

# U.S.-CHINA RELATIONS AT A CROSSROADS BRIEFING ON HU JINTAO'S STATE VISIT

THURSDAY, JANUARY 13, 2001  
WASHINGTON, D.C.

**WELCOME/MODERATOR:**

**Doug Paal**

Vice President for Studies  
Carnegie Endowment for International Peace

**SPEAKERS:**

**J. Stapleton Roy**

Director, Kissinger Institute on China and the United States  
Woodrow Wilson International Center for Scholars

**Yukon Huang**

Senior Associate, Asia Program  
Carnegie Endowment for International Peace

**Michael Swaine**

Senior Associate, Asia Program  
Carnegie Endowment for International Peace

Transcript by Federal News Service  
Washington, D.C.

*Transcript Not Checked Against Delivery*

(Off-side conversation.)

[00:01:36]

DOUG PAAL: Good morning, everyone, and welcome to Carnegie Endowment for International Peace. My name's Doug Paal, I'm vice president for studies here. I see some of you are familiar with us. I'm sorry to go through the introduction. Thank you.

There are a lot of things going on in preparation for the visit next week by Hu Jintao on a state visit to Washington, and you have many choices of places to go, so we're grateful you've taken the time to come and join us this morning.

We have a panel that is assembled to look at several aspects of this visit. I'm going to make a few remarks about the context and the expectations for the visit. I'm going to ask Yukon Huang to talk about the economic side in greater detail and then Michael Swaine to look at the military-security dimensions of this visit – not only that, but also Secretary Gates' visit to China in the past week, of course.

[00:02:33]

To set the context, and Stape really is our monitor and will offer his thoughts as he goes forward. Stape can observe on all of these topics and more with deep, deep experience, not only with China itself but also in handling U.S. official dealings with China, the ins and outs of protocol and expectations.

The context – I find it useful to look back and say, where have we gone with China since the beginning of the relationship which started in '72, '73 with Nixon's initiative? We had seven, eight years during which Ambassador Roy served in Beijing and during the transition from being a liaison office to a full embassy, and then up to 1989, '90, the U.S. had a pretty good common understanding with China that our strategic objective was anti-Soviet.

We had a common purpose, and that common purpose, as was true in the Cold War, allowed us to overlook a lot of our differences – human rights, systemic differences, different interests in the region.

When the Tiananmen incident occurred in China and the collapse of the Soviet Union ensued, we lost that central, coherent strategic rationale for the relationship and we entered a period of sort of walking around each other, China and the U.S., trying to figure out where we're going, what is our strategic purpose.

[00:04:08]

And the Chinese became highly concerned in that period about American efforts that they thought were intended to contain China, to keep it from realizing its potential. The United States was highly concerned about trade and human rights issues. This is heavily oversimplified, but we had a period when things really didn't cohere very well.

After 2001, the U.S. turned its attention to counterterrorism, and China, which had negotiated its entry into the World Trade Organization, focused on rapid development and development of military capabilities, initially focused on their concern about Taiwan's temptation to become an independent entity and to escape China's efforts to reunify Taiwan.

*Transcript Not Checked Against Delivery*

[00:04:59]

And so again, the period of – the first decade of the 21<sup>st</sup> century didn't really have a theme in the U.S.-China relations. In that period, China now has gone from being a large and consequential but not very modern and not very powerful country to being a much more powerful, much more economically successful country with much more broad-ranging interests, not just in the periphery of China and inside China, but also well beyond, in Africa, Latin America and the trade routes of the world, the sea lanes of communication, energy sources.

And the U.S. and China now have to decide how we're going to handle our differences. President Obama in 2009 tried an original approach to the Chinese. He decided to work on the main themes that he had identified in his campaign that needed international attention and seek Chinese cooperation, and those of course were the financial crisis, climate change and nonproliferation, nonproliferation being code words for Iran and North Korea.

[00:06:06]

The results of that on those three issues were mixed. Chinese cooperation on the global financial situation was quite successful in the initial phase. Chinese cooperation on nonproliferation was pretty good on Iran and mixed on North Korea, and on climate change, we had a real breakdown and barely an agreement out of Copenhagen, and so some disappointment.

But after that, we very rapidly descended into a period of more contentiousness, and things happened that weren't all caused by China, but things happened to which China reacted very strongly. One was the sale of arms to Taiwan by the United States, second was the president's visit with the Dalai Lama. But this escalated through the year with differing views about how to operate in the South China Sea, concerns about North Korea's provocative actions in March in sinking a South Korean ship later in the year.

[00:07:13]

And all of us observed a heightened rhetoric in the newly freed media of China. Where you can't really criticize China in China's free or not official media, you can easily criticize the United States, and that became sort of a major activity of China's thinkers, and a real debate arose. And I hope maybe we can get Ambassador Roy to talk a little bit about this in detail later.

The Obama administration saw all this and said, this is getting very difficult, we need to find some way of managing it. And they decided to offer a state visit to President Hu Jintao to come to the United States. This is something that was assumed to have an appeal to him because he's coming to the end of his 10 years of power, he would want to have a legacy visit. The previous official visit he had to Washington was unsatisfactory to the Chinese in many ways, and even to the United States, because some things went wrong in the visit.

[00:08:14]

And they thought this would have kind of an allure to the Chinese that could then lead to some improvements in the overall relationship. People in the administration, namely the current national security advisor, Tom Donilon, who was then deputy, and Larry Summers, who was running the National Economic Council, went to China in September and tried to lay out a roadmap for the administration to the Chinese about what things could be done that would lead to a successful state visit.

*Transcript Not Checked Against Delivery*

And they talked about things like currency and trade, resumption of a military relationship that had a been ruptured by the Taiwan arms sales in February, and dealing with the North Korean and other issues that have arisen in regional affairs.

Meanwhile, the U.S. was also taking measures to strengthen its alliances with Korea and Japan, to bolster its relationship with the countries of concern in Southeast Asia as well so that this was not just an appeal to the Chinese, it was also some backbone in the policy to try to show China that we were firmly planted in East Asia, to try to send a signal to people in China who have concluded that the U.S. is down now because of its economic plight and it's a good time for China to push out into areas of former American dominance. And I think Michael will talk a little bit about this when he gets to this portion.

[00:09:49]

After the Donilon and Summers trip to China, we have seen quite a few steps, none of which satisfies us 100 percent in our relationship with China, nor had anyone expected that kind of progress. But we've seen incremental progress in a number of areas, even in climate change, where with the recent Cancun meeting, the gap between the U.S. and China on an important area of verification has been closed.

Currency has adjusted in the period since June. Inflation adjusted about 5 percent, real terms about 3.6 percent – not enough to say we're satisfied, but enough to say we didn't get nothing, that something got done.

The trade-market access issues – the Joint Commission on Commerce and Trade held a meeting here in December, and there were a number of things that were decided, some of which have yet to be implemented. But those decisions were characterized by the participants in the Joint Commission on Commerce and Trade as the most far-reaching and successful of any of the previous commissions, which had been going on for 20-plus years.

[00:11:04]

Finally, the Chinese agreed to resume military-to-military talks. We had a series of staged events. The Defensive Consultative Talks took place in early December, and as many of you are aware, Secretary Gates went to Beijing earlier this week for a trip that got a lot of publicity, and I'm sure we can talk about that.

Finally, the – during this period, when we were trying to get the U.S.-China relationship onto a more manageable path where our differences could be handled without getting into extremes or with high levels of friction, North Korea took a number of actions, most prominently firing into the Yeonpyeong Island and killing four people and revealing to a number of observers its new uranium enrichment facility, which is obviously an attempt to bait us back into talks and to giving them some resources

[00:12:01]

And this level of provocation had sort of finally tilted the public and the government in South Korea to the point where they were no longer going to just passively react to the provocations and somehow try to buy off the North Koreans. Attitudes had hardened in South Korea, and the United States concluded that the continued effort by North Korea to build nuclear weapons and to develop the missiles to deliver them was becoming increasingly a direct threat to the United States, and therefore we had to convey that to China, because China had been seemingly sitting on its hands through the whole period and not taking effective action.

*Transcript Not Checked Against Delivery*

President Obama called President Hu Jintao on December 5 and said he wanted to send another delegation, this time led by Deputy Secretary Jim Steinberg and Jeffrey Bader from the NSC, to go to China and talk about what we could do, not only about North Korea but also to get to the final state of preparations for the upcoming state visit.

[00:13:00]

Now, the Chinese have never said, announced or told us that they did something with North Korea, but State Councilor Dai Bingguo did take a trip to North Korea, and the behavior subsequently of North Korea was that somehow they had figured out they weren't going to play our tune anymore and they were going to – it was their decision, they were no longer going to be provocative with South Korea, they had done enough.

So one has to infer that China had some important impact on North Korea, at least for the short term, and perhaps we've bought some quiet between now, the state visit and a decent interval thereafter. Hopefully it'll be longer than that, and maybe a negotiation can follow to make it more permanent. But at least we have a temporary truce.

Now, next week the visit's going to take place, and there are a number of baskets for this visit. They've got the economic basket of activities. Hu Jintao will speak in Chicago, visit a Chinese-invested factory that makes auto parts in the Chicago area. He's bringing some CEOs with him. There will be some effort to – currently being negotiated in Beijing by a team that is there, trying to wrap up some of the projects and complete some of the work that had been started by the Joint Commission on Commerce and Trade in December.

[00:14:19]

There's a human rights and political issues basket of issues that they'll be addressing. The United States and China likely are to agree to resume the human rights dialogue. This has not been a terribly fruitful thing, and it's been turned on and off with the political temperatures in the relationship, but it's better than no dialogue in that it allows the U.S. to put forth its concerns about named individuals, cases that are being adjudicated or people we think should be released from prison as prisoners of conscience.

[00:14:51]

And the Chinese will present their usual cases about Guantanamo Bay and other things that they don't like or talking points that they have on the shelf. There's a separate anticipated dialogue to emerge, which is a rule-of-law dialogue, and to my knowledge we have not had an organized rule-of-law dialogue. This will be a new area and a chance to see what we can do to support the very beginning effort in China to have rule by law, rather than rule by man. I'm sure this is a very open-ended agenda.

On the security side, there's a basket of concerns, and obviously the two presidents will want to talk about, again, North Korea, about the U.S.-Japan alliances. I'm sure China will want to raise Taiwan and urge that no arm sales further be made to Taiwan, and the U.S. would say, well, why don't you stop arming up against Taiwan and make this an easier solution?

[00:15:48]

*Transcript Not Checked Against Delivery*

And they have issues on much more far-ranging than in the past of Iran, Sudan and the like that turn up on the U.S.-China foreign policy agenda. Mr. Hu will be welcomed on the South Lawn of the White House on the 19<sup>th</sup>. Hopefully the weather will cooperate, that's a tough time of year. Then they will have a lunch with the vice president and he'll go to the White House for a full-blown bells and whistles state dinner that evening.

The following day he'll make a speech here in Washington after meeting with members of the leadership in both houses of Congress on Capitol Hill. He'll make a speech to a large gathering hosted by a large number of NGOs and think tanks here in Washington, and that will presumably be his foreign policy and U.S.-China policy speech for the occasion. And then he'll go off to Chicago to make his economic policy speech before leaving.

When you look at this trip – just in summary – when you look at this kind of visit, there's always the temptation in the media to say, well, what kind of T-shirts did we get from this one? You know, what were the deliverables, what presents did they bring? The Japanese say, what – (in Japanese).

[00:17:06]

And I think that's sort of inevitable, but it's really not that helpful to look at this way. I think most of the deliverables were delivered between September and now – the Gates visit, the Joint Commission on Commerce and Trade, climate change and the like. There'll be a few more things out of this visit.

But we're maturing in this relationship to a point where it's like our other big relationships. We don't expect a lot of gifts from the German chancellor. Sarkozy came and went this week and there wasn't any talk about that sort of thing. And China's going to be more of a normal relationship as we go forward. We're not going to – I hope we won't be focused on what little things got left behind by the visitor.

[00:17:46]

And as we go forward, I hope that this new period will allow us with the Chinese to get past this last year, 2010, where debate within China and confusion about relative power of the U.S. and China really caused the Chinese to experiment in ways that probably damaged Chinese foreign policy interests with their neighbors. It certainly raised concern about what China's long-term ambitions are.

If the Chinese officially say they understand that, they've been making statements to urge their people not to think of China as number one, but just another big country, not to think that they can push the U.S. out of its place in the world as number one. And obviously, that's the official line now. But there are people who have got different views, and they can express them in China.

The goal is to have both the U.S. and China find a way to narrow that – the bandwidth of disagreements so that we have a manageable area within which to handle what will always be emerging frictions in U.S.-China relations.

[00:18:59]

This is particularly important because we will, in 2012, go through transitions. In China, the current president, Hu Jintao, will step down. In between now and then, he has to make secession arrangements with his colleagues. And the successors will come in, and presumably they'll need time to get their affairs in order and to decide what the flavor they're going to impart to Chinese government will be 2012-2013.

*Transcript Not Checked Against Delivery*

So we're going through a transition period that has the potential for throwing up new challenges. And the U.S. will have an election. Congress will have its concerns about things like trade and Chinese military capabilities that could be reflected in legislation that will also have its effect on bilateral relations.

So we're going into a critical period, and this effort, this invitation to Hu Jintao is an effort – as I read it – by the administration to bound the amount of disagreement between the U.S. – put some boundaries on it and to put us in a place where we can actually work on our issues without being distracted by repeated flare-ups of confrontation between the U.S. and China around China and in areas where our interest now bump into each other. So that's just a broad look at the context and the expectations for this visit, particularly.

I'd like now to turn to my colleague, Yukon Huang, who's got great experience –

[00:20:26]

MR. : No, let me –

MR. PAUL: You want to do that now?

J. STAPLETON ROY: Let me say a few words.

MR. PAUL: Please.

MR. ROY: (Inaudible) – take over. Good morning. In U.S. embassies, whenever you have an important American visitor coming to your country, you always send a cable saying – a scene-setting cable saying your visit is occurring at a critical juncture. If I were sending a cable to President Hu, I would say the same thing to him. Our program refers to the relationship as being at a crossroads. You could refer to it as occurring at a strategic moment in the relationship.

[00:21:10]

But what the – what this jargon language is really saying we're having difficulties in U.S.-China relations at the moment. The underlying factors are not as bad in some ways as they appear on the surface, but public attitudes in both countries tend to see the relationship as not moving in the right direction, moving less toward cooperation, perhaps, than toward eventual confrontation.

And visits by senior leaders can make an enormous difference in altering those types of trends. I mean the classic case is President Nixon's to China in 1972. We're not at that type of a critical juncture in our relations with China. But President Hu's visit is the return visit for President Obama's visit to China in November of 2009.

[00:22:09]

At that time, they issued a joint statement that set out a broad, positive roadmap for the relationship with the goal being – agreed to by both sides – that we wanted a positive, cooperative and comprehensive relationship. But over the last year, the positive cooperative aspects of the relationship have been overshadowed by the frictions in the relationship and by the areas of mistrust between us. Doug has already illustrated some of those.

*Transcript Not Checked Against Delivery*

So the real question and the challenge for this visit is will it be successful in restoring a sense that leaders on both sides see this relationship as having a strong, positive potential which is more significant than the competitive factors that exist in every relationship between strong, powerful countries.

[00:23:14]

One of the challenges for the relationship is that there's an asymmetry in the way that it is viewed in each country. While there's concern in the United States about China's growing military strength, at the political level, the real problem is that ordinary Americans tend to see China's economic growth as damaging the American economy and coming at the expense of the American worker.

Whereas on the Chinese side, the problem is much more viewed as a strategic problem for China since they believe the United States is carrying out a thinly veiled containment strategy against China that is designed to hold China down, keep it in place and preserve the American position of primacy in East Asia and the world.

So we are fortunate in having Dr. Huang and –

[00:24:15]

MR. : Michael Swaine.

MR. ROY: Michael Swaine. (Laughter.) I was going to say Dr. Swaine – that's what I was trying to fumble around for the right term because they are – they are experts in these two areas, the economic aspect and the political security aspects. So I will ask them to make their presentations now. First, Dr. Huang and then Dr. Swaine. And then we can have some broader discussion and get to a question-and-answer period as well. Dr. Huang.

YUKON HUANG: Thank you, Ambassador. Thank you, Doug. These – these discussions were never really focused on the political security aspects. The economic issues have contributed to their share of the tension building over the past year. What I would like to do is to classify these economic issues into three categories. I call them the three wars: the currency wars, the technology wars, the financial wars.

[00:25:19]

I think the challenge between America and China in the coming year is whether the basis for addressing these economic issues can be shifted from what I would call a win-lose framework to a win-win framework so that both sides actually see that there's something to gain rather than from a framework which dominated the past that conveyed a sense that I will win only at your expense, which is very, basically, nonproductive.

Now, both the U.S. and China have a lot at stake. They would likely certainly change the tenor of these discussions. And I would even more so on China's side. China would like to reestablish what I would call the theme of its position prior to the crisis. And namely, it was a theme that said China's rising but it's an opportunity rather than a threat.

It would like to allude to the fact that in Asia, China's rise has led to increasing trade markets, more rapid growth, more outward flows of investment to neighboring countries. And together, East Asia's benefitted considerably.

## *Transcript Not Checked Against Delivery*

[00:26:22]

However, if you look at the China-U.S. bilateral relationships, tensions have been aggravated because this relationship tends to look at it as a zero-sum game. I can only gain if you lose. And this obviously serves no one's interest. So how do you go from a win-lose to a win-win kind of approach? How do you establish the basis of tackling what I call the longer-term issues, many of which are going to be very contentious and difficult to resolve?

And let me start with the currency war. Now, in a very politically charged atmosphere, the U.S. message which comes across to China is very, very simple. We have a large – very large trade deficit with China. And a solution to this is that you must appreciate your exchange rate by as much as 20 percent. And if you do so, American problems will be resolved.

[00:27:16]

Now, this is a win-lose message. It essentially says that I, America, need to grow more rapidly. I need to export more. And for me to do so, you've got to export less. You've got to grow less. It's a win-lose. And there's a way of actually changing this whole debate around so it's not a win-lose to win-win strategy.

Now, China's response has, in my view, been overly conservative, reactive rather than imaginative. It needs to rethink how it wants to address this set of issues. A more flexible exchange rate system is clearly in China's advantage. It offers an important tool to address what I would call a very important current concern and that's inflation and that China needs, in its instruments, to address.

[00:28:03]

Now, the trade imbalance issue is much more complex. It involves a range of what I would call fiscal and structural issues, policy actions on both sides to resolve these imbalances. Now, moving forward, if both sides can take this wide range of actions and move from what I would call a beggar-thy-neighbor sentiment to a more positive approach, I think a lot of progress can be made.

Now, China's growth is actually shifting gradually in ways which will address these imbalances. But this is – this shift is actually going much more slowly than it should be and China can do much more in this regard. Now, if you look at the exchange rate issue – and let me just give you a few numbers.

China introduced a more flexible system last June. It was able to do so because the euro had collapsed and because euro collapsed, it allowed it to introduce a more flexible system. Now, if you go to details, you'll see that China's adjusted the exchange rate 135 times over the last six months.

[00:29:04]

And what is interesting is if you look at the three politically charged events, and that was Prime Minister Wen's visit to the United States and Europe, the G20 discussions in Korea and the upcoming visit to Hu, if you take those three events, China basically appreciates exchange rate 31 times and reduced it six times for a net gain of 3 percent or more.

However, the remaining period – the intervening period, the rate went up as many times as it went down and overall, actually, depreciated rather than appreciated it. So the net change, as of today, has only been 2.5 percent.

## *Transcript Not Checked Against Delivery*

So what China's basically trying to establish is I want flexibility. But it's not yet convinced that appreciating currency is really in its goals and I think we have to bear that in mind.

[00:29:51]

Now, why does it feel that appreciating the currency isn't such a big deal, but flexibility is? And it's primarily because they think, actually, the trade imbalance problem is going to resolve itself. China's trade imbalance – trade surplus last year, 2010 fell to 3 percent of GDP from 8 percent five years ago. And some people are forecasting that it'll actually fall to maybe 2 percent over the next few years.

So it actually doesn't see the trade surplus issue as being a big deal. It's actually happening even though the exchange rate hasn't changed that much. Now, what is a big deal is the pattern of growth in China. And the issue here is that China has and will continue to have an extraordinarily high labor productivity based upon past investments. So its trade surpluses are likely to continue to be significant in the coming years.

Now, what is interesting is though trade volumes globally have fallen because of the financial crisis, China has actually been increasing its share. And to some extent, its share has been increasing in emerging markets because it depressed markets in the United States and Europe. So I think a very interesting development in the coming years is that the other emerging-market countries who see themselves as – increasingly as competitors to China may be as vociferous on the exchange rate issue as the U.S. has been in the past.

[00:31:14]

Now, let me move to what I would call the technology wars. This, in fact, in my view, is likely to more emotional and contentious in the coming years than even trade and currency. Let's take the Americans' perspective. What they see is that China's being very aggressive in trying to acquire foreign technologies.

It's put forward rules and guidelines to encourage domestic companies to move up the value chain. It's promoting a strategy of what the United States calls indigenous innovation. It's providing support to its companies to acquire and improve their technologies. And from the U.S. perspective, this is seen as being unfair, in some cases, breaking internationally recognized guidelines.

[00:32:00]

Now, let's look at this from China's perspective. China sees itself mired in low-cost, labor-intensive production processes that generate wages of 2,000 renminbi a month, on average. If they want to move to a high-income status, this just won't work.

Approximately half of China's trade is processing. More than half of China's trade is processing. Of that processing trade, 90 percent of it might be what I'd call high-tech products but all of that is produced overseas. China's only producing about 5 percent of the high-technology commodities. And it sees that this needs to change if it wants to increase its income levels and move to high-income status.

[00:32:39]

*Transcript Not Checked Against Delivery*

So there's a natural conflict here. The rules of the game are very blurred. One side says that you're subsidizing production. The other side is subsidizing consumption. And WTO role's a little ambiguous in this regard.

Let me give you the example of green-growth technologies. China sees this as a growth vehicle in the future. It is going very rapidly, trying to help and increase production of energy-saving technologies. It sees this as being consistent with climate change rules. It sees this as being very helpful to the global economy.

It's putting a lot of money and subsidies into this area. But this is making the United States very nervous because U.S. is seeing itself not being able to be competitive in areas like solar cells, wind turbine engines, high-efficiency batteries, a major problem.

[00:33:27]

Is there a potential win-win approach here? And I think there is. But that approach requires a very hard look at whether you can combine U.S. comparative advantages in technology, research, design and marketing with China's productive power and there should be room in the future to develop what I would call the win-win approach in this area.

Finally, let me turn to the issue of what I call financial wars. And this I would like to begin by noting that it's a very sudden development over the last year. Let me start off by noting that U.S. policies toward stimulating the economy over the last several months, as symbolized by QE2 – quantitative easing two the monetary expansion has made many countries nervous.

They see as encouraging capital flows through their countries and they've been critical of this. And they see this as putting pressure on the exchange rate. And China's among some of the more vocal critics. Now, I think the criticism from China's side and from some of these other countries is overdone. U.S. policies toward QE2, I don't think will have these detrimental effects.

[00:34:35]

It is in the global interest, in fact, for the U.S. to revive its economy. So let me put that to the side. But it is policies like this that's basically encouraged China to try to internationalize the renminbi and this is actually a very startling development. It's likely to accelerate at a pace which we probably would not have imagined a year ago.

Now, if you think about it, China is the second largest economy. It's the world's largest trading country. Yet, the renminbi is not an international currency. You can hardly find it. Holdings overseas are negligible. This is actually a very strange phenomenon.

Attitudes in China have changed a lot. They now see it as in its own interest to international the RMB. In the past, when they looked at this issue, they never – they could never figure out whether making the RMB an international currency was an opportunity, a necessity or a trick. And they now say to themselves, you know, if we have strong objectives in making it – the renminbi an international currency, there's much to be gained in this process.

[00:35:47]

## *Transcript Not Checked Against Delivery*

And one of the reasons that U.S. – the United States has been able to run current account deficits more or less at will because the dollar is the international currency and this contributes to their fears that the value of the dollar would decline and the reserves would decline.

So how do you begin? How has China been trying to encourage this process? Well, first of all, they're basically saying, well, let us try by trying to make the renminbi a unit of settlement for trade. And if you go back over the last year from essentially zero, six months ago, approximately \$500 billion equivalent of renminbi trade has been settled in renminbi. That's startling.

[00:36:26]

If you go up to – if you look at the opening of offshore accounts in renminbi in Hong Kong, they now total \$300 billion renminbi equivalent. And there are estimates that this will go to two to 3 trillion (renminbi) within the next several years. This is just an incredible increase. So I think the process of internationalizing the renminbi will continue and accelerate.

But there are lots of uncertainties about this. And the reason why there are lots of uncertainties is the process of internationalizing the renminbi goes counter to all our understandings about how the process should work. Usually begin by saying that the renminbi should be convertible. You can change it to any currency you want.

Then you begin by also – then follow that by saying it should be – currency – capital should be freely going into China and out of China. Neither of these two conditions exist. It's only after these two conditions exist that you can actually have international currency, but China's starting the other way.

It would like RMB to be an international currency, but it is unwilling to let money move in and out of China freely. It's unwilling to let the currency to be exchanged freely and mainly because it wants to control the value of the renminbi. Now, there's a major inconsistency or conflict between having the renminbi as international currency and trying to control its value.

[00:37:57]

And this particular conflict is not fully appreciated in China. But nevertheless, the process is underway. The forces are great. By actually making the renminbi a potential international currency, the demand for its use is enormous. And just the other day, you read that the Bank of China is going to make it – or allow renminbi accounts to be established in New York.

And once you get going, you create a huge constituency, of firms, of companies, of banks who want to use the renminbi. It's unstoppable momentum, actually. Now, why is this movement a win-win solution for both sides? And the reason is that this is a slippery slope. It's more or less inevitable that the outcome is that the renminbi becomes more freely used.

[00:38:43]

It's more or less inevitable that the value of the renminbi starts to move in line with market sentiments. And when it does that, the big debate about appreciating or depreciating the renminbi becomes obsolete. And this is clearly the U.S. interest. Let me stop here.

*Transcript Not Checked Against Delivery*

MR. ROY: Okay, thank you. Michael?

MICHAEL SWAINE: Thank you. I – as Doug suggested – let me say a few words about the mil-mil relationship between the U.S. and China and the Gates trip and then connect that to the Hu Jintao visit.

[00:39:25]

And just as parenthetical, it's interesting to note in light of what Stape said about asymmetries between the U.S. and China and the way they perceive the sort of center issues in the relationship, the recent results of the Pew Research Corporation's measuring of U.S. public opinion towards China, if you've seen this, that emphasized, indeed, that most Americans are concerned about China as an economic issue and as a potential economic threat.

And there are relatively fewer – a minority of Americans really regard China as a security threat. I mean, the public's attitude here does not quite converge with the kind of viewpoints that you see in – at least in some quarters in Washington about what the nature is of China's emergence and how it affects the United States.

Which is not to say that arguments in Washington are (round?). But there certainly seems not to be an upswell of public sentiment in the United States for treating China as a more security-oriented threat and to move towards sort of a polarized situation. Indeed, the polling suggested that most Americans want the U.S. to work harder with the Chinese to improve the relationship. And that's, I think, exactly what's going on right now with the Hu Jintao trip.

[00:40:48]

Now, as far as the mil-mil's concerned, what we've seen here is – as everybody knows, there's been some real concerted undertakings here to try to resume the relationship, not just with the Gates visit. This started before the Gates visit. But the Gates visit is a very meaningful indicator of this. Coming out of the Gates visit, there, I think, are some very significant consequences, at least for the near term. It's clear that there is a desire on the part of both sides to revive the military-to-military contact and indeed go beyond that to try to expand it and deepen it in some ways.

There is discussion of a possible framework for a long-term mil-mil relationship that will make it more durable, indeed will hopefully deepen some level of understanding and maybe even lessen the level of distrust that exists between the two sides while also increasing the level of personal contact, which I think is vital in the mil-mil area to have that kind of interaction between the leaderships of the U.S. and Chinese military.

[00:41:57]

It goes without saying that this requires follow-up, obviously. It requires a serious commitment and support, not just by the military leaderships on both sides, but more importantly by the civilian leadership. And that leads to the point that this resumption to a great extent – and Doug sort of alluded to this – coming out of the Donilon-Summers trip to Beijing, that the civilian leaderships on both sides, I think, recognize the need to have this mil-mil relationship revitalized to bring it more into line with the civilian interactions that are, although very contentious in some areas, nonetheless somewhat more positive in tone and in outcomes than you've seen in the mil-mil area.

[00:42:46]

*Transcript Not Checked Against Delivery*

And there are perceptions that the mil-mil side had lagged very badly and indeed was a source of real problems. So what you see there is, I think, the civilian leadership really saying this has to change in some way. Now, at that level what this indicates, at least to some degree, is it sort of rebuts the idea that the military in China has this sort of independent position that it can pursue on U.S.-China relations, that it's going to go out there and do what it wants. I mean, this kind of tone has been there in some of the mass-media discussion about this, that the Chinese military is sort of off the reservation and will stay off the reservation.

But what's happened now through this visit, I think, shows that at least that is not true in the sense that the military, whether it likes it or not, has had to re-engage with the U.S. military and do so in somewhat meaningful ways.

Now, that said, the ability of the two sides – the militaries of the two sides to move forward with some of these understandings and some of these plans is by no means assured. The PLA has, for example, not accepted the U.S. proposal to open a strategic dialogue on four critical areas – on cyber, on space, on nuclear and on ballistic missiles – which the United States has very strongly proposed. The Chinese haven't rejected it. They said they'll consider it.

[00:44:19]

Now, that in some people's view is language for "no thanks." But I'm not so sure that that is necessarily the automatic conclusion to draw here. The Chinese have also agreed to have the head of the Second Artillery, which is in charge of the ballistic-missile program in China, visit the United States in an unprecedented action on that side, which at least is an opening to contact there that I think is a significant step forward.

This is really all good news. But none of this should really obscure the fact that the two militaries, in my view, are indeed in many ways growing increasingly suspicious of one another. They're arguably becoming more resolute and in some ways more rigid in defending their respective missions and their responsibilities. And therefore their interactions are serving as a major source of overall strategic distrust in the relationship.

[00:45:20]

Now, this isn't to say that such distrust doesn't exist in other quarters inside the governments of both sides. It certainly does. But the mil-mil relationship and military-related security issues in general, in my view, are increasingly driving the competitive and the adversarial dimensions of this relationship. And they certainly can't be ignored. And so in that sense it is heartening that there is an effort here to try to re-engage the militaries on both sides and really try to move this situation forward.

And what drives this suspicion, of course, is the basic distrust I alluded to earlier in the security realm, particularly the idea that, as Stape alluded to, the United States, as China becomes stronger, is attempting to constrain China's movement and indeed limit or prevent China from moving forward in areas that it regards as critical to its national interests, including areas regarding sovereignty and territory along its maritime periphery.

[00:46:29]

## *Transcript Not Checked Against Delivery*

The United States for its part sees China clearly through the acquisition of its capabilities on the military side and some of its recent activities as moving in a direction that creates real concern for the ability of the United States to continue to perform its role in the Western Pacific as the predominant maritime power, to provide security assurances, to provide confidence for its allies and friends.

There's a real uncertainty there that, I think, between the two sides is going to increasingly be shown over time to influence the way the – not just the two militaries interact but the way the two governments interact because it fuels all manner of suspicions, not just directly on mil-mil issues but also in other areas. It plays into and reinforces suspicions that operate on the issues such as North Korea and even on Iran.

[00:47:25]

So it's something that certainly can't be ignored. So as you look towards now the Hu Jintao trip – what visit, what is needed? Well, I think that in order to be able to address some of these specific issues – these security-strategic issues – mil-mil and the larger questions that they certainly relate to and reflect, there – at some point there needs to be, if not in this visit but soon thereafter – there needs to be a reaffirmation, in my view – I mean, this is really a critical point in the U.S.-China relationship, I think. The kind of interaction that we see at senior levels of the government now – and with Hu Jintao's trip he's trying to set a certain tone, establish a legacy and then be able to create momentum that his successor will then have to follow through on.

And I think it's important in that context for the U.S. and China to be very clear and reaffirm very clearly their mutual stake and their mutual commitment to the need to move forward in this relationship in several ways.

[00:48:35]

One – and these are along the lines, to some degree, I would say, of the – of a – of the comments that were made by Brzezinski recently in a New York Times op-ed about this situation – there needs to be a recognition that the U.S. and China are interdependent in many ways. As a result of that interdependency, issues and problems in the relationship must be negotiated. They can't be solved, certainly as you guys just suggested, through a zero-sum type of mindset. There has to be a recognition that the issues are only manageable through negotiation and through some level of mutual accommodation, one towards the other.

Secondly, there has to be a clear recognition that the U.S.-China relationship is no longer a bilateral relationship. It is a global-related relationship. It is linked into the global patterns in the world that are increasingly requiring much broader understanding and much broader interactions beyond just bilateral interactions. U.S.-China problems are not just solved by the U.S. and China in many areas. They have to be solved by a larger group of powers involved as well.

[00:49:47]

There needs to be, coming out of this, therefore a desire to seek common ground in the relationship without by any means avoiding the serious differences that exist. And there needs to be a really serious effort to discuss those differences, I think, more frankly. And I mean this specifically, these larger strategic differences of changing relative power and influence and relative objectives and the objectives of the two sides over time.

Now what do I mean by that? Well, in my view the strategic dialogue that the U.S. and China have undertaken now for many years doesn't really touch on this kind of an issue. It tends to be focused on narrower

*Transcript Not Checked Against Delivery*

issues that are specific to the individual problems between the two sides. And it tends to of course because it consists of high-level officials on both sides. You tend to have somewhat formalistic or narrow exchanges of views that reflect the existing policy positions of the two governments.

What a deeper strategic dialogue needs is something that's more free-ranging, something that talks more conceptually about the relative interests, core interests and other interests of the two countries and how they might change over time, what the implications of that are that – for their national security interests and behavior, in Asia in particular.

[00:51:14]

This kind of thing can't really occur in a formal government-to-government interaction. It has to occur on a "track 2" or a "track 1.5" level with strong government support. Now, that's somewhat different from the plethora of dialogue and interactions that we've seen that go on today between the U.S. and China. Many of the track 2 dialogues are bottom-up. They tend to be established by a scholar here or a scholar there, with some degree of government interest in it. They're not top-down. They're not something that is developed and supported by the respective governments but allowed to go forward in a venue that is much less high-sensitive, much less formalistic, if you will.

[00:51:57]

So I think there needs to be a serious consideration to that kind of an approach in going forward here because so many of these issues relate to these broader strategic questions. So I would like to see coming out of the Hu Jintao trip a real affirmation of these kinds of points. Many of them have been made before, but I think they need to be very clearly reiterated on this instance again, particularly after what's happened in the last year or more in the U.S.-China relationship and particularly in the security area. And I hope some kind of a statement like this that is not just a statement but also feeds into things that can be undertaken by the two governments in a follow-up way after the passing of this state visit, that this can occur through Hu Jintao's trip.

I'll stop there. Thank you very much.

[00:52:52]

MR RAY: Thank you, Michael. Let me pose one or two questions and then we can open the floor.

Dr. Huang, you referred to the growing role of the renminbi in international trade – rather dramatic figures in terms of the increase. China has declared that it is uncomfortable with having the dollar as the reserve currency and that it would like to have other reserve currencies out there.

Can you conceive of any circumstance under which the United States might have to start borrowing in foreign currencies as opposed to in dollars when it borrows abroad to finance our deficit?

DR. HUANG: Let me start by commenting that we're still a long ways before the renminbi will be what I call true international currency. But I also have learned from experience that we tend to underestimate the pace of how these changes can occur, particularly in the case of China. So I'm a little bit more like – not quite sure how fast it will go. Most people think this is going to be slow. I tend to say I could be surprised.

*Transcript Not Checked Against Delivery*

[00:54:10]

I don't see a situation in the near term or reasonable operating term where the dollar is not a – the major international currency. You know, where the U.S. would actually – could be constrained by the fact, that it would have to borrow in terms of foreign currencies rather than the dollar. And so I don't think that's going to happen in the near term.

But I do think that an increasing amount of trade will be like China's trying to denominate the renminbi to try to maintain more value. I think that the renminbi becomes more acceptable or used – it will actually decrease the demand the dollars and therefore lead to the dollar value declining.

And some people will think this is bad, and some people will actually think this is good. Actually, as the dollar value declines is not because we're competitive. This is has a positive impact upon the U.S. exports. Yet it goes counter to what I would call long-standing American principle: The dollar should be strong.

[00:55:06]

But nevertheless, one of the objectives of the debate going on, of course, is the renminbi value should increase relative to the dollar. So I personally say whatever happens in that regard is actually helpful and probably smooth.

MR. RAY: Michael, could you – the Chinese military is clearly getting stronger, and they're on the cusp of being able to produce what you would call world-class military technology on their own. In the past their most advanced technology they've had to purchase largely from Russia.

But clearly they're moving into a – they're giving high priority to becoming a more technologically advanced military. But the thing that's really noteworthy about China's military is that 35 years ago they still had a strategy of people's war. They really were a non-technological military force.

[00:56:07]

This type of change requires enormous changes in strategy. And it also involves generational changes where the senior commanders have a – have grown up in a different environment from the more junior military people.

Could you comment – does this have some significance in terms of how China will use its military capabilities? You know, what's in the back of my mind is China's building up its naval capabilities, and in the Pacific both Japan and the United States have been major naval powers for a century or more. We sent our naval on an around-the-world cruise at the beginning of the 20<sup>th</sup> century. And the Chinese still haven't done that, to the best of my knowledge.

How is China's naval – or how is China's military strategy going to change, and are they likely to make mistakes in that process in understanding how you use capabilities and how new capabilities will shape up against countries with very mature strategies and mature military capabilities?

[00:57:22]

MR. SWAINE: I think we need another two hours, then. (Laughter.)

*Transcript Not Checked Against Delivery*

That's an excellent question. Of course, the – the Chinese are in their military – in the military security area, the Chinese are truly undergoing a revolution. They are facing a set of security requirements that are in many ways very different from what they've had in the past, that reflects both the structure and the size of their economic dimensions – so their economic growth and their growing political influence both in Asia and beyond.

To a certain extent a lot of the drive that has occurred behind military modernization has taken place through a combination of the desire to overcome obsolescence, the kind that Stape just referred to, combined with an increased perception of the need that China has to have more capability to influence very sensitive and potentially controversial issues along its periphery.

[00:58:32]

First and foremost was Taiwan. And that has driven much of Chinese military modernization now for 20 years – nearly 20 years. But the Chinese are – I think they're now confronting the situation where they have to a more varied and much more complex set of military requirements that deal not just with the Taiwan situation but also deal with broader issues along their maritime periphery in particular that they regard as unresolved and that they think military capabilities will assist in influencing, not necessarily determining, but influencing.

And that includes disputes in the South China Sea. That includes disputes in the East China Sea. That includes general questions of defending what they regard as their periphery – their maritime periphery out to a certain defined area. And what that really does, then, is, as I said in my remarks – it bumps up against the perceptions, the concerns, the priorities of countries along the Chinese periphery: the Japanese in particular and the United States as Japan's closest ally, and security ally in particular, and of course U.S. responsibilities.

Now, I think the Chinese doctrine or approach, if you will, beyond on Taiwan is to create a military that has the capacity to support China's political and diplomatic and to some extent economic objectives in a variety of ways. And that doesn't mean necessarily negative ways.

[01:00:22]

Part of the effort is to show that China has – is a great power. It's arrived on the scene. It has a very – at the very least, a regional class, if not a world-class military. And that it can support certain activities that these types of militaries undertake in various areas that go beyond just the periphery. And by that I mean things like dealing with nontraditional security threats: the Gulf of Aden. Dealing with disaster relief and deploying forces to assist in that effort that the United States does and gets much benefit from doing that, in the eyes of other countries around the world.

So there's a prestige factor involved here that I think is very much desired to be tapped into by a lot of Chinese leaders. But at the same time, there is this issue of increasing the level of presence to be able to caution against or deal with uncertainty. Now, that uncertainty I think is what is that uncertainty? How far does it extend? Does it mean defending energy, channels of communication and transportation?

[01:11:35]

These kinds of issues I think are still very much in flux in China. So when "Stape" asked, you know, could there be mistakes made? Do they – do they have a clear beat on exactly what they need and when they need it? My

*Transcript Not Checked Against Delivery*

answer would be probably not. A lot of these issues are under debate. And a lot of the ability of the Chinese to acquire certain types of capabilities to address certain types of missions I think are under debate.

And yes, they certainly could make mistakes as they go along, both in over interpreting and misreading the intentions of others, including the United States, but also in their own assessment about what they think they need in a particular area, militarily, to serve this or that mission. And what one good example of the kind of – and I'll stop here – the kind of different interpretations you get is about a decision to develop an aircraft carrier.

I mean, the Chinese, for years and years they debated about this internally. And there was a lot of resistance against developing an aircraft carrier for a lot of very sensible reasons. But I think it – ultimately, in my view, it came down to a question of – an issue of national prestige and an issue of the ability of the Chinese to use a carrier to perform a variety of missions that don't involve necessarily power projection in a conflict sense, but a presence issue that can reinforce both positive messages in the region and elsewhere. And that I think tipped the balance, particularly coming out of U.S. deployments of carriers for disaster assistance and such in recent years.

[01:13:15]

But there's still a lot of debate about it. As a military weapon, it doesn't perform the role or it's unlikely to be able to perform the kind of role that U.S. carriers perform, certainly on a global level. The size, the scope and the sophistication that's required to operate that kind of a weapons system in that manner is – in my view, is probably decades away from Chinese capabilities.

So you know, you've got this argument, still, about what exactly you're going to do with that kind of a platform, how effective it might be in different ways. So the debate, I think, goes on in some areas in China.

MR. ROY: I think both of our speakers have very effectively laid out why the U.S.-China relationship is so important. We are talking about very big issues, whether on the economic side or on the political-security side, in how China and the United States are able to manage to their relationship. Against that backdrop, let's open the floor. I think the – are the microphones in the rear? If you could identify yourself and then ask your questions, I'll start right here.

[01:14:46]

Q: Thank you very much. Josh Rogin, Foreign Policy Magazine. Thank you all for your presentations, great information all around. I wanted to ask you about a couple of items that are in the news this week related to the visit. The first one was an article coming out of the Gates trip, saying that, you know, a senior Defense official assumed that Hu Jintao was surprised and shocked that the Chinese had tested their new fifth-generation fighter – (coughs) – excuse me – right as Gates was visiting.

You know, if you read the Wall Street Journal piece you would believe that Hu Jintao doesn't know what's going on in the PLA and they're going rogue. You know, based on your expertise and analysis of how a Chinese system works, I'm wondering if that rings true to you or what do you think is really going on here?

[01:15:28]

The second one is an article this morning in the Washington Times was about, you know, the Obama administration. If you're to believe this article is about to announce another \$4 billion worth of arms sales to

*Transcript Not Checked Against Delivery*

Taiwan, these are the F-16A and B upgrades that, I mean, a lot of people in this room knew were coming a long time – I don't know if they're coming next week or a year from now or five years from now.

But the article makes it seem like this imminent and the White House is just waiting for Hu Jintao to leave town so they can drop this bomb on the relationship. You know, again, I'm wondering if you could sort of, you know, either endorse that or debunk that for us and tell us what you really think is going on here. Thank you very much.

[01:16:10]

MR. SWAINE: Both of those –

MR. : Do you want to just (do one now ?) and answer each question?

MR. : No.

MR. SWAINE: Well, you're referring to – the first question refers to the testing, the recent indications of a Chinese test of what's called the J-20, which is described in the West as a fifth-generation stealth aircraft – uncertain whether it's a fighter or a fighter bomber. It's big. The Chinese rolled it out not too long before the Gates visit and engaged in a limited flight test of what is a prototype. And then all hell broke loose, in terms of media commentary at least.

[01:06:54]

As to what was going on in all this? My own take on this is that it was probably pretty impolitic for the Chinese to coincide this testing with the Gates visit and I think the officials of the U.S. government took that view. They didn't think this was particularly helpful and they didn't particularly like it and so there was a polite query made about it.

And Hu Jintao said – or seemed to indicate that he didn't know anything about it. And then the question of (courtesy ?) emerges, well, what's all that about? And there's where you get some level of breakdown in interpretation and analysis. So that is to say, some level of debate about this.

It is quite possible that – in my view, it is quite possible that Hu Jintao did not know that this flight was going to occur at this time. It is quite that the scheduling of this flight was done internally, within the Chinese military-industrial complex. However, it's probable that people within the military knew about this.

[01:08:11]

Now, that of course raises the question, well, did they deliberately seek to undertake this test flight in the military, making that decision, knowing of the timing of it and desiring to send a signal both to Gates and the United States and perhaps to their own civilian leadership? That, of course, assumes a picture here, again, of the Chinese military is off their – off the reservation, running around doing things that they shouldn't be doing.

My own sense is I wouldn't go that far as saying that the Chinese military did a kind of in-your-face move to Hu Jintao and to the United States with this. My sense is that it's quite possible that a decision was made do this. It was made at a lower level of the government or within the military and that there was some desire, perhaps, to have

*Transcript Not Checked Against Delivery*

this done. To say, well, you know, we've got our own stealth fighter, too. And the implications of this were not terribly well-thought through.

[01:09:15]

But I hesitate to say that this was intended as a signal to the Chinese civilian leadership by the military and as something that would provoke the United States in a significant way. My own sense is that I think there's been a lot, perhaps too much made of this in the media in terms of the politics of this. We don't know for sure how the civilian and the military side interact on these kinds of decisions. That's really the bottom line: We don't know ultimately what the decision process was.

But there is adequate room to believe, it seems to me, judging on how these kinds of testings' go on and such, and how this Chinese system operates in other areas that, in fact, Hu Jintao was not aware of this. And you can argue that if they had been aware of it they most likely would have said let's not schedule this now, which is what U.S. officials say they do if they have something similar like that on their side.

[01:10:21]

So we created a snafu in that regard. But I don't think it's a major breach in the relationship that's going to require some kind of massive response on the part of the United States or somebody else. Maybe others have a different point of view.

MR. ROY: Let me – let me just weigh in, myself, on this. I think President Hu's problem was he didn't see the relevance. China is developing a stealth fighter; we have an operational stealth fighter. China is probably years, if not decades away from having an operational stealth fighter. Why shouldn't they have a flight test of their stealth fighter when Gates is there?

Let me tell you a story. I was in China when president – Vice President Mondale visited in 1979. He, of course, was vice president to the United States, not the president. But his visit coincided with the visit of the King of Nepal to China; who was the head of state of a sovereign, independent country. So Vice President Mondale was given functionally the equivalent of a presidential visit.

They actually had an honor guard for him, whereas you don't normally have honor guards for vice chiefs of state. But this was the first senior American leader to visit China after the establishment of diplomatic relations. But members of the Mondale party were upset that there were banners across the street saying warm welcome to his majesty, the king of Nepal and there weren't equivalent banners saying warm welcome to Vice President Mondale. (Laughter.) Well, what was the issue?

[01:12:07]

MR. : Stuff happens. (Laughter.)

MR. ROY: In other words, the American vice president was being accorded more honors than you normally get because he clearly was an important official of an important new relationship. And the king of Nepal was being treated the way he ought to be treated. And there was no reason to take any umbrage on the U.S. side. Well, I react that way to the stealth fighter, quite frankly.

*Transcript Not Checked Against Delivery*

[01:12:29]

I think the Chinese have a right to rollout and flight test their military equipment – (laughter) – any time they please. And for us to act as though that’s somehow is it at affront to the United States frankly just blows my mind. (Laughter.)

MR. SWAINE: Well, jeez, Stape, I was trying to be a little more delicate about the – (laughter) – about the possible U.S., you know, umbrage that was taken here because it was taken.

MR. ROY: If you want to be affronted, you can find reasons for affront anywhere you turn.

[01:12:58]

MR. SWAINE: I tend to agree.

MR. ROY: I think the United States does not need to be easily affronted. Anyway, that’s my view. Do you want to add –

MR. : No, that’s –

MR. ROY: On the arms-sales question?

MR. PAAL: Josh, I’ll take on the F-16 issue. (Laughter.) Not because I want to. The upgrading of F-16s is an ongoing process since they were first sold in 1993 and that will continue to be the case. The next round of upgrades is going to be a more extensive and expensive package. I don’t know that it’s in the shoot right now.

[01:13:33]

I love the idea of planting this article to get everybody excited at the Chinese Embassy on the eve of their president’s visit because – (laughter) – headlines of that sort would be very damaging to the legacy that Hu Jintao has built of managing the tensions in the Taiwan Strait, down to a much lower level, and building a more peaceful relationship across the strait.

I’m confident that the relevant officials in the U.S. government are mindful of that and will handle it appropriately. The upgrades will go forward. They will go forward at an appropriate time. I don’t think this time would be viewed as the appropriate time.

[01:14:21]

Q: “Hank” Levine with the Albright Stonebridge Group. I wanted to pose a question, keying off something Stapes said, and that is that, you know, visits of the type that we’ll have next week, indeed, can have a huge impact and can be very significant. But I guess my question is whether the current circumstances, particularly dynamics within China, are reducing, to a certain extent, the significance or the potential outcomes?

You know, I subscribe to what I think is the sort of conventional wisdom that each generation of Chinese leaders has had less ability to act as an individual, has had to consult more with a broader set of constituents. And

*Transcript Not Checked Against Delivery*

today in China and again, you know, with the growth of social media, the Internet, the growth of special-interest groups, whether it's SOE heads, maybe a louder voice for the military and so on.

[01:15:17]

I guess, are we in a situation now where President Hu Jintao is more constrained in what he can either promise or deliver on with regard to the kinds of policies that the U.S. government would like to see; whether it's deepening cooperation broadly or some of the economic issues and so forth and so on?

MR. ROY: Short answer: Is President Hu more constrained than earlier generations of Chinese leaders? The answer is of course. Martin Van Buren did not have the same authority as George Washington. Polk was not in the same category with Thomas Jefferson. They had the honor of being the revolutionary generation and that carried over into their stature as presidents.

In China's case, we're moving into a period where the top leaders of China no longer have revolutionary credentials. They're not the Mao, Zhou Enlai, Deng Xiaoping group; but they are still the top leader in China. And being the top leader in China is different from being the number-three or the number-four leader. So even if Martin Van Buren may not be in George Washington's stature, he was still the president of the United States. And President Polk was able to have a war with Mexico because he was president of the United States.

[01:16:53]

So I think that while, relatively speaking, Hu may not have the individual authority of some of China's earlier leaders, I think he is still arguably the most influential leader in China and the person that we would want to manage the U.S.-China relationship through personal relationships and governmental and state relationships with him as the representative of the country of China.

Q: Doug Spellman at the Woodrow Wilson Center. It seems to me this question of military-to-military exchanges is a very complex one and there may be some asymmetry involved in it in this sense. As we find more about the Chinese military establishment, it seems to me the possibility of being somewhat reassured is greater than the possibility of being alarmed.

[01:18:00]

On the other hand, Chinese finding out more about our military establishment has more potential for them being alarmed rather than reassured; in the sense that they're finding out how complex and sophisticated our weaponry and so forth is. Do you think that's problem? And if so how do we guard against it?

MR. ROY: Michael, would you like to take that on?

MR. SWAINE: Well, I think it's the this – again, this asymmetry is very notably found in the mil-mil relationship and this is one expression of it. I think that has – the interpretation, the perception on the Chinese side that there is – that it doesn't serve their interests to be unduly transparent about their own capabilities because those capabilities are lacking so much compared to the United States has, I think, along with the very deep rooted and long-running historical resistance to being transparent in general, has resulted in the kinds of limitation in really talking about capabilities that we've seen.

*Transcript Not Checked Against Delivery*

[01:19:20]

But to me – I mean, the mil-mil relationship is not primarily about learning about capabilities. I mean, although, that can be important in some ways to be able to make the other side really cognizant about certain capabilities or certain limitations et cetera. It's more about understanding how the minds of the each side works; and looking at their security interests; and looking at how their militaries fit into their overall policies; and where the priorities are, and what their concerns are; and how they react to, or would likely react to this or that kind of issue that would emerge – crisis management; crisis behavior; knowing who you're dealing with on the other side; having a better sense about how they think about issues.

[01:20:13]

And then, also being able to have greater interactions with people down the system, so that they come up the system with a greater appreciation about the mindset of the other side; and they don't fall prey to certain types of very easy misconceptions. I think that's a critical element of where the mil-mil relationship needs to go, and not one that's primarily oriented towards, you know, using capabilities to show deterrence or resolve.

MR. ROY: Anybody in the rear? Yes – here.

Q: Thanks very much. Scott Wilson from The Washington Post. On this visit, if you could a little bit about how you think the issue of human rights is going to figure into it? You talked about the resumption of the human-rights dialogue. But for a visit that President Hu would like to go very smoothly and appeal to the American public, this seems to be a possible issue that will be disruptive.

I believe that Falun Gong demonstrations in 2006 was one of the reasons that trip didn't go as well for him as he would have liked.

[01:21:24]

And for President Obama, what can he – what should he want to get out of this? He's about to have the distinction of being the only U.S. president to host a head of state for a state visit who is currently imprisoning a Nobel peace prize laureate. And how – after emphasizing human rights in his U.N. address this year – how is he going to manage this? How is he going to talk about this? If you could just – whoever would like to address that could talk a little bit about that. Thank you.

MR. ROY: Let me comment on that briefly myself, because I was the American ambassador in China at a time when human rights was very high profile in our relations with China. We also have the evidence provided by the WikiLeaks that has provided some insight into even when we are not publicly waving the flag of human rights in our dealings with other governments, that it's always a factor in how we deal with governments if there are human-rights concerns that are important to the American people and the American government.

[01:22:31]

I am certain that the human-rights issues that are of concern to us will be raised with President Hu during his visit. But you have to separate human-rights concerns into two categories. One is the question of profile: Are you high-profile or low-profile in how you handle it? And what is the question of effectiveness? Is the way that you raise the issue more likely to produce progress in the area you'd like to see progress, which is also relevant?

*Transcript Not Checked Against Delivery*

And I have, in my experience in the U.S. government, frequently found that those two issues get totally confused, and that people prefer the high-profile approach even when it is known that it will be less effective. In which case, we're reducing human rights to politics. And I think human rights is far too important for that.

[01:23:29]

I would hope that the issues are raised during the visit by President Hu in ways that will be most effective in terms of advancing human-rights interests. And I give less concern to the question of whether it looks that the United States is posturing in a high-profile way on a human-rights issue regardless of whether that's the best way to advance the cause that we stand for.

Would anybody else like to comment on that? (Laughter.)

Q: David Gries, China Vitae. The question goes to the influence of the military on the Chinese political system. And I would like to ask the panel to make a comparison, say, to two decades ago when the military was much more broadly represented in the central committee and the Politburo. Today, there are only – I believe Xu Caihou and Guo Boxiong are the only military men in the Politburo; none on the standing committee.

[01:24:41]

Is some of the what appears to me, at least, to be difficulty in military-civilian relations a buildup to the 18<sup>th</sup> party congress where perhaps the military expects to have greater representation?

MR. ROY: Michael? Would you like –

MR. SWAINE: My view on this has been clear for some time. I don't believe that the military operates in China as an independent, cohesive political actor along the lines of militaries in, say, some developing countries where they act as the primary bulwark of institutional support for the regime.

I think the Chinese military's political influence at senior levels of the government in terms of basic policy has declined significantly since the period of Mao Zedong and Deng Xiaoping. I think they've become – as part of the process of professionalization and what you call institutionalization of career patterns and of decision making, they have become a military that is more oriented towards certain professional interests, but that do have implications for larger policy questions.

[01:26:12]

I think when they confront those kinds of issues, they communicate their views, particularly in response to what the senior leadership wants them to convey. But at the same time, there's no question that there is a, sort of, strong mission that the military performs in China, as all militaries do: national security; national defense; sovereignty; territorial integrity.

And they have – many senior officers have very strong views about how to manage particular types of policy – not policy, particular types of activities.

*Transcript Not Checked Against Delivery*

So what you do see, I think, in some cases is although you don't have the power influence at the senior level in terms of influencing basic policy issues, you do have, certainly, Chinese military influence over narrower defense decisions and over the operation of the Chinese military in carrying out certain missions. In those areas, I think you have some degree of lack of coordination, and some degree of problems of communication between the civilian leadership and the military leadership.

[01:27:33]

But again – well, I don't want to draw too strong a parallel, but those kinds of problems exist in most systems, including in the U.S. government. I'm not equating the two, but you do have issues where the military is able to take certain actions which, indeed, are not known by the civilian leadership, and in some cases don't necessarily jive with what the civilian leadership would like to see happen. So there's a tugging and a hauling that goes on, and I think that certainly is the case in the Chinese instance.

[01:28:13]

Q: My name is Stein Tønnesson. I'm a Jennings Randolph senior fellow at the United States Institute of Peace. And I have one question for each of the two speakers. The first is to Huang Yukon, and it's mainly about how to organize my summary of your excellent introduction, because you spoke about three wars: one currency, one technological and one financial. And you mentioned – and then, you tried to approach them with a win-lose or win-win formula.

It seemed to me that the currency one you considered to be win-lose – at least, the approach that has been made to it. When you go up to the technological one, that was the real issue and the main cause for concern. But I did not get quite – if you thought that opened itself to win-lose or win-win.

And then, the financial one – there, I think you returned to the currency issues. And my impression was that you just now found a win-win approach to the currency issue when talking about the financial war. So my end impression was that you only two wars, the financial one and the technological one. So the questions – please clarify this for me.

[01:29:28]

The second question is then to Michael Swaine. And you have already been asked about one kind of asymmetry between the Chinese and the U.S. military. I would like to ask about another asymmetry, which is not so often discussed. And that's in combat experience. Because if you go 30 years back, the Chinese People's Liberation Army had massive combat experience from many places. Today it has none because it has not fought any war since 1979 with Vietnam, except for a little naval battle in the Spratly area in 1988.

Would it not be natural for a growing army like the Chinese one, which is also considered by some nationalist circles in China to be a kind of peace-loving army instead of a people's liberation army consisting of "office" officers, rather than, really, fighting officers – when they compare themselves with the U.S. who has enormous – lot of combat experience, would they not want to seek some chance to get combat experience?

Is that playing any kind of role in the relationship? (Laughter.)

[01:30:46]

*Transcript Not Checked Against Delivery*

MR. SWAINE: Oh, god. (Laughter.) Well, I think it certainly is true – and people, sometimes, overlook the fact that the U.S. and Chinese militaries have a huge disparity in their experience and their ability to conduct modern combat operations. I mean, this is obvious.

As you say, the Chinese military last conducted a significant combat operation beyond the Spratlys in the early 1980s. I mean, there was ongoing conflict after the '79 border war with Vietnam that was quite significant. But it's been now – what, that's, you know, 20, 30 years. And that certainly, I think, plays to caution. In my view, it plays to caution on the part of the Chinese military and the civilian leadership in assuming that they can undertake certain roles because they don't have experience in doing certain things.

[01:31:49]

Now, your question is, well, does that, though, play into, well, we need to get that experience, so let's do something. (Laughter.) Well, then you run into the problem of what exactly is it that the Chinese propose doing that doesn't have really, pretty enormous costs to it? And you can't think of anything.

MR. ROY: (Off mic.)

MR. SWAINE: They do exercises. You know, I mean they do exercises, but exercises are not the same as real combat, of course. So I think they're going to have live with exercises for quite some time.

MR. ROY: I'll just add on that. All professional militaries try to maintain the potential to deal with combat situations under noncombat conditions. In other words, the training process has to do it. And it has been shown to be successful in some cases, and less successful in other cases.

Often, what you learn from war situations is that your preparation did not address the type of combat situation that you get into. But the idea that militaries have to somehow seek combat experience artificially as part of the training function, I think, begins to make militaries far more dangerous than they should be.

[01:33:10]

And I don't see any evidence in Chinese foreign policy that suggests that there are pressures to engage in avoidable combat situations so that they can make up for their lack of war-fighting experience. And I certainly would hope on the U.S. side that we don't engage in that sort of thing.

MR. PAAL: And just a final observation, before we go to Yukon. The Chinese really are upgrading their ability to prepare their troops through appropriate training. But they – even absent American recent combat experience, the training and deployment of Chinese forces falls well below what we would expect of a normal peacetime development.

[01:34:59]

And I'll give you one example that I'm drawing from memory, from the Defense Department report. I believe China has 39 modern submarines. And in 2009, of 39 submarines, only 12 had any cruises at all. So it's very hard to imagine how you'd maintain a combat level of proficiency when they're not even leaving the ports.

## *Transcript Not Checked Against Delivery*

MR. HUANG: Yeah, I think your observation about the linkage between the first war and the third war is quite correct. I actually at one time thought about combining them. But let me go back.

The first issue is – I say currency wars, but it's actually about trade wars. And the third issue is really about capital movements. And trade and capital movements together are talking about current account. But I separated because there's actually – these issues are really big issues, and it became too complicated to actually try to combine them.

[01:34:56]

But let me spend a little bit more time about the first one. The first one is a win-lose because the general message out there is the U.S. needs to grow faster, it needs to revive its economy, it needs to export more. And it will be easier for the U.S. if China exports less – that's the win-lose.

Now, what is the win-win solution? The win-win solution begins by saying, globally – and both of us – will benefit if both of our economies are strong and there is strong demand for each other's product lines. And U.S. will benefit in fact if the Chinese economy is very strong and if it steps up its imports of U.S. products. So the focus should actually be on stimulating Chinese demand for U.S. imports, rather than trying to say, China, you need to somehow cool your exports.

And then you get into a range of issues, which I said was very, very complicated. How do you actually increase demand for U.S. products? How do you stimulate demand for imports in China? And there is, for those of you who've been looking at this, a whole range of discussions about the balance between consumption and investment, and how these should shift in the future, and if you do this in a good way, it'll actually increase imports, and the trade balance will actually become less of a problem. And I won't get into that, but it's a very complicated [96:08] matter.

[01:36:09]

Now, topic number three is a very broad issue about capital movements in China. And it ultimately provides the solution to this exchange rate – some of these issues. But that's a very long-term – and therefore, I don't see this as a solution to the first question. And the first question, I think, has to do much with consumption and investment savings. And exchange-rate issue – I say it myself, it's going to solve itself, but how long it will be, I don't know.

[01:36:37]

But I think the really interesting point of number three is that if China liberalizes its capital account – and it can actually be far more relaxed in saying to Chinese firms and households, if you want to move your money out, please do so. They have concerns about too much money coming in because of pressures, but it can really be very relaxed about saying, move it out; why don't you buy an apartment in New York and London rather than building all these apartments in Beijing, and leave them half-empty?

And if China did that, actually – the renminbi moved out – it would actually be a counterbalance to all the speculative hot money flowing into China. It would actually reduce the pressures on the appreciation of the renminbi.

*Transcript Not Checked Against Delivery*

So it's actually in China's interests – and if some people actually say that you actually liberalize and go whole-hog on this, the renminbi actually – pressure would actually fall to the other side. It would actually depreciate in value, rather than appreciate. So I don't know the answer to that question, but I see that that flexibility – and they have room for flexibility, with \$2.8 trillion in reserves. They have a lot of flexibility to say, I don't care too much if money flows out.

[01:37:41]

I think Chinese firms should diversify their financial holdings. And we should encourage them to go forth. And this would be helpful. It would actually get more renminbi out there. It would help the internationalization of the renminbi. So I think there are very imaginative ways of encouraging this process, which serves both sides' interests.

MR. PAAL: Just a – just a brief comment to get back to our theme of this visit coming up next week. Four CEOs are going to accompany Hu Jintao from China to the U.S. And I think they should be seen as harbingers of the next big story in U.S.-China economic relations, which will be inward Chinese investment in the United States.

The three CEOs are from Lenovo, Huangshan, which is a huge auto-parts company, and Haier, all of whom have factories in the U.S. employing American workers, producing for the global marketplace. And the fourth CEO will be the head of the Chinese (ph) Investment Corporation, which is sitting on these vast resources, and needs to deploy them in overseas investment.

[01:38:49]

This is going to be a tricky first period when China invests. These companies are already success stories. Other Chinese investments may be made more clumsily; we have the Japanese experience where emblematic firms were bought – or emblematic buildings – and controversies erupted.

Chinese investment will be very small by comparison with British and Dutch and German investors in the U.S. But because they're Chinese, they're new, they look different, then the politics are different. And they're not quite a full-market economy at home. There will be a lot of turmoil and debate.

But I would encourage you – looking at all the news on this subject, pay a little bit of attention to this, the beginning story of inward investment.

[01:39:37]

Q: I'm Vincent Yao from Taipei Economic and Cultural Representative Office. I just want to bring the discussion back to Hu's visit next week. Because Ambassador Roy, you just mentioned, in 2009 President Obama went to China, and U.S.-China issued a joint statement. I think that Dr. Paal, in your recent article, you also mentioned that this joint statement was historic in terms of U.S.-China relations in recent years.

[01:40:09]

But we heard this rumor going around that they are going to have another joint statement in this trip. What do both sides expect to put in this new joint statement, if the previous one was already historic? (Laughter.) What they really expect from having this joint statement?

*Transcript Not Checked Against Delivery*

MR. ROY: I'll let Dr. Paal handle that issue. But I would say that we haven't reached the end of history – (laughter). And therefore, I think you can have supplements to historic statements or visits.

MR. PAAL: I'd probably start where you start. I was asked about whether there'd be a joint statement this time. I said, why a new one, when we just had one in 2009? But apparently, there is some desire in both sides to see if they can come up with a joint statement, and to see if they can put something new in there that needs to be said in the aftermath of a difficult year.

And Kurt Campbell was in China trying to negotiate this – is Assistant Secretary of State for East Asian Affairs, was in China. I understand he's now on his way back. Whether he's got an agreed document that he can present to our government for approval, or they failed to reach an agreed document, I simply don't know.

[01:41:30]

It's in the nature of such statements that you don't have a statement until you have a statement. (Laughter.) Until the last word is agreed by both capitals, it's not there. And so I don't know that they're there yet. They still have a few more days. There may be something we want that China is reluctant to give, or China wants that we're reluctant to give that could get us over the – over the finish line, or fail to reach the finish line.

And I'm sorry to give you such an ambiguous answer, but I think that reflects reality.

MR. ROY: I'll just add one point. There are often joint statements at the end of visits, some of which are forgotten very quickly. So I do not think there's an intention to have a joint statement of the nature of the joint statement that was issued in November 2009, because that was designed to lay out a roadmap for the overall relationship.

[01:42:26]

The joint statement there – or joint declaration, or whatever they're working on now – I think will have a – be of a different nature, not a replacement for the earlier.

Q: Thank you. John Harper with the Asahi Shimbun. Aside from obvious things like wanting to avoid war and wanting a strong global economy, do the U.S. and China really have that many common interests? I mean, from a Machiavellian, realist perspective when it comes to things like currency, military development, climate change, and to some extent, North Korea, is there really that much overlap? I'd be interested to hear your comments. Thanks.

[01:43:08]

MR. ROY: I think there's enormous overlap at the macro-level, at the big level. The ultimate issue between China and the United States is if we are able to manage our relationship in ways that benefit both of us and benefit other countries. We happen to be the two countries in the world at the moment who probably have more potential to affect others for good or for bad, depending on how we manage our bilateral relationship.

And therefore – also, another way to look at it is to step back and think, what are the implications for the United States if we actually end up in an adversarial relationship with China? And how will China be able to

*Transcript Not Checked Against Delivery*

continue the process of raising the living standards of its people if it has an adversarial relationship with the United States?

So we clearly have a common interest in trying to maintain a relationship that will be beneficial. And we have discovered you can't do it without it being mutually beneficial. So that is an enormous common interest.

[01:44:26]

But the other issues that you touched on – such as Korea, which involve fundamental issues of proliferation, of weapons of mass destruction – are very big issues, not just small issues, and involve the security of both of our countries. Because the potential for nuclear technology getting into the hands of terrorist elements is a concern that both of our countries share.

But I think at the economic level, despite all of the other talk about it – in fact, the IMF, I think, reached – and they had a study – or the World Bank, which was it? – that showed that China's growth now is having a very significant impact on economic growth in other parts of the world, as much as half of 1 percent stemming from how China's economy performed.

And when our economy ran into difficulties in 2008, China's economy was very adversely affected. So once again, there's an enormous common interest that affects the welfare of peoples in both countries.

So when you've actually worked in U.S.-China relations, you don't even worry about whether we have common interests. They are so obvious in almost any issue that you are addressing.

[01:45:53]

Take climate change for an example. China and the United States are the two largest contributors of greenhouse gases at the moment. If we're not able to reach a common understanding on how to address this question, other countries won't bother with the issue because if the two largest contributors of greenhouse gases won't address the problem, then their efforts to address the problem won't have much impact.

So therefore, we're in a leadership position in an issue, which if it is as bad as it could be, or as the scientists think it might be, will have enormous impact on the interests of many other countries, as well.

So it's a legitimate question. But to me, the reason why the United States and China need to have a positive, cooperative, comprehensive relationship is precisely because the interests that our two relationships confront us with for either cooperation or failure to cooperate are major, major issues – and that if we're cooperating, they're much easier to solve. And if we're not cooperating, they're, in many cases, impossible to solve.

Last question. Yes, ma'am.

[01:47:15]

Q: I'm Xiao Ning (ph), from People's Daily. Because I focus on economic news, so my question first go to Dr. Huang. I notice you use a word "complex" when you talk about trade-deficit issues. Do you think it's misleading – do you think it's misleading under the circumstances of global network of supplies –

*Transcript Not Checked Against Delivery*

MR. ROY: What was the word you said –

Q: Complex.

MR. ROY: Complex. Complex.

Q: So my question is, do you think it's misleading when we discuss trade-deficit issues expressly between China and the United States under the circumstances of global networks of supplies?

[01:48:00]

Second question is, tomorrow is the date of World Bank to issue its first RMB bond in Hong Kong. Do you have any comment on it? My third question go to Michael. Maybe it's not professional, but I think that's a question in many mind of Chinese: we know U.S. arms sales to Taiwan is a backlog that have prevented the further improvement of a military relationship between two countries.

But my question is with more than two or three million Taiwanese people now living in mainland, and with the steady improvement of the relationship across the strait with less and less potential of the war between the two sides, do you think – what make it necessary for U.S. side to insist that arm sale to Taiwan?

[01:48:57]

Third question to Ambassador Roy, because this is the last opportunity for me. Just now, you mentioned, is China's right toward each side, willing to test its – (inaudible) – I don't know which word is right. G20? G20? Okay. So do you have any comment on China's policy to encourage indigenous innovation – because which also have cause the concern in many U.S. companies? Thank you.

MR. ROY: Dr. Huang? You want to begin?

[01:49:38]

MR. HUANG: Well, let me start with your last point about the renminbi – World Bank renminbi bonds in China. And that's a straightforward – that's an example of what I call the internationalization of the RMB, allowing international agencies to raise money in local currency. They've allowed firms to do this. They've allowed Malaysia to buy Chinese bonds and hold as part of its reserves. So I think this is the process accelerating; and China will encourage it.

I used the word “complicated” or “complex” because trade issues, linkages between the U.S. and China regarding trade deficits is a complex problem.

And one of the reasons why the exchange rate is highlighted in the media is because it's very simple – now, the exchange is one price, and everything goes away. And I don't think the audience, the world has, frankly, the patience to go beyond that. If you actually wrote and say that trade relations are complicated, no one will read it – (laughter) – you know? It takes a lot of effort.

[01:50:34]

*Transcript Not Checked Against Delivery*

Now, let me say why is it complicated. The exchange rate is one of many factors which influence the trade imbalances – fiscal, monetary policy; consumption; investment; savings. And those are much more important. If you get into that discussion, it becomes a very complicated set of issues. But in fact, the solution ultimately is, major changes in those issues will resolve the imbalance.

And the issue is, is it moving the right way? And frankly, from my view, it is. But it's not moving as rapidly enough, and there's things you can do to accelerate it.

Now, the second point I'd like to make in terms of trade is if you look at China's trade, there are products coming directly from China to the outside world. There are products which are going through what I would call the East Asia production-sharing network.

These processed goods – Dell Computer, which comes here, has seven parts produced in different countries. It gets exported from China, so that \$500 computer shows up as an exported \$500 from China, of which only \$25 actually originates in China. The other \$450 goes elsewhere, or comes from elsewhere, including the United States.

[01:51:39]

Now, China's trade surplus with the United States is solely from the processed trade. It is not from the direct trade. So China's trade surplus with the United States is not actually a trade surplus with China. It's a trade surplus with the East Asia region. And ironically, it's actually a trade surplus with the U.S. itself, because the example of the iPod – \$150, 450 of it stays in China; \$145 originates outside of China, of which \$80 originates in the U.S.

So the iPod and the iPad would not be successful globally, and Apple wouldn't be successful globally, if it couldn't use China as a production base. The key issue for the U.S. is what does Apple do with that \$80 of profit and resources? And to what extent is that, what I call, the long-term interest of the U.S.? Not really whether or not there's a trade deficit.

[01:52:38]

Now, this is too complicated, you know. (Laughter.) It's too complicated to put in a newspaper. It's too complicated for politicians to digest. It's too complicated for American audience. And therefore, that's why I say complicated, yes. But I realize that if you get into it, it's too complicated. (Chuckles.)

MR. ROY: Michael, do you want to answer your part of the question?

MR. SWAINE: Briefly. I can certainly understand and appreciate that many people in China see the warming of cross-strait relations, improvements in a variety of areas and ask the question, well, what's the U.S. doing? Why does it consider – why does it even consider selling arms to Taiwan? This is very, very destabilizing, et cetera, et cetera.

[01:53:22]

I mean this goes to the heart of the difference in perceptions that exist and the knowledge that exists on both sides. Obviously, the U.S. response to this has been longstanding and the policy is that it regards the need to

*Transcript Not Checked Against Delivery*

have a peaceful solution to the problem uncoerced. In this context, even though you have cross-strait improvements, you have a continued deployment on the Chinese side of capabilities that are very relevant to Taiwan and in some cases are only relevant to Taiwan.

Short-range ballistic missiles, which not many Chinese, in my view, know about. They don't know what the pattern is on the Chinese side. They just see or are told what the U.S. is going to do. And so you have a lot of focus on the U.S. behavior and the U.S. calculations on this as if China is doing nothing to sustain this military tension or indeed to make it worse, in some ways.

Now, the argument on the U.S. side has been why doesn't China, given the improvement in cross-strait relations, it's kind of a you-move-first kind of argument that the two sides are stuck in. The Chinese are not going to make a unilateral drawdown of their military capabilities unless they have something strong and reassuring on the other side that involves, most likely, U.S. arms sales.

[01:54:50]

The U.S. is not about to make any unilateral change in its policies about the sale of arms to Taiwan. It just looks at the situation and says China needs to reduce the tension on the military side. We respond to that situation as we see fit. We don't negotiate with the Chinese. That situation has continued, now, for a long time.

My question is – I'm not sure it can continue indefinitely. That's a different argument that we can, you know, have some other time or discussion. But I think it's going to be over time, perhaps, more incumbent upon both sides and particularly the United States to think more about how it might be able to reach some kind of understanding with Beijing that indeed addresses these two concerns and is – permits a drawdown of both commitment on the U.S. side or an action on the U.S. side to sell arms and Chinese deployments and Chinese developments on the military side, but we're a long way away from that at this point.

MR. ROY: On indigenous innovation, the concern the American business community and the American government about indigenous innovation in China is solely – solely related to the question of whether it's being pursued in a manner that amounts to trade protectionism. If so, it's in violation of WTO commitments. Indigenous innovation is a good thing, but not if it results in restricting legitimate interests of foreign suppliers and access to the domestic market. That's the issue.

[01:56:35]

MR. PAUL: Well, thank you all for so many of you to stay so long with this discussion this morning. I want to thank Stape Roy, our moderator, Yukon Huang for his economic observations and Michael Swaine and ask you to join me in thanking them. Thank you. (Applause.)

(END)