO) air quality standards.\textsuperscript{106} Acid rain, stemming from the burning of China's high sulfur coal, causes $2.8 billion of damage to China's forests, agriculture, and industry every year.\textsuperscript{107} Other environmental concerns such as water quality and quantity, biodiversity loss, and food security are also reaching critical levels in China. Declining conditions have had measurable impacts on the health of Chinese citizens and economic growth.\textsuperscript{108}

\textsuperscript{105} Ibid.
\textsuperscript{108} The World Bank estimates that 178,000 people in major Chinese cities suffer premature deaths each year from pollution, and mortality rates from chronic obstructive pulmonary disease are five times those in the United States (World Bank, 1997; Mufson, 1997). The World Bank also estimates that air and water pollution damages equaled roughly 8 percent ($54 billion) of the Chinese GDP in 1995 (World Bank, 1997).
Over the years the United States and China have negotiated on various environment related issues. They have an extensive, active programme of bilateral environmental engagement with each other. These programmes help China address its environmental challenges while advancing United States' global environmental objectives and enhancing its ability to influence China's behavior. In 1997, Vice President Gore and China's Premier launched the U.S.-China Forum on Environment and Development to expand U.S.-China bilateral cooperation and dialogue. Under the Forum's aegis, a number of cooperative projects have been undertaken which, aimed at the local problems that contribute to regional and global environmental threats, and in the process have opened doors for U.S. companies. Outcomes of the last two sessions of the Forum (April 1999 and January 2000) include:

- The U.S. and China signed a joint statement on environmental cooperation on March 19, 1999 which marks a significant step in China's evolution toward greater cooperation with the U.S. in combating climate change, and commits both countries to cooperate on further development of international market mechanisms to mitigate greenhouse gases. The statement acknowledges that sustained economic growth can be achieved while taking action to address climate change. Both countries also commit to assure that increased trade does not harm natural resources and endangered species, and recognize the potential of China's WTO accession to advance clean energy and environmental protection goals.

- China has begun to examine market mechanisms, including domestic emissions trading, as tools to reduce sulfur dioxide emissions. An emissions cap and trade program could result in cost-effective reductions of sulfur dioxide and increased demand for sulfur scrubbing technologies.

109 Fact Sheet: China PNTR and the Environment, June 1, 2000
other pollution control equipment, and more efficient coal combustion equipment that U.S. firms might provide.

- The U.S. and China agreed on a $100 million Clean Energy Program under which the U.S. Export-Import Bank will provide financing for U.S. environmental exports to China. The program focuses on facilitating the deployment of clean U.S. technologies in the areas of energy efficiency, renewable energy, and pollution reduction. In January 2000 China identified the first project - a wind power station in Inner Mongolia - that might qualify for Clean Energy Program financing.

- The U.S. and China held a second meeting of the Oil & Gas Industry Forum in Houston, TX (July 1999), where they explored access to information, markets, acreage, and parity for foreign companies. The two countries are working on a joint study of natural gas utilisation in China to assess the potential for expanding natural gas production, a healthier and cleaner alternative. China is planning major investments to expand natural gas use.

- The U.S. and China have begun implementing the Housing Cooperation Initiative called for by President Clinton in July 1998. One of the objectives of cooperation under the Initiative is to promote the use of environmentally friendly, energy-efficient housing materials and design.

- The U.S. and China agreed to cooperate on an Urban Air Quality Monitoring Program, using U.S. equipment and technical assistance from the Environmental Protection Agency and California Air Resources Board. The Chinese have already purchased about $5 million in U.S. equipment to implement the first phase of this program in 11 Chinese cities and have signed a contract for an additional $13 million to implement phase two in 33 other Chinese cities.
• The U.S. and China have an extensive program of energy efficiency and renewable energy cooperation, including completion of a feasibility study for energy efficient buildings, installation of solar home systems, energy efficiency and renewable energy market assessments, and training and outreach programs.

• The U.S. and China have established a water resource management working group that includes a strong focus on developing commercial opportunities for U.S. companies.

China has acceded to a number of important international environmental treaties and has met its explicit obligations under these agreements. These agreements -- which have resulted in the strengthening of China's environmental protection institutions and increased contact with the international community -- provide United States best leverage for holding the Chinese to their commitments and inducing them to improve further. America's strong environmental engagement with China also provides them with opportunities to influence China's position on multilateral negotiations on global environmental issues. The following are the spheres where China has taken important steps:

• China is compliant with its commitments under the Convention on International Trade in Endangered Species (CITES). Parties to CITES are required to enact legislation establishing a scientific authority to determine the effect of trade on CITES-listed species and a management authority to regulate trade in the same.

• China is ahead of schedule to meet its commitments under the Montreal Protocol to the Vienna Convention for the Protection of the Ozone Layer. China is committed to phase out the use of chlorofluorocarbons (CFCs) and

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110 Ibid.
halons by 2010 and restricts trade in certain ozone depleting substances by 2002 or 2005, depending on the substance.

- China is in substantial compliance with its obligations as a signatory to the UN Framework Convention on Climate Change (UNFCCC).
- China participates in bilateral, regional, and international efforts to manage sustainable international fisheries.

Through continued engagement and explicit support for environmental projects, both countries can provide a framework within which businesses, NGOs, and foundations can successfully promote environmental problems.\textsuperscript{111} Such bilateral cooperation is vital in the emerging environment sensitive world where both the United States and China have important roles to play in future.

5.4 Security Issues

5.4.1 Arms control, disarmament, and nonproliferation

Arms control, disarmament, and nonproliferation have become prominent issues in U.S.-China relations after the end of the Cold War. Chinese sales of nuclear and missile technology to Pakistan and Iran further aggravated U.S.-China commercial relations. It is being said that a Chinese government owned company had sold Pakistan specialised magnets for use in equipment that enriches uranium for nuclear weapons. Similarly, Chinese were also providing Iran with technology for advanced chemical weapon factories. Under U.S. laws, these sales-if proved-could trigger economic sanctions unless the president issues a waiver for reasons of national interests or national security requirements. Nonproliferation experts calculate that the Chinese actions may have violated the nuclear non-proliferation treaty and four U.S. laws (See Annex 2.1 on U.S. Trade Laws). Two laws from the 1970s were passed by Congress to deter the spread of

\textsuperscript{111} Aaron Frank, op.cit,no.104,p.5
nuclear technologies from Europe to Third world countries, while two later laws were response to revelations that Washington had maintained close economic ties with Iraq while it was developing nuclear arms. The sanctions spelled out by the laws include: a ban on economic and military aid, a cutoff of international loans or loan guarantees, and a refusal of any sensitive U.S. commercial exports to china.

Even as President Clinton ordered a suspension of $10 billion in export-import bank financing of U.S. business deals in China, pending further investigation of the Pakistan and Iranian deals, the administration quietly approved Beijing’s participation in developing the world’s most advanced nuclear power reactor in the United States. Six Chinese nuclear engineers were granted visas to work with Westinghouse Electric Company on the reactor program. Officials justified the visa decision as securing a job-producing piece of China’s multibillion-dollar civilian nuclear technology market. China already operates French-built reactors and is also purchasing more from Russia and Canada. In this case, economics and the lure of China’s huge market won over nonproliferation concerns.

Similarly, the United States has sold F-16 fighters to Taiwan, an act Beijing believes to have created a serious threat to China’s national security interests. And yet U.S.-China differences on arms control are much less significant than problems in other realms, since the former usually do not involve policy principles. Indeed, unlike its attitude toward human rights, Beijing seldom challenges the nonproliferation principles Washington adheres to (although it often cites U.S. arms sales and its proliferation record to cast doubt on the sincerity of Washington’s belief in these principles)112.

112 Vogel, op.cit, no.42, p.202
In the past several years, Beijing has made substantial efforts to accommodate Washington's arms control agenda. Among other things, China in 1992 promised to abide by the Missile Technology Control Regime (MTCR) and acceded to the Nuclear Non-Proliferation Treaty (NPT). In 1993, China signed the Chemical Weapons Convention (CWC). In 1995, it suspended its nuclear energy cooperation agreement with Iran and stopped providing Tehran with Silkworm missiles. It has also placed its nuclear energy cooperation program with Algeria under the inspection of the International Atomic Energy Agency. These cases indicate that Beijing is willing to act responsibly on the arms control issue. In 1996, China signed the Comprehensive Test Ban Treaty; and in 1997, China joined the Zangger Committee of NPT exporters. On January 12, 1998, the President signed the required certifications to implement a nuclear cooperation agreement with China, citing that there had been "clear assurances" from China on nuclear non-proliferation issues. The actual U.S.-China Nuclear Cooperation agreement had been signed in 1985, but no cooperation had occurred under the agreement as of 1997, primarily because of concerns over China's proliferation activities.

It is true that in some cases, such as the continual transfer of nuclear technology to Pakistan and, more recently, the sale of tactical missiles to Iran, China has not acted in accordance with U.S. expectations. However, this is a reflection of the normal difference in the two countries' specific national security concerns. Just as it is difficult for the U.S. to cut off its supply of arms to Taiwan, it is difficult for China to stop its arms shipments to Pakistan.

\[^{113}\text{CRS Issue Brief IB92056, Chinese Proliferation of Weapons of Mass Destruction: Current Policy Issues}\]
With China's membership in the international arms control regime, the two countries have a number of common interests in this area. These include the full and effective implementation of existing arms control treaties, and the expansion of arms control regimes to address new challenges.

Towards these ends, the two countries should:

- ensure the effective implementation of both the Chemical Weapons Convention and the Biological Weapons Convention;
- address more seriously and thoughtfully the implementation of their obligations under Article VI of the Nuclear Non-Proliferation Treaty;
- strengthen controls over the export of militarily sensitive materials and technologies;
- identify new arms control initiatives that would enhance regional security; and
- pursue the entry into force of the Comprehensive Test Ban Treaty and an early start of negotiations on a cessation of the production of fissile materials\textsuperscript{114}.

Both countries have an interest in ensuring that their nuclear policies are consistent with the de-emphasis on nuclear weapons after the Cold War, and with the commitment to the eventual abolition of nuclear weapons. This is another area in which an expanded strategic dialogue between the United States and China would be useful, even if it did not lead to formal arms control measures\textsuperscript{115}.


\textsuperscript{115} Ibid
Bilateral strategic dialogue might also address the reservations that each country has about the other's nuclear program. Chinese experts are concerned about reported steps that the United States has taken to target China with nuclear weapons and to provide missile defenses to American friends and allies in the region. For their part, Americans are concerned about the expansion and modernisation of China's nuclear arsenal and ballistic missile capabilities.

The United States and China are also negotiating other arms control agreements. Washington wants to conclude with Beijing a detargeting agreement for nuclear missiles. Both China and the United States have such agreements with Russia. But China also wants to conclude an agreement on no-first-use of nuclear weapons. The United States has never signed such an agreement, concerned that it would undermine U.S. alliance commitments. The two sides are discussing a fission material production cutoff regime.

5.4.2 Espionage

Over the past years, cases of alleged Chinese espionage against the U.S. have become the major irritants in the bilateral relations. The U.S. media sources have reported about ongoing investigations of four cases of alleged Chinese espionage against the United States dating back to the 1980's. The most serious case involves China's alleged acquisition of significant information about the W-88, the most advanced miniaturised U.S. nuclear warhead, as a result of serious security breaches at the Los Alamos nuclear science lab between 1984 and 1988. Another serious instance involved allegations of espionage against a Taiwan-born Chinese American nuclear scientist, Wen Ho Lee of Los Alamos Laboratory. This particular issue prompted the congress to institute a committee under the chairmanship of Senator Cox. Senator Cox after investigating the issue
also submitted a detailed report to the Congress. The FBI is also continuing investigations into several other instances of reported espionage.\textsuperscript{116}

5.5. Sovereignty Issues

5.5.1 TAIWAN:

The Taiwan question has always been the single most important and most sensitive issue at the core of China-U.S. relations. Problems over Taiwan reflect its complex history. Taiwan "locals", mostly descendents of seventeenth century settlers from Fujian Province who brought Taiwan under Chinese control, have tense relations with the "mainlanders", the 15 percent of population who fled to Taiwan from the advancing Communists and subdued the locals and their descendents\textsuperscript{117}. The United States has been allied to the Kuomintang since World War II, but the link was solidified in 1950 during the Korean War. In December 1954, the U.S. signed the so-called Joint Defense Treaty with the Taiwan authorities, thus placing Taiwan Province of China under the protection of the United States.

The United States remained allied with Taiwan against Beijing until the early 1970s when Kissinger and Nixon visited China. In the 1972 Shanghai Communiqué, signed during President Nixon's visit to China, the U.S. acknowledged the Chinese position on both sides of the Taiwan Strait that "there is but one China and Taiwan is a part of China." In the 1978 Communiqué that laid the foundation for establishing full diplomatic relations on January 1, 1979, the U.S. further "recognised the government of the People's Republic of China as the sole legitimate government of China."

\textsuperscript{116} See CRS Report RL30143, \textit{China: Suspected Acquisition of U.S. Nuclear Weapon Data}

\textsuperscript{117} Vogel, opcit,no.42 p.36
With the "Normalisation Communiqué," the Carter administration transferred diplomatic recognition from Taipei to Beijing on January 1, 1979. However, it was still desired by U.S. to maintain as broad as possible a range of commercial, cultural and other, non-diplomatic ties with Taiwan. To make this non-diplomatic relationship with Taiwan work, the Carter administration had to create a legal basis. The vehicle for this was the Taiwan Relations Act of 1979. The TRA created the legal basis for establishing the American Institute in Taiwan, the organisation that became the United States unofficial representative office in Taiwan, and maintain continuing contacts between Washington DC and Taipei.

However, the 96th U.S. Congress also added a section to the TRA that the Carter administration had not asked for: Section 2 (b) which obliged the U.S. "to provide Taiwan with arms of a defensive character," and which also enjoined the U.S. to "maintain the capacity...to resist any resort to force or other forms of coercion that would jeopardize the security, or the social or economic system, of the people of Taiwan." The insertion of Section 2 (b) to the TRA presumably was intended to cover, as vaguely as politically possible, the termination of the U.S.-ROC Joint Military Assistance Treaty, which was abrogated effective January 1, 1980 by the U.S. under the terms of the treaty. The abrogation of this treaty was done in order to complete normalisation of relations with Beijing.

In August 1982, the U.S.-China signed the third joint communiqué- in which they pledged to--"Respect for each other's sovereignty and territorial

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integrity and non-interference in each other's internal affairs constitute the fundamental principles guiding United States-China relations."

Despite the communiqués and the Taiwan Relations Act, in recent years, the Taiwan issue has posed delicate problems in the Sino-U.S. bilateral relations. The controversial statements made by U.S. government officials, the arm sales to Taiwan and Taiwan president Lee-Teng Hui's visit to the U.S. has heightened the tensions between the two countries.

Besides, Washington's political as well as strategic interests over Taiwan; the PRC has great interest in Taiwan. Taiwan is one of the major trading partners of China. In these past years, both China and Taiwan have tried to negotiate bilaterally over managing cross-strait relations, which is critical to the leaders in Beijing and Taipei. So long as tensions across the Taiwan Strait remain low, there is every reason to hope that mainland China and Taiwan can continue to nurture their own constructive relationship, reaching accommodations according to their own terms and at their own pace. The role of the United States is to refrain from acting in a way that might heighten tensions, while insisting that differences are resolved through peaceful means.

5.5.2 TIBET

The Beijing-Washington confrontation opened a new chapter in 1959, when the Tibetan spiritual leader, the Dalai Lama, fled his homeland and exiled in India. Since then, Tibet crisis has become a recurring issue. A number of factors have contributed to the heightened interest, including: the Dalai Lama's

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119 White paper on the U.S. China relationship by Committee of 100, More Information: c100chna.htm
120 Ibid.
and the Tibetan community's ongoing international political activities; reports of human rights abuses and China's continuing repressive social and political controls in Tibet; and disputes among U.S. policymakers over the direction of U.S. policy toward China. As a matter of policy, the U.S. government recognizes Tibet as part of China and has always done so, although some dispute the historical consistency of this U.S. position. Since normalisation of relations with the PRC in 1979, both Republican and Democratic U.S. Administrations have favored policies of engagement with China. Accordingly, they have sought to minimize areas of potential tension with Beijing where Chinese leaders have taken strong positions, such as on the question of Tibet's political status.

The Tibet issue is a difficult issue in U.S.-China relations because it is one of the world's most intractable conflicts. It has been continuously recurring in the bilateral relations without any substantial effort from both the sides for any reasonable solution to it. The PRC has great leverage in Tibet. While the exiles in the mid-to-late 1990s capitalised on earlier gains in the West from internationalisation, visible separatism in Tibet abated. There were 'riots' in Lhasa during the first half-dozen years of internationalisation, but no major demonstrations since 1993. Repression, political persuasion, acculturation and social mobility contributed to the remission of separatist activity. Many PRC officials argue that economic and cultural change in Tibet will ameliorate separatism and that the Dalai Lama's passing will end the Tibet Question.

The PRC has not acknowledged a Tibet Question in U.S.-China relations. Even had the PRC done so, conflicts over other issues after 1989 precluded it

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121 CRS Report RS20395, *Tibet and China: Current Issues and Implications for U.S. Policy*
122 Kerry Dumbaugh, op.cit, no.33.
from regarding foreign states as levers for realizing negotiations over Tibet. This has been especially true as to the U.S., which officially recognizes Chinese sovereignty over Tibet, but has been a bulwark of the Tibetan exiles. At the same time, because of the 'Tibet Lobby,' the U.S. has been reluctant to play a role in the prenegotiation process. Officially, it feigns ignorance as to why no negotiations have taken place and leaves it to the parties to solve their problems.

In the case of Tibet, there are no strategic U.S. interests involved. Craig Thomas (R-WY), has stated, however, that concern among Americans about human rights in Tibet is sufficient to generate continuous official interest in the situation there."125

Geopolitical changes in the post-World War II era, starting with China's 1950 invasion of Tibet, have served to move the Tibet issue gradually forward to the prominent place it occupies in the U.S. foreign policy debate today. President Bush met with the Dalai Lama, the first U.S. head of state to meet with his Tibetan counterpart, and under President Clinton the improvement of the Tibetan human rights situation had become an added condition on the renewal of China's MFN trading status. However, the official U.S. position that Tibet is a part of China remains unchanged. Presidents have been unwilling to sacrifice good relations with Beijing to the cause of Tibetan independence because they have believed that favorable ties with the PRC to be more important for American interests in Asia.126

5.5.3 Hong Kong

125 Ibid
126 Guangqiu Xu "The United States and the Tibet Issue" Asian Survey v37, n11 (Nov, 1997)
On July 1, 1997, Hong Kong reverted from British back to Chinese sovereignty in a remarkably smooth transition. The former British colony is now known as the Hong Kong Special Administrative Region (SAR) of the People's Republic of China. Also on July 1, 1997, Hong Kong officials swore in the new and provisional legislature, the Beijing-appointed body that temporarily replaced Hong Kong's duly elected Legislative Council. On May 24, 1998, new legislative council elections were held under agreements adopted on September 28, 1997, by the provisional legislature 127.

The United States attention on Hong Kong's postcolonial fate after the Chinese takeover has focused on whether or not Beijing will allow Hong Kong to retain its freedom of expression. In this circumstance, Beijing faces a more profound challenge in the absence of a well-coordinated strategy to handle the Hong Kong problem 128.

Indeed, Beijing's basic aims in Hong Kong are contradictory. On the one hand, Beijing's leaders certainly understand that Hong Kong's continued prosperity will be crucial for the PRC to sustain its long-range plans of nationwide economic development, and that Hong Kong will serve as a the single most important example in carrying out Beijing's "one country, two system" policy toward Taiwan. On the other hand, however, Beijing's leaders also understand that Hong Kong has such a distinctive political culture from that of the mainland and are worried that Hong Kong's tradition of free political expression will not only make their rule over Hong Kong difficult but also have an adverse impact on the mainland's political development. Hence, from

127 Kerry Dumbaugh, op.cit, no.33.
Beijing's perspective, the development of Hong Kong's political situation should not elude the PRC's control.

Beijing will try to balance the two aims, with the hope that it will achieve both. At some point, though, it will have to choose between the two aims. Despite its desire to control autonomous economic and political institutions in the former colony, if Beijing fails to maintain prosperity in Hong Kong, profound negative consequences will extend far beyond the region. It will endanger China's overall reform-and-opening process, create a new source of crisis between the mainland and Taiwan, and, consequently, worsen the prospects for improved Chinese-American relations.

In these years, Washington's strategy has always been to encourage Beijing to emphasize the maintenance and promotion of prosperity as the top priority of its Hong Kong policy. Washington also has made the Hong Kong issue a central part of its strategic dialogue with China, emphasizing to Beijing's leaders that their proper handling of the Hong Kong issue will help create and enhance an important positive theme in U.S.-China relations. The United States has been very careful about taking any steps that may reduce Hong Kong's capacity to remain a key international commercial and financial center. They very well understand that revoking China's MFN status will directly jeopardize Hong Kong's trading power as well their own economic interests.

The trade and non-trade issues discussed above will be featuring with varying degrees and measures in the Sino-U.S. bilateral relationship in the 21st century. However, positive and enduring U.S.-China relations cannot exist without a clearly defined, long-term vision of the substance of the relationship.
Such a relationship cannot be sustained without a clear, consistent approach and effective means of implementation by both the countries. Such policy must not focus on single or selected few issues but must cover a wide range of issues including the future of Taiwan, weapon proliferation and arms control, the advancement of democracy, the expression of human rights, environmental protection and restoration, drug trafficking, illegal immigration, protection of intellectual properties, free trade and open market access and others. Many of these issues are interrelated. They cannot and should not be dealt with separately. In the greater interests of both countries, any single interests group shouldn’t dominate the common policy. It should not be based upon short-term interests while overlooking long-term interests.