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The Two Chinas
A Contemporary View

Edited by Martin L. Lasater

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Martin L. Lasater

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The Heritage Foundation
January 28, 1986

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Preface

On January 28, 1986, the Asian Studies Center of The Heritage Foundation and the Asia and World Institute of the Republic of China on Taiwan co-hosted an all-day seminar on U.S.-China relations. The purpose of the conference was to provide journalists, Capitol Hill staffers, academics, and the interested public with up-to-date analysis of political, economic, and military developments in both the People's Republic of China and Taiwan.

A total of ten presentations were made, including a keynote address by Senator Frank H. Murkowski, Chairman of the Senate Foreign Relations Subcommittee on East Asian and Pacific Affairs. Senator Murkowski summarized the important interests served by continued close, friendly relations between the United States and the People's Republic of China (PRC), but he also stressed the intention of the Congress to see that the 1979 Taiwan Relations Act was fully implemented. The Republican Senator from Alaska noted specifically the responsibility of Congress to ensure that Taiwan's air defense capabilities did not deteriorate if the Administration proceeds with its proposed sale of advanced avionics to the PRC.

Also noteworthy was a proposal for a U.S.-Taiwan Free Trade Area by Heritage President Dr. Edwin J. Feulner, Jr. and Richard V. Allen, Chairman of the Council of Advisors of the Asian Studies Center. Dr. Feulner and Mr. Allen suggested such a Free Trade Area (FTA) would be one way to redress the large U.S. trade deficit with Taipei, which in 1985 totalled some $13.5 billion dollars. Free Trade Areas are negotiated bilaterally and have as their objective the removal of trade barriers to stimulate more balanced trade. A FTA exists between the United States and Israel, one is being negotiated with Canada, and several countries in Latin America and Asia have expressed interest in establishing FTAs with the United States.

The remarks of each of the other eight panelists were equally valuable in helping concerned citizens come to grips with the complexities of U.S. relations with Beijing and Taipei.

Dr. John F. Copper of Rhodes College in Memphis, Tennessee, documented the progress Taiwan has made in recent years toward democracy. Dr. Copper cited evidence in such areas as efficiency in government, level of public support, interest group articulation, political party development, free elections, open communications, quality of leadership, and

minority representation—common criteria used by political scientists to measure the degree and pace of political modernization.

Dr. Harold C. Hinton, a well known China scholar from George Washington University, examined from a broad historical point of view recent political developments in mainland China. Professor Hinton analyzed developments in three key areas—political succession, economic reform, and political liberalization—and offered some interesting predictions of China's future course of development.

A highly entertaining and informative session was held with journalists Fox Butterfield of *The New York Times* and Dr. David Aikman of *Time* magazine. Mr. Butterfield was in China during the early normalization days of 1979-1981, while Dr. Aikman served in Beijing more recently from 1983-1985. Both journalists presented frank assessments of their experiences in trying objectively to cover China for their publications, an experience both rewarding and frustrating in many highly personal ways.

Dr. Joseph B. Kyle of the American Institute in Taiwan, the corporation formed by the 1979 Taiwan Relations Act to conduct unofficial U.S. relations with Taiwan, presented an in-depth analysis of the strengths and weaknesses of Taiwan's economy, now in a state of transition from labor intensive industry to capital-technology intensive industry. Dr. Kyle also discussed in some detail the status of U.S.-Taiwan trade and ongoing negotiations designed to redress the large U.S. trade deficit.

Dr. Jan S. Prybyla of Penn. State University examined in both theoretical and practical terms the economy of the mainland, noting the uniqueness of "the Chinese road to socialism." Based upon analysis of socialist economies worldwide, Dr. Prybyla was less than optimistic about the prospects for continued systemic reform of China's economy in the future.

Dr. June Teufel Dreyer of the University of Miami presented an overview of the Chinese People's Liberation Army (PLA) and its modernization program. Dr. Dreyer noted that the PLA has achieved great strides recently, but also has run into significant problems. Dr. Dreyer also discussed the role of advanced technology in maintaining or upsetting the qualitative military balance in the Taiwan Straits.

The final presentation of the conference was made by Mr. Edward W. Ross of the Office of International Security Affairs, Department of Defense. Mr. Ross delivered the most comprehensive explanation to date by the Reagan Administration of the evolving U.S.-PRC military relationship. Detailed remarks were given on U.S. arms sales policy to China, as well as the U.S. rationale for selling the PRC advanced avionics to upgrade China's F-8 fighter interceptor.

All in all, this conference ranks as one of the most interesting and informative discussions of U.S.-China policy heard in recent years. These published proceedings should take their place in the "must read" section of the libraries of China watchers and the interested public on both sides of the Pacific.

Martin L. Lasater
Director
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Dr. Edwin J. Feulner, Jr.: On behalf of the Asian Studies Center of The Heritage Foundation I would like to welcome you this morning. This is the Louis Lehrman Auditorium, and I am Ed Feulner, the president of The Heritage Foundation.

Today's seminar is cohosted by Dr. Philip Chen, Director of the Asia and World Institute in Taipei. Dr. Chen will have a few remarks in a moment, but first I wanted to state briefly why this seminar is being held and why it is important.

There has been an unfortunate tendency in recent years to focus attention almost exclusively on the growing relationship between the United States and the People's Republic of China. This is an understandable trend in many ways, but it is also an unfortunate one because of the many deep historical, economic, and cultural ties we have with the Chinese people on Taiwan, the Republic of China.

What we hope to accomplish in this seminar is to bring the two systems of China into a more balanced perspective. Only in this way can we as Americans more clearly define our interests and pursue policies of wisdom and benefit to all.

Our program will begin today with a panel on "Political Liberalization on Taiwan and in the People's Republic of China." Two outstanding China scholars, Dr. John Copper of Rhodes College in Memphis, Tennessee, and Dr. Harold Hinton of George Washington University here in the nation's capital, will examine recent political developments on Taiwan and the PRC respectively. I will have the honor of chairing that panel.

The next panel will be on the topic of "China—A Journalist's View." Fox Butterfield of *The New York Times* and David Aikman of *Time* magazine will relate their experiences in trying to cover China. Hugh Newton, who played a vital role in organizing the conference, will chair this panel.

Following Hugh's panel we will break for an informal box lunch, and then reconvene at 1:00 for our afternoon session. The session will open with a major economic proposal by Richard V. Allen and myself on how to help redress the current trade imbalance we are facing in the Pacific. This will be followed by our keynote address by Senator Frank Murkowski, chairman of the East Asian and Pacific Affairs subcommittee of the Senate Foreign Relations Committee. He will discuss the present and future state of U.S.-China relations, as seen from the perspective of the U.S. Congress.

Richard Allen will then chair our third panel, which will examine the economies of Taiwan and mainland China. The panelists will be two highly qualified economists, Dr. Joseph Kyle of the American Institute in Taiwan and Dr. Jan Prybyla of Penn. State.

The final session will discuss the military balance in the Taiwan Straits. This panel will be chaired by Martin Lasater, Director of our Asian Studies Center. The panelists will be Dr. June Dreyer of the University of Miami and Mr. Edward Ross of the Department of Defense. For those of you in the news media, I am informed that Mr. Ross will have an especially significant and specific series of comments on the question of U.S. arms sales policy to the PRC.

At this time, it is my pleasure to introduce my colleague, Dr. Philip Chen who, as I mentioned, is the Director of the Asia and World Institute in the Republic of China. Philip holds a Ph.D. in government from the University of Massachusetts. He is a Professor and the founding Chairman of the Graduate School of American Studies at Tam Kang University. He is one of the most called-on private consultants to the Republic of China government and to various private industries in the Republic of China.

Philip, welcome to Washington. Thank you for co-hosting and thank you for being here.

Dr. Chen: Thank you, Dr. Feulner, distinguished participants, ladies and gentlemen. It is indeed a great privilege and honor for me, also for the Asia and World Institute in Taipei, to co-sponsor this conference with your prestigious organization, the most distinguished think tank in the United States capital.

I recall at the celebration of your foundation's tenth anniversary in 1983, President Reagan had this remark: "Historians who seek the real meaning of events in the latter part of the 20th century must look back on gatherings such as this." The Asia and World Institute is also ten years old this year. We are two years younger than you. Although much smaller in size and much smaller in operation compared to Heritage, we do share quite a few characteristics.

For example, you all know that The Heritage Foundation has one particular service: one phone call and they will deliver the paper, free of charge, the same day. In contrast, reporters who want the current papers from the Brookings Institution must send their own messenger with a written request on letterhead stationery.

The Asia and World Institute also provides such papers, materials, by request on the same day, except we don't send messengers, and we do not require a written note on letterhead stationery. *Newsweek* once described the Asia and World Institute with five words, "semi-official think tank in Taipei." We are not a government-affiliated organization. We are a pri-

vate, nonprofit, independent think tank in Taipei. The reason they call us "semi-official," is because two-thirds of the thirteen members sitting on our board have been drafted by the government and by the ruling Kuomintang party for very high posts. And they're still sitting on the board. That's why I think people describe us as semi-official.

We derive our funds from contracts with both government and the private sector, including grants from private enterprises and industries such as the textile industry.

United States-China relations have been the subject of great interest and continuing attention throughout universities, institutional conferences, and hundreds of seminars similar to this one this morning. While policy toward China has been the subject of great debate for many years, American perspectives have been, in the past, slowly shifting back and forth between uncertainty and optimism, idealism and realism. Peace, security, friendship and national interest will be determined by the decisions reached as Americans consider the future course of U.S. policy towards mainland China and the Republic of China in Taiwan.

Of course, the United States does not determine everything that happens in the world, but what the United States does, says and feels will have a profound influence in every part of the world. The views of American scholars and journalists, as you are, receive special attention. What the 19 million people resident in Taiwan deserve is your fair and equal treatment.

We appreciate your cooperation, Dr. Feulner, and your understanding of the new power of the media and the bureaucracy and think tanks. Most of all, we are grateful for your friendship. Thank you.

Dr. Feulner: Thank you, Philip.

We lead off the program today with perhaps the most difficult question of all. What do the current political trends in Taiwan and in the PRC mean?

Both societies seem to be in the midst of political liberalization of some sort, but how far these trends will go is an open question of immense importance, both to the United States and to the neighbors of both Chinas throughout the Pacific Basin. To help us grasp the significance of these political developments, we have asked two leading China scholars to look first at Taiwan and then at the PRC.

Our first panelist, Dr. John Copper, former Director of our Asian Studies Center here at The Heritage Foundation, is now the Stanley J. Buckman Distinguished Professor of International Studies at Rhodes College in Memphis, Tennessee. He is the author of numerous books and

articles on China. His topic today will be recent political developments in the ROC.

Dr. Copper: Thank you, Ed. What I'd like to talk about is political development and democratization in Taiwan, the Republic of China. My thesis is that what has happened in Taiwan in terms of political change over the last two or three decades matches their phenomenal economic development.

Now, this is a thesis that you probably have not heard very frequently, and it may be one that you're not ready immediately to believe, but let me simply state it and, as I go on, I'll attempt to explain why I believe that to be true and to present evidence for that conclusion.

Political development in Taiwan (or Nationalist China or the Republic of China—the nation's official name) has occurred at such a pace and has reached such a level that neither the fact of that process nor its lessons for other developing countries can be denied. Taiwan used to be described as a nation that was authoritarian, lacking in terms of political modernization of a democratic type. It was also said that there was a gap between economic development and political development, thus creating a potentially revolutionary situation. Plainly these things are seldom heard anymore.

In fact, some observers are now looking at Taiwan's experience in political development, as well as in economic development, as a model for Third World countries—especially those that have discovered that the Western model by virtue of it being Western and the fact that Western Europe and the United States had two centuries to accomplish political development is not a useful model. Third World nations are for the most part in a hurry both by desire and necessity—like Taiwan has been.

In this presentation I want to examine the causes and origins of Taiwan's political development, cite proof of the genuineness and significance of political modernization there, and assess recent problems that nation has experienced that challenge continued democratization and how those challenges have been met.

The Origins of Political Development

Political development is generally seen to have occurred in Taiwan for four reasons: (1) rapid economic growth, which made political change a *sine qua non*; (2) pressure and direction from the United States; (3) a constitutional system already established by the Nationalist Chinese before they went to Taiwan, which made democratization rather easy; and (4) Taiwan's need for international recognition in order to retain its

nation-state status in the context of efforts by the People's Republic of China to undermine and deny Taiwan its sovereignty.

Most observers have argued that the former two factors are more important than the latter two. Upon more in-depth analysis, however, it appears that it is just the opposite. Certainly a comparative analysis would suggest this. Many nations have experienced economic development without seeing commensurate or comparable political development. Clearly two of the three nations with which Taiwan is frequently compared in terms of miracle economic development—South Korea and Hong Kong—do not offer much proof of the thesis that economic modernization causes political modernization and democracy. South Korea has repeatedly experienced military rule and political instability. Hong Kong has seen little—some say virtually no—political modernization of the democratic kind during three decades of rapid economic growth based on economic development plans very similar to Taiwan's. And the number of nations that the United States encouraged, cajoled, pressured and even intimidated to promote political modernization and democracy that either ignored the United States or failed in their efforts is legend. During the 1950s and 1960s, in fact, so many failed that many Americans began to think that the U.S. political system was not a valid model for underdeveloped nations or that they must be given much more time to implement the American model and that pressure to make the process go faster was counterproductive.

In order to understand why Taiwan is a special case it is necessary to examine the factors mentioned above that fostered political development. Every nation is unique in its politics, and Taiwan is no exception.

Taiwan's economic development is certainly a cause of its political development for obvious reasons. First, Taiwan's economic development was the product of astute government planning and the hard work and desire of the people to experience a better standard of living. Second, Taiwan's economic growth model was the free market capitalist system which, to work effectively, required political freedoms and a more effective government.

Based on planning which emphasized agriculture in the first stages of development, light industry in the second, and capital intensive and knowledge intensive industries in the third, Taiwan experienced "miracle" economic growth beginning in the late 1950s that has continued until today. Growth was particularly impressive from the 1960s on. Depending upon what period of time is considered and how economic growth is measured, Taiwan may be considered the fastest growing economy in the world in recent years. Certainly it is among the fastest (which include

South Korea, Hong Kong, and Singapore). And Taiwan has accomplished this in spite of virtually no natural resources and what many observers have called a serious population problem (a population density three times that of Japan and nine times that of the People's Republic of China). It should also be noted that Taiwan's economy (in terms of per capita income and other measures) was essentially the same as the China mainland in 1950. Furthermore, while U.S. economic aid helped, that aid was less per capita than Cuba received from the Soviet Union in the 1960s and it was terminated in 1964, after which Taiwan's economy grew faster than before.

Taiwan's economic growth was so fast that it engendered a shortage of labor, which in turn equalized incomes (to the point that income disparity by the late 1970s was less than in the U.S. or Japan). Economic growth also led to urbanization, which required political development to solve urban problems. Taiwan's economic growth, based as it was on exports, also necessitated political decisions allowing (even encouraging) travel abroad, thus evoking a desire for increased political participation such as was seen in other capitalist nations and a high degree of cooperation between business (where the young, energetic, and enlightened leaders of the future were) and government. Taiwan also became a highly "penetrated" nation as a result of foreign business and tourism.

Economic growth in Taiwan, which affected the entire population because of the fact that it increased per capita incomes quickly and evenly, likewise had the effect of creating a consumer oriented society and in some senses a materialist culture. This led to a more aware public and one that increasingly demanded more from government, especially increased political participation. And a good and rapidly improving educational system made that meaningful.

Also unique about Taiwan's economic development was the fact that it not only equalized incomes (engendering less income disparity), it also relieved ethnic tensions (between Taiwanese and Mainlander Chinese) while creating a sense of national identity and purpose. At the same time it fostered some insecurity among the populace, who feared that their accomplishments would be lost if political change were not engineered carefully. It made them want change, but only well thought out change. It made them criticize their government, yet it put limits on that. It made them confident of their political leaders, yet not complacent about the political system.

In short, economic development in Taiwan produced political change of a positive sort for very special reasons. These reasons were not generally present in other developing countries, or at least not to the extent they

were present in Taiwan. It is for that reason that Taiwan is now often cited as a nation whose experience in economic and political development proves the interrelationship between the two (or that economic development causes political development) when most observers were losing confidence in the validity of this relationship.

Second, U.S. influence—both pressure and advice—are considered to have promoted political change in Taiwan. It indeed did. However, it should be remembered that U.S. influence did not have this effect in many other places. In fact, it was counterproductive in promoting political modernization in many nations. Taiwan is a special case for a variety of reasons.

American advice from the start was generally good advice. Clearly it was regarding land reform. And it was accepted because Taiwan's political leadership realized that it was necessary to promote economic development and vital for them to avoid the problems that they had experienced earlier when they were in China. Another important factor was that the government was not in debt to landlords and had large amounts of land formerly held by Japanese to distribute to landless farmers. Later, American advice was taken seriously because of the need for U.S. economic and military assistance to promote economic development and to protect the nation from Communism. When U.S. aid ended in 1964, Taiwan's need for the American market was just as essential to growth as aid had been. And it led to more learning about the U.S. in order to compete in that market.

Third, and a much overlooked factor in Taiwan's political development, is the fact that Taiwan's leaders brought with them when they left China after their defeat by the Communists a constitution, a political philosophy, and a well-planned and well-organized political system. The constitution they brought assumed political development (and, in fact, laid the groundwork for it), mass participation, and democracy. Both the Nationalist constitution and Sun Yat-sen's Three Principles of the People linked economic and political development (something generally not seen in other developing nations).

Although not all constitutional provisions were put into effect immediately due to the state of war with the People's Republic of China and because of ethnic differences between the Taiwanese and the Mainland Chinese (who went to Taiwan in 1949), this may have been fortuitous in that democracy was not tried too much in haste (as it was in a number of other countries where it then failed). The growth of democracy was controlled at the local level by the central government and the Nationalist Party and because of factionalism among the Taiwanese in local politics.

The mediating role of central authorities was crucial—which at the same time involved them in the democratization process. Without control from above, democracy at the local level would certainly have led to abuses and probably disappointment with democracy. Top leaders did not fear or oppose democratization in local government because they could control it, because they had promised it, and because they felt it was in some ways debased and they could do better when the time proved right to do it.

Thus, when the country became more developed economically and was more secure, the national government was able to establish democratic practices quickly and easily—by in some ways allowing democracy to "seep up" in the sense that the populace had experienced democracy in local government for some time and that democracy was in place in the entire system, though it was restricted or limited in national politics due to factors already mentioned.

Finally, Taiwan's status in the international community has been a crucial factor influencing political development. In the years immediately after the Nationalists were defeated in China and fled to Taiwan they called Taiwan "Free China." Having said this and being on center stage in the global arena they were thus obligated to prove it. They had to show that Taiwan was a China where basic freedoms and rights were given to its citizens. Although the political system in the 1950s was clearly more authoritarian than democratic, its leaders were not attracted to the totalitarian model and were determined to implement democracy so that the term "Free China" would be credible. To the overseas Chinese and the rest of the world, certainly by comparison with the People's Republic of China, this was the case.

Later, as it became clear that "recovering the Mainland"—the goal of the Nationalist government—was not likely to be realized and as the nation's legitimacy became more and more challenged in the global arena (with more and more nations granting diplomatic recognition to the People's Republic of China and Peking gaining membership in international organizations at Taipei's expense), it became clear that Taiwan had to appeal to the international community as a nation deserving of its sovereignty and nation-state status. Economic development and providing a better life for its citizens was one way of doing this. Here Taiwan plainly succeeded. But this was generally perceived as not enough; political development—particularly democracy—was also needed. And this would provide Taiwan with some of the status it had lost due to a change in its international stature. It would convince other nations of its right of existence, the rationality of its unwillingness to negotiate with Peking concerning unification (because its citizens did not want to become part of

the People's Republic of China, but rather desired to keep their present government), and the need to resolve the "Taiwan issue" democratically—which would certainly be to Taipei's credit and not Peking's in the event that the "problem" became a critical global issue. It would also prevent Taiwan from becoming a "pariah nation" as it was sometimes called.

Becoming a model of political development to Third World countries made Taiwan's status improve even more. Third World nations viewed themselves as small and subject to unfair treatment and pressure from the large nations. The government of Taiwan sought to put itself in this same category, as well as a nation that was democratic and free.

Measures of Political Development

Scholars of political development are divided on precisely how to determine when political development has taken place, or how to measure political development. However, a number of criteria can be cited which are generally thought to be related to political development or which can be used to measure the degree and pace of political modernization. The most common of these will be used to assess political development in Taiwan and prove the thesis that political modernization has already occurred there and is continuing at a rapid pace.

Efficiency in Government. Taiwan's government is efficient by almost any standard of measurement. The services provided by the government as compared to the cost of government give Taiwan's political system very high marks. The cost of government is low compared to Western democracies, yet services are almost equivalent. The time of response to demands by business or the public is quicker than nearly all other countries.

This must be seen against Taiwan's past, when corruption and inefficiency in government were rife. Today the level of corruption in Taiwan is about the same as in the United States or other Western democracies. If corruption is defined to include government employees receiving high salaries for doing very little (sometimes called bureaucracy) or to include obstruction of decisions for self-serving purposes, Taiwan's political system compares very favorably to almost all Western democracies.

Public support. Mass or public support for the government is frequently cited as proof of political development, particularly of the democratic kind. Public opinion polls in Taiwan reflect around 70 to 80 percent support or have confidence in the government—considerably higher than in most Western democracies. Martial law, which is often cited by Taiwan's opponents as reflecting a lack of public support in the governments is opposed (according to various public opinion polls) by only about 6

percent of the population, while the majority support it.

Voter turnout also reflects a high level of public support for the government in Taiwan. Turnout has been in the 70 percent range in elections over the last three decades. This is very high for a country that does not have compulsory voting.

Interest Groups. Theorists of political development and democracy alike advocate the need for groups that promote special interests. In Taiwan interest group influence in government is provided for in the constitution. Interest groups very effectively represent various segments of the population: professions, labor, farmers, women, minorities. And interest groups have been effective in representing group political interests vis-à-vis both local and central government while increasing participation in the political process. Similarly they have helped link economic and political modernization through "combined" problem solving.

Compared to other developing nations, Taiwan has a greater variety of interest groups and their political influence both constitutionally and in practice is more. Their impact on political parties and elections is also considerable.

Political Parties. Taiwan has been a one-party system—though it would now be better described as a one-party dominant system like Japan and Singapore. Independents have long played a role in elections in Taiwan and since 1980 independents or politicians "without party affiliation" have joined together to form what is for all intents and purposes an opposition party. They have a platform, jointly campaign and in other ways behave as a political party (even though the formation of new political parties remains technically illegal).

Meanwhile the Nationalist Party or Kuomintang carries out the functions of political parties in modern nations: recruitment, personnel training and selection. In short, it is a well organized political organization that fulfills the function of interest aggregation. In recent years it has also become much more democratic in decision making and fielding candidates. It has also become very representative of Taiwan's population in almost every respect.

Elections. Taiwan has had regular elections at the local and national levels since 1950. The first-ever island-wide election was held in 1950—just one year after the Nationalists fled to Taiwan after their defeat by the Communists. Since then elections have been held more frequently than in most Western democracies. Elections at the national level were for some time supplementary (many elected officials holding seats in representative organs of government permanently) and lacked party competition. But this began to change in the 1970s, and in the 1980 election (consider-

ing the fact that reappointed representatives were for the most part no longer active and could not participate in debate and fulfill other duties of office) a meaningful number of representatives in the National Assembly and Legislative Yuan were elected and there was party competition between the Nationalist Party and "without party" or Dang Wai politicians. Elections now are both meaningful and competitive at all levels of government.

Political Communications. Efficient political communications is a vital ingredient of political development according to nearly all observers, though it may mean a variety of things. Generally, widely used media (newspaper readership and radio and television that have listeners and viewers) are conducive to political participation, particularly intelligent participation, and the transmitting of information by the government to its citizens about government decisions, activities and programs. In Taiwan, both because of a high level of political interest and higher standards of living (making the purchase of newspapers and the ownership of radios and T.V. widespread) all forms of media communication have improved markedly in recent years. In addition, in the context of improving efficiency in government and ridding corruption, President Chiang Ching-kuo has directed government officials and civil servants to communicate governmental decisions through the media to the public and to enlist replies in the form of additional demands, supports, and comments. Thus the level of political communication in Taiwan is high.

Freedom of the press and media competition have also increased markedly in recent years. There is especially a high level of competition between Taiwan's two leading newspapers—*The China Times* and *The United Daily News.* There are a number of other newspapers and magazines reflecting a broad spectrum of opinions on political, social, economic, and other issues. Opposition politicians frequently complain that their publications are banned by the government and that the leading newspapers are controlled by the government or the Nationalist Party. However, many of the banned publications are banned because the publisher wants them to be banned to attract more readers. Furthermore, there are clearly newspapers in Taiwan that are considered opposition papers by most citizens.

Quality of Leaders. The level of education, experience in office, and talent of Taiwan's leaders compares favorably with Western democracies (in level of education very favorably). And improvements have been seen in all areas over the past three decades.

A noticeable change has occurred over the last two or three decades in the type of elected officials in Taiwan. They tend to be increasingly

Western-trained, have college or university training at the graduate level, have traveled abroad, have business experience, and have been schooled in party affairs or local government (or both). Unlike Japan and a number of other Western democracies, experience in local government, where democracy has its roots in Taiwan, is an avenue to leadership in the national government.

Secularization. Religion has never played an important role in Chinese politics and does not today in Taiwan. In this sense, Taiwan may be considered more developed politically than Western democracies where there are religious parties and where religious affiliation or qualifications play a role in leadership selection and government decision making. Thus it is hard to say that Taiwan's political system is becoming more secular since it has been very secular in the past.

Some students of political development also regard the influence of the military in the political system as evidence of the system not being secular. According to this criterion Taiwan has been less secular, but considerable progress has been made in "civilianizing" the government in recent years. While the government has been technically civilian in the past, the military played an important role and was generally perceived as a part of government in a variety of ways including providing leaders for top decision-making positions in government. However, with the demotion of Wang Sheng two years ago (considered a likely successor to the President by many) and President Chiang Ching-kuo's statement recently that his successor would be picked according to constitutional processes and would not be a relative, nor would there in any way be military influence in the government (through succession or otherwise), the process of "civilianization" has seemed to have proceeded some distance. Clearly the perception in Taiwan after so many years of civilian government, with a declining influence of the military in political decision making, and these recent announcements, is that the government is secular in any sense of the word.

Minority Representation in Government. Using this criterion of political development, Taiwan has made remarkable progress in the last two decades. In the early 1970s Chiang Ching-kuo, as Premier, ordered the aggressive recruitment of Taiwanese in the Nationalist Party and the government. Almost immediately they were recruited at a rate above their percentage of the population—a kind of affirmative action program. Taiwanese now comprise more than 70 percent of the membership of the Kuomintang (compared to their 85 percent of the population) and are still being recruited by the Party and the government at a higher rate than the rest of the population.

Women are guaranteed seats in elected organs of government by the constitution. However, they have been successful in running for office to the extent that these constitutional provisions have not been needed in recent years. Women now play a role in the political system in Taiwan equivalent to or exceeding that of most Western democracies. For example, in the last national election women won more than 8 percent of the seats in the legislative branch of government (compared to 2 percent or less in both houses of Congress in the United States).

Distributive Capabilities of Government. As already noted, income distribution in Taiwan is even—more even than the U.S. and Japan. This has been caused both by rapid economic growth, causing a labor shortage, and by government planning to create a mass consumer economy while giving benefits of economic development to virtually all of the population. Taiwan has recently established systems providing for social security, workman's compensation, health insurance, unemployment to further guarantee economic equality and security. In fact, Taiwan has done this faster perhaps than any nation in the world in past decades. The same applies to opportunities for employment, education, and travel. And it applies as well to opportunities for positions of authority in the political system. Very few political systems, in fact, have provided such equal opportunity and evenness in access or benefits from economic and political development as seen in Taiwan in recent years.

Conclusions

Taiwan has over the last two decades or so experienced political development to match its rapid economic development. Political development was, in fact, engendered by economic growth. But it was also evoked by other factors—including deliberate planning to make Taiwan a democracy. Taiwan's political leaders wanted this, as did the populace, and Taiwan was under pressure to accomplish it in order to survive. Few nations have wanted to modernize politically so quickly or were willing to take the risks to accomplish this. A strong culture and a desire to retain national sovereignty and independence made both the government and the population move faster than they would have otherwise.

For these reasons Taiwan is a good model for other nations which do not have the time that Western countries had to develop politically and to democratize.

Taiwan has faced other adversities in the process. Peking claims that Taiwan is its territory and threatens to use force against Taiwan to bring unification. Thus Taiwan has to spend large amounts of money on defense. Realizing this, Taiwan's accomplishments are more impressive.

Over the last two years Taiwan has faced other problems. Two or three officials ordered the killing of a U.S. citizen, resulting in bad publicity for the government. A large financial organization collapsed, bringing financial ruin to a number of companies and many more individuals. Mine disasters have made things worse. So has the world economy, upon which Taiwan depends as an exporting nation of huge magnitude. The question of succession is also bothersome; Taiwan does not have a recognized successor to the President. All of this has caused in recent months what some have called a "crisis of confidence."

Notwithstanding, a national local election was held last year proving that political development and democratization continues in spite of problems and adversity. In fact, it seemed to demonstrate that Taiwan thrives on adversity. Perhaps because it is used to it.

In any event, Taiwan is a model of political development that other nations can profit from studying in-depth. If my remarks have drawn attention to Taiwan as a political success story, they will have served an important purpose.

Dr. Feulner: Thank you very much, John Copper, for those insights on the very impressive political developments in the Republic of China.

Our second panelist is Professor Harold Hinton. I'm delighted to welcome him to The Heritage Foundation and to our day-long China seminar.

A well-known China expert, Professor Hinton holds the Chair in Political Science and International Affairs at the Institute of Sino-Soviet Studies at George Washington University here in town. He has been affiliated with GWU for a number of years, thirty to be exact. He has authored, edited or contributed to more than a dozen major books on developments in China and numerous articles and essays on related subjects. He travels frequently to Asia, and he consults with various research entities both in Washington and elsewhere around the country. We are delighted to have you with us today, sir, to discuss the topic of recent political developments in China.

Dr. Hinton: It is obvious that the east coast of China has not sprouted a chain of fast growing economic regions like Taiwan. One major reason for the inferiority of the mainland's performance is the fact that for two millennia China's successive rulers have insisted on controlling not merely the fertile East but the generally barren West, which was of little economic utility until its minerals became industrially exploitable in recent times. This vast hinterland has acted like a tail holding back the coastal

areas. Among the reasons for which China has persisted in ruling a large portion of Inner Asia, there is at least one that is valid and important. If China did not control its hinterland, someone else would, and in the traditional past nomadic confederations temporarily dominating some or most of the hinterland occasionally invaded, conquered, and ruled China Proper. At the present time, the beneficiary of any loss of Chinese control over the border areas, which was recently predicted by the notorious KGB journalist Victor Louis, would obviously be the Soviet Union.

To this day and for the foreseeable future, the Chinese political system stresses national unity and control by a powerful central elite. At present three major aspects of that elite's domestic problems and policies—political succession, economic reform, and political liberalization (or its absence)—seem especially worth analysis.

Political Succession

Mainland China is in the midst of what is probably the most carefully prepared and managed political transition in history. That this process has nevertheless encountered problems is not surprising.

For reasons of age, health, and fatigue, Mao Zedong turned over effective control of affairs to Premier Zhou Enlai about 1970, as Mao told Edgar Snow in an unpublished portion of an interview given on December 18 of that year. After purging his rival Lin Biao in September 1971, Zhou rapidly built up a powerful centrist bloc composed of the "commanding heights" of the political system: the Communist Party apparatus, the state bureaucracy, the police, and the mainstream of the military leadership.

As his successor in charge of this coalition, Zhou groomed Vice Premier Deng Xiaoping, whom he rehabilitated from political obscurity in 1973. Deng was significantly less acceptable to Mao and the radicals, such as those later known as the Gang of Four, than Zhou was, and after Zhou's death in January 1976 Deng was purged again. Soon after the death of Mao (September 1976), Deng launched a political comeback in increasing opposition to the rather bumbling transitional leadership of Hua Guofeng. Beginning in 1977, Deng picked up the support of most of Zhou Enlai's old coalition, and in 1980-81 he got rid of Hua Guofeng and the other radical holdovers at the Politburo level.

At the same time, Deng brought in his own team, headed (after him) by Party General Secretary Hu Yaobang and by Premier Zhao Ziyang, both about fifteen years younger than himself. There is some doubt about Hu's ability, although he is outspoken and unconventional, but none about

Zhao's. In September 1985, Deng brought into the Politburo a group of still younger and evidently very able men, notably Hu Qili and Li Peng, who are probably intended to succeed Hu and Zhao respectively.

This highly purposeful process has inevitably aroused opposition; it has consisted of three main components: the remaining Maoist radicals (mainly at the middle levels), older elements of the military leadership, and the "Stalinists" (i.e., believers in centralized, Soviet-style, economic planning and administration). These groups have tended to cooperate, not very effectively, in the essentially vain hope of checking Deng's steadily increasing power. As their leader and as a potential counterweight to Deng, they have put forward successively Hua Guofeng (a radical, more or less), Ye Jianying (a senior military man), and most recently Chen Yun (a Stalinist economic planner and specialist in party discipline). The radical Deng Ligun, working for the time being with Chen Yun, was mainly responsible for launching the short-lived campaign against "spiritual pollution" (foreign social and cultural influences) in late 1983, apparently in the hope of parlaying it into an instrument with which to replace Hu Yaobang with himself. For his efforts, Deng was retired from the Central Committee in September 1985. At an important party conference held at that time, which on the whole was a triumph for Deng Xiaoping, Chen Yun made some highly critical comments on the abuses generated, at least as Chen saw it, by the quasicapitalist aspects of Deng's economic program, on whose success his reputation is likely to stand or fall in the long run.

At present, Deng is apparently trying to prevent the military leadership, already politically weakened by numerous retirements and a manpower cut of one million, and the remaining radicals from coalescing with Chen Yun's group. To this end, presumably, he has permitted some favorable comment on Lin Biao, who was both a general and a radical, in the military media, even though Lin was heavily if posthumously attacked during the Gang of Four trial of 1980-1981, which Deng masterminded.

In China, as elsewhere, you can't beat some one with no one, and Chen Yun is likely to be no more successful than Hua Guofeng and Ye Jianying in containing the power, policies, and succession plan of Deng Xiaoping. Whether Deng's succession arrangements will hold together after his death or incapacitation is a more difficult question. The answer appears to hinge on whether the economic modernization program succeeds well enough to satisfy the demand of the people for a better material life, without creating enough "spiritual pollution" to evoke a destructive reaction from the Maoists or the Stalinists. The chances of a favorable outcome appear to be a little better than even.

Economic Reform

An even more serious problem for Deng Xiaoping than political opposition per se, in all probability, has been the difficulties of the modernization program, on whose ultimate success, by the middle of the next century, he has staked his historic reputation. The latter stands high at present not only with most Chinese but with *Time* magazine, which has twice named him Man of the Year (for 1978 and 1985). Deng's political opponents, being naturally less appreciative, have of course tried to capitalize on the shortcomings and problems that have inevitably dogged the modernization program.

The earliest major component of the modernization program in the post-Mao period to be put in place was the "open" policy toward the outside world; it got rolling about 1978 under Hua Guofeng with the signing of treaties of peace and commerce with Japan. This process both contributed to and reflected an early burst of overoptimism; and after Deng Xiaoping assumed effective charge of policymaking at the Third Plenum (or Third Plenary Session of the Eleventh Party Central Committee) in December 1978, various overcommitments, especially large contracts with Japanese firms, were drastically cut back.

Next came agricultural reform, which was launched on a nationwide scale at the Third Plenum after a trial run under the supervision of Zhao Ziyang in Deng's native province of Szechwan. Under the new policy, known as the responsibility system, agriculture has been virtually decollectivized. In addition to retaining their private plots, peasant households may now contract with the commune authorities to produce, over as long a period as fifteen years, mutually agreed upon quantities of agricultural commodities. Anything above these quotas may be disposed of by the households as they see fit. This arrangement has had a very beneficial effect on agricultural output and overall peasant prosperity, but it has also reintroduced income inequalities into the Chinese countryside.

Meanwhile, the essentially unreformed industrial sector was still floundering in a morass of excessive centralization, arbitrarily fixed prices, deficiencies of energy supply and infrastructure, and low growth rates. The "open" policy, beside generating some "spiritual pollution," was also in difficulties. Foreign investment and technology were not flowing in at the desired rate, and the benefit of what did come in was being reduced by the overall inefficiency of the economic system. A very large program of offshore oil exploration in the South China Sea, for which Peking had contracted with a number of foreign (including American) firms, and from which it had hoped for large revenues, was yielding little but gas. A

potentially important nuclear power cooperation agreement with the United States, initialed by President Reagan during his visit to China in May 1984, ran into trouble in Congress later that year.

It was evidently considerations such as these that led the Chinese leadership, in 1984, to bite the bitter bullet of economic reform, with its risks for the principle of central political control. A major Central Committee directive of October 20 mandated some freeing up of the price system, a degree of industrial decentralization, and lower subsidies to consumers (in the form of cheap food, clothing, housing, and essential services).

Results began to appear much faster than most foreign observers had expected, but not all of them were to the liking of the Chinese leadership. China's overall economic growth rate for 1985 approximated 15 percent, the highest in the world, but much of it was paper growth. There was considerable inflation in the urban areas. In the new, more permissive, environment millions of peasants stampeded out of grain production into less laborious and more profitable activities, with a resulting substantial drop in the size of the grain harvest for 1985. Plant managers, enthusiastically exercising their enhanced authority, placed large orders for foreign, mainly Japanese, equipment, with a profoundly negative effect on foreign exchange reserves. "Spiritual pollution" in the form of corruption, already rather luxuriant as in the case of the celebrated Hainan scandal, soared to new heights.

All this naturally aroused serious concern on the part of Deng Xiaoping and righteous wrath on that of his opponents. On their behalf, Chen Yun spoke out at the important party conference already mentioned on September 23, 1985, and at a forum of his own, a meeting of the Central Commission for Discipline Inspection held the following day. He deplored the current trend, the result by implication of Deng Xiaoping's economic program, toward "decadent capitalist ideology and conduct." He denounced corruption and "spiritual pollution" in vigorous terms and called for a tightening of party discipline and control, the all-purpose Communist remedy, as the only appropriate solution.

Even before September 1985, something of a reverse course in economic policy was underway, with Deng Xiaoping in the lead as usual. The Seventh Five Year Plan (1986-1990) envisages a growth rate of "only" 7 percent per year. An agricultural conference was called in December 1985 in an effort to turn the countryside in a more "socialist" direction. Some aspects of the "open" policy, especially the authority of plant managers to obligate foreign exchange, have been cut back, and Deng has recently referred to Shenzhen, the most important of the four Special

Economic Zones by virtue of its proximity to Hong Kong, as an experiment. There has been increased emphasis on trading with the Soviet Union and Eastern Europe, a logical development to the extent that China has some four hundred obsolescent factories, built with Soviet aid and technology in the 1950s, that need to be re-equipped.

Instead of a planned dialectical synthesis of the good features of socialism (as the base) and the good features of capitalism (as the superstructure), the Chinese economy appears to have acquired an almost random mixture of the good and bad features of both, with emphasis on the bad according to some observers. On the other hand, China possesses enough human and material resources so that in the long run even its huge size and population and its overly authoritarian political system will probably not prevent it from attaining a reasonable level of modernization. The process will presumably be rendered easier if there is a measure of political liberalization.

Political Liberalization

In some ways, Deng Xiaoping's historic role corresponds with that of Khrushchev, but his current policy more closely resembles Lenin's famous New Economic Policy (NEP) of the 1920s, in that it combines a degree of economic liberalization with a tightening of political discipline in some respects, with the aim of avoiding a loss of party control in the course of economic experimentation.

The incipient movement on the part of Chinese dissidents for a Peking Spring ("socialism with a human face") and for the so-called Fifth Modernization (political liberalization) was largely crushed in 1979-1980. The symbol of this crackdown was the 15-year sentence imposed on the articulate dissident Wei Jingsheng. Hope remains today in the China Spring movement among Chinese in the United States. Nevertheless, the intellectual and political atmosphere does appear to be getting gradually more relaxed, mainly for the simple reason that increasing numbers of Chinese are grasping, subconsciously at least, the truth that authoritarian political control and economic progress in the information age are mutually incompatible.

One of the major obstacles to political liberalization in the near future is the fact that it is opposed not only by the party leadership but by elements of the youth, especially in North China, where the political climate has always been more conservative than in the South. In the contemporary Chinese context, conservatism equates roughly to residual Maoist, or alternatively Stalinist, tendencies. Many young people in the North, including students, appear to feel that Deng's current policies

deny the Maoist values they were taught as children, without compensating in the form of guaranteed career opportunities. Deng, and still more Hu Yaobang, are also considered to have moved, especially in economic matters, too close to Japan, resentment of which runs very deep in China at all age levels. Currents such as these appear to have been the source of the student demonstrations in Peking in September and December 1985.

Although frantic, short-lived mass campaigns in the Maoist manner seem to be gone for good, the Deng leadership has launched three major campaigns with adverse effects on the human rights of the Chinese people. The most serious and long lasting of these is the current population control (or one child family) campaign, which began after the Third Plenum and, in spite of a slight recent slackening, has not only prevented millions of births but has increased abortion and infanticide (especially female) to epidemic levels and created problems and misery for many if not most Chinese families. Another campaign, against ordinary crime, began after Deng Xiaoping's car was held up in August 1983 and lasted at high intensity for several months. The third, against "spiritual pollution," began in October 1983 but was cut back early in 1984, largely it appears because it had begun to make China look ridiculous abroad and to harm the outlook for foreign investment.

At present, a fourth campaign, a party "rectification" campaign, is getting under way, and it is apparently intended to be the main event of 1986, as economic reform was the main event of 1985. Chen Yun's influence will presumably benefit from the fact that this is his department, but Deng Xiaoping is likely nevertheless to remain more equal than the others in the Peking leadership.

An interesting recent development has been the partial relaxation of official controls over the Catholic Church in China, parallel with the Vatican's de-emphasis on its relations with Taiwan. Among the landmarks in this process have been the release of the long imprisoned Archbishop of Shanghai and the restoration and reopening of the Peitang (North Cathedral) in Peking just in time for Christmas Eve 1985.

Many Chinese appear to realize that, in the long run, political liberalization is as necessary as economic reform. The question is whether something along the lines of the developments in Poland, prior to the Soviet-directed declaration of martial law in December 1981 (which Peking applauded), is possible in China: an autonomous trade union movement, strikes, intellectual and political ferment, and so forth. Not only are there powerful forces in China opposed to such a development, as we have seen, but it might bring on Soviet intervention, in spite of the tremendous risks and costs that would be entailed. As a matter of fact, no

country bordering directly on the Soviet Union, with the exceptions of Norway and Finland and the partial exception of Turkey, has experienced any significant measure of political liberalization. This suggests that further liberalization among Moscow's neighbors, including China, may have to wait on the emergence of a corresponding trend in the Soviet Union, something for which no one now living would be well advised to hold his breath.

Dr. Feulner: Thank you, Professor Hinton. Our format calls for questions and comments from the floor. Who will be the first?

Mr. Neilan: Ed Neilan from the *Washington Times*. What do these political liberalization trends in each place have to do with each other?

Dr. Feulner: I'll give you both a crack at that one.

Dr. Copper: Well, observers have long asked the question, "Is there gradual convergence in any way that would bring Taiwan and the mainland together sometime in the future?" Looking at political development, I'd have to say the answer is no.

Taiwan's political development has followed the capitalist model of economic development. It doesn't relate at all to what is happening in the People's Republic of China.

I think if you talk to the leadership in Taiwan who have been behind this change, they will say their future is on Taiwan. It's not a future that's connected with the People's Republic of China at all.

I have not talked to anyone on Taiwan who seriously thinks that what's going on in the mainland is going to lead to a reconciliation.

Dr. Hinton: I don't think that the two things are really causally related, but I think there's a broad parallel. The Chinese political tradition is profoundly authoritarian and to a certain extent basically incompatible with modernization in at least the Western or post-World War II Japanese sense.

I think this was realized some time ago in Taiwan and more recently is beginning to be realized on the mainland. Each within its own political parameters has taken the steps that it thinks are the minimum necessary to promote a degree of efficiency for modernization. International respectability is a secondary thing.

Dr. June Dreyer: I'd like to direct my question to Professor Hinton. I gather from your talk that you think—and I would certainly agree—that although the Chinese may not have managed their succession problems extremely well, there have been a lot of other countries that have man-

aged them worse. Do you see any signs that Deng Xiaoping may be planning to replace his first successor generation with his second successor generation without ever having Hu Yaobang truly in charge?

Dr. Hinton: June, that's a very interesting comment. Yes, I think there's a good chance that the second generation is really too old, and will end up being bypassed. The third generation looks very adept to me.

We have dealt with a number of these individuals, particularly Li Peng, and Hu Qili to a lesser extent. Both come across as very impressive. I think Deng really knew what he was doing when he brought them on.

Dr. Dreyer: Do you see any movement from a hard authoritarianism to a soft authoritarianism?

Dr. Hinton: In the long run, I think there would be a trend to a softer authoritarianism. Deng, after all, is a man of the old generation. He expects people to snap to when he says something, and by and large, they do. I think the upcoming people, particularly the third generation, are less like that. They are more concerned with getting the job done and they won't have the same hangups about the Japanese, the Long March, and so forth, which instilled a very authoritarian, although also very courageous and enduring, psychology to Deng's generation.

Mr. Emerson: Terry Emerson. What elements in the mainland succession struggle would benefit the most from any substantial United States support from military modernization?

Dr. Hinton: Well, the answer of course is the military. Deng Xiaoping has taken great care to keep his finger on the military button, retaining to date, at least, the chairmanship of the military committee of the Party, although he occasionally makes the suggestion that he's going to turn it over to Hu Yaobang, who does not have any military background. Deng has eased out quite recently the senior military people. My guess is that the people coming up below them by definition have to be more concerned with technical modernization than the older people. So I think they are bound to be pleased with and to benefit over the long run from U.S. military aid.

Is that a bad thing? Not necessarily. I think the Soviet military are a big problem for the Chinese, for us, and a lot of other people. The Chinese military are not that kind of a problem. I think they're going to leave political decisions strictly to the political leadership. They're not particularly concerned with using their military might abroad, except perhaps over the very long term. If they do have such an ambition, it would be toward Taiwan. I think they still see the country as unreunited. But with

that single important exception, I don't think they're going to be a problem.

Therefore, I think the real problem with giving military aid, or any other kind of aid, to China, which would tend to reinforce its military capabilities over time, is long-term. Deng Xaioping talks about the middle of the next century. What would it mean to the rest of Asia? The answer is the rest of Asia is both uncertain and nervous about this, and I think we ought to take account of that.

Unidentified Guest: I think you alluded to the purge of the senior military leaders in China. Simultaneous with that, there was a rather major reduction in the size of the army and reorganization of a number of military regions. What is the significance of what appears at present to be a major reorganization of the Chinese army?

Dr. Hinton: Well, the senior types weren't purged; they were retired. There was a cut, allegedly, of a million men in the overall strength of the PLA, and they did restructure the military regions. These are major steps; you are right. Deng Xiaoping has a reputation for this kind of thing because he spearheaded the transfers of the military region commanders in late 1973 for Zhou Enlai.

General Stilwell wanted to cut the Nationalist Army by some incredible amount in World War II. It didn't mean he wasn't afraid of the Japanese, but he felt that a leaner, meaner, tougher army would be much more effective. That's what the Chinese are doing, too. They've had a big, foot-slogging, mud soldier army for a long time, with horses and what have you. They're trying to get rid of that in favor of a leaner, meaner army.

What do they do with a million men when they demobilize them? That's the real question. It can create a very serious employment problem. It probably has already.

I think they have very skillfully tailored their military modernization program so it's not costing them all that much money. But the Chinese are adept at being able to fit in carefully selected bits of new technology into their military. I expect them to be able to make considerable progress in this way.

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Mr. Hugh Newton: Ladies and Gentlemen, I am pleased to begin the second session of our seminar, an unusual look at China from the view of two senior journalists, Fox Butterfield of the *New York Times* and Dr. David Aikman of *Time* magazine.

Mr. Butterfield will start. He's been a correspondent for the *New York Times* since 1969. He is a graduate of Harvard College where he majored in Chinese history. He spent a year studying the Chinese language in Taiwan on a Fulbright scholarship, and then returned to Harvard for his Master's degree in East Asian studies.

He opened up the first *New York Times* office in Beijing since 1949 back in 1979 and was there until 1981. He is the author of *China, Alive in the Bitter Sea*, and he's currently the New England Bureau Chief of the *New York Times* in Boston.

Mr. Butterfield: I've been asked to talk today about the work of American journalists in China. It strikes me that what makes reporting on China unique is the longstanding American romance with China.

It's hard to say where this comes from. It might have something to do with all the American missionaries who went to China starting in the 19th century and dreamed of converting the heathen Chinese to Christianity. Or maybe it has something to do with all those American businessmen who dreamed of the hundreds of millions of Chinese customers. If only each Chinese would buy a single American-made toothbrush, the Americans would get rich. Or perhaps it had something to do with writers like Pearl Buck.

But, in any case, clearly Americans feel different about China. They feel closer to it than they do to Japan or India. For many Americans, China is "our" country in Asia. Certainly there is no other country where every American visitor feels compelled, or qualified, after a seven-day visit, to write a book about the country—witness Shirley MacLaine and John Kenneth Galbraith . . . or myself.

But often with China, our perceptions are based on very flimsy knowledge. I remember when I first began to study about China at Harvard in 1958 as an undergraduate, what I knew about China was probably the common wisdom of all Americans, that if you wanted to get there, you dug straight down.

Many years later, in 1979 when I got to Beijing and opened the *New York Times* Bureau there, I was invited to a high school and the students wanted to talk about the United States. I asked them what they knew about the United States, and one girl put up her hand and said, "Well, there are only two things that I know about America." I said, "What are they?"

She said, "Well, the first thing is that the United States has had three great Presidents: Washington, Lincoln and Nixon."

I said, "What's the second?" And she said, "Well, if you want to get there, you dig straight down."

More seriously, the results of this kind of flimsy knowledge—on both sides—is to contribute to what I think is our romantic thinking about China. There is a strong desire on the part of many Americans to see China do well, and they want the Chinese to be our friends.

It was true in World War II with Chiang Kai-shek and I think it is equally true today. It was this romantic thinking about China which colored our view of the disastrous Great Leap Forward in China in 1958 when Mao wanted to have instant industrialization, asked peasants to build backyard blast furnaces, and 15 million people ended up starving to death.

It was the same rosy-colored thinking which led many otherwise intelligent Americans to hail the Cultural Revolution. You think back to a funny story that Shirley MacLaine has told on herself. In 1972, when she went to China, she went down to a commune and met a very prominent physicist who was growing tomatoes. She was rather taken aback by this, and she asked him if he didn't think he was wasting his time raising tomatoes on a farm when he could be doing physics in his lab in Beijing. He said, no, he was really learning from the poor and middle-level peasants, and it was helping China.

Shirley MacLaine was really taken by that, and then in 1979, when Deng Xiaoping came to the United States and she was invited to the White House to dinner and sat between President Carter and Deng, she recalled this to Deng Xiaoping. Deng Xiaoping looked at her and he said, "That man lied."

And now I think we're being swept away again by all the reforms that Deng Xiaoping is undertaking. I don't mean to minimize the importance of them. We heard from Professor Hinton this morning about some of the things that are happening. Clearly it's important but, with apologies to my colleague from *Time* magazine, reading the *Time* magazine cover story on Deng as Man of the Year, you could come away with the impression, and I think many Americans did, that China is going capitalist.

Of course, it's not just American news editors who tend to be enthralled with China. Some politicians get carried away, too. Remember President Nixon's toast in the Great Hall of the People. Even President Reagan when he came back from China seemed to have liked it, and referred to it as a "so-called Communist country."

This tendency to see China through rose-colored glasses makes it easier for positive stories about China to make the front page. When the head of the Communist Party propaganda department, for example, pledges that

writers will be given literary freedom, that's a front-page story, or when the New China News Agency reports when the Communist Party will retire many elderly officials, that's a front-page story.

But this attitude makes it hard to get what you might want to call bad news stories on the front page. For example, when I was in Beijing, I recall at the time of the arrest and then the conviction and sentencing of Wei Jingsheng, China's leading dissident, that story did not get on the front page. In fact, later that year when there were trials of a number of lesser known dissidents, it was very hard to get those stories in the paper at all.

I think there's another factor at work here as well. I believe there is what you might call a double standard in American reporting and thinking about human rights in China and Asia as a whole. I don't mean that we are more concerned with abuses of human rights in non-Communist countries in Asia, like Taiwan or the Philippines. What I mean is that we seem more concerned with abuses in what we think of as "Western" countries, like the Soviet Union, than we are in China.

Any time Andrei Sakharov receives a phone call now, in Gorky, or his stepchildren in Boston hold a news conference, it's reported. It's news. That's fine with me, and I think it is important. But we should make equal efforts to cover dissidents in China.

There is a prevalent view in America that Asians think that life is cheap, and therefore, Chinese and Asian lives don't count as much as ours. I recall I was in Beijing and discovered that a Chinese off-shore oil rig had collapsed, that all 72 people aboard had drowned because of some bureaucratic bungling, and there was a major, though unreported, debate in Beijing over how to handle the issue, and who would get the blame.

I wrote the story for the *New York Times*, but it was held for a week, even though a few weeks before that, the collapse of a Norwegian rig had been front-page news for several days. I often wish I had a dime for every time someone asked me, "Don't you think Communism is better suited for China than democracy, given the number of people in China, its huge population, its shortage of resources, and the Chinese tradition?" Personally, I find this proposition to be condescending and racist.

Let me say a few words about the actual conditions of reporting in China. First, I must admit that the Chinese Communists certainly never tried to openly censor what I wrote, or harass me, the way the KGB sometimes does with foreign correspondents in Moscow. The Chinese are too subtle and sophisticated for that.

Their control system is also, I think, much more thorough than the Russians. It's so good, in fact, it's like a form of radar that picks you up wherever you go. I remember going to visit an American scholar I knew

who was doing research in the industrial city of Wuhan, like our Pittsburgh, a major iron and steel center on the Yangtze River.

It was easy to tell that I was being followed when I drove from my hotel room to his dormitory room on the campus where he was doing research, because when I looked out the back window of the taxi, there were no other cars on the road, but a few minutes after I got to his dormitory, the phone rang and I heard a woman's voice asking rather loudly in Chinese, "Do you have an American visiting you? Is he a journalist? Is it the man from the *New York Times*?"

My friend laughed and explained to me there was a certain Mrs. Zhou who was in charge of security on the campus and whenever anything unusual happened everybody on the campus was required to report it to her. Clearly, my arrival was unusual.

The incident, he said, was a good example of the effectiveness of what the Chinese call the *danwei*, literally, the unit, a place where you work, whether it's your office, factory or school. Every Chinese belongs to a unit. It's like a form of separate citizenship. Often I notice when Chinese go out to a place where they are not known, the first question they are asked is not, "What is your name?" but "What is your unit?"

To give you a personal story, when I first got to Beijing, I went to the Beijing Hotel to try to get a hotel room. I went up to the desk. The clerk looked at me for a few minutes, and then he said "Ni nar," literally meaning, "Where are you?" but which has come to mean, in Communist parlance, "What is your unit?" And I said, "I don't have a unit. I just got here."

And he said, "That's impossible. Everybody in China has a unit." And he said, "We only give out hotel rooms to units, not to individuals." So that set off a rather frantic search, by me, to try to find my unit. I first went to the Foreign Ministry which had administered my visa, but they declined this apparently awesome responsibility.

Then I went to the American Embassy, but a friend in the State Department shook his finger at me and said, "Fox, you forget the great tradition in the United States of the separation between the government and the press. You can't be part of this unit."

So then I went to the China Travel Service, which deals with foreign tourists, and they said, "Yes, we help foreign tourists, but you're not a tourist now. You're a resident."

So I went to the Diplomatic Services Bureau, which helps foreign residents, and they said, "Yes, we help foreign residents, but we only give them apartments, not hotel rooms, and there is a year's waiting list for apartments."

So finally I went back to the American Embassy and I appealed to the American Ambassador, then Leonard Woodcock, and he reconsidered and wrote a letter for me to the Foreign Ministry, and they reconsidered and finally agreed to make me a part of their unit. With a letter from them, I got a hotel room.

But the unit is not really a joking matter, because, in addition to providing you with your job and your housing, it also provides a whole other range of daily necessities which, depending on the time and situation in China, may cover things like ration coupons for rice or television sets. The unit may provide schooling for your children, medical care.

To put it in more familiar terms, imagine if all of you in this room just finished school and you were assigned to the same unit, you worked in the same office, you would also be given housing in the same apartment building. You might shop in the same store. Your children would go to the same schools, and you would use the same doctors. In other words, wherever you went throughout your daily rounds, other people who know you would have you under some rough form of surveillance.

On a more positive side, I should say that I was lucky to arrive in China in 1979 at a time when the Communists were allowing their people more freedom to meet with foreigners and more freedom to talk among themselves than at any point since the Communists had come to power in 1949. Hence, I was able to make some real Chinese friends. Some I met at Democracy Wall, when we were reading wall posters together. Some I met by accident when I went into restaurants where, under the Chinese system, you share tables.

Some of these people later were able to come to my apartment for dinner. In some cases, I went to their houses for meals. But none of these friendships came easily. For every ten people I tried to talk to, I might see one of them again later.

They knew it was dangerous to be seen with foreigners. One friend, a young television reporter, was seriously criticized for meeting me and told never to do it again. Another person, a middle-aged woman journalist and a Communist Party member, was sent to a labor reform camp after she had talked to me about her unhappy marriage to a Navy officer, and I was told later by somebody else in her unit that the crime she was charged with was leaking state secrets to a foreigner.

I was not able to develop sources within the Communist Party, or government higher-ups, people I could call up and ask questions, but I did make friends with a fairly large number of the children of high Party and army officials, and through them, I was able from time to time to tap into China's grapevine, or "backroad news."

Their parents would bring home classified documents and bulletins, bulletins that in China often take the place of newspapers in our society, providing an inside look at politics both in China and overseas. At first, I was kind of skeptical. I thought this was just gossip, but over a period of time I came to realize that a lot of the information was valid. For example, I was able to learn from a couple of these friends that Hua Guofeng would be demoted as Premier nine months before it actually happened.

Finally, I should say that, of course, as foreign correspondents, there were certain restrictions on our travel. We were not able to move freely around China. You have to apply for permission first, and it was often denied.

But even in this process, I tried to follow Chairman Mao's dictum of turning weakness into strength, that is, to take advantage of the situation and to learn from my experience. So I close with another personal story, one of my favorites.

Before I got to China I had the not-very-secret ambition to be the first American to go skiing in China. I was encouraged in this because I had read accounts of skiing in Chinese magazines and had seen pictures of Chinese coming down the slopes with smiles on their faces. In fact, just before we got our visas to go to Beijing, the New China News Agency reported that China was going to open a ski resort for foreigners in order to earn badly needed foreign exchange to pay for its modernization program. So when I got to Beijing, I went to the Foreign Ministry and applied for a ski trip. Months passed. Finally, an answer came back, "There is no skiing in China."

I thought perhaps there had been a misunderstanding, so I reapplied, this time enclosing copies of the clippings from the newspapers and magazines. Again, months passed, and the answer came back, "Yes, there is skiing in China, but it is an area closed to foreigners."

Well, a few days after that by accident I was sitting in the lobby of the Beijing Hotel and two American friends of mine came through with skis over their shoulders. You can imagine I was more than a little perturbed. I asked them where they had been. They said, "Oh, we were just up in the northeast and we had a terrific week skiing, and you'll never imagine who we met while we were there. Why, it was a group of reporters from *Ski* magazine doing a feature story on China's first ski resort."

Well, you can guess the look on my face. I was more than a little angry. So I went back to the Foreign Ministry and reapplied again, this time giving exact specifications on how to get to China's ski resort. And a few weeks more passed and the answer came back, "Yes, Mr. Butterfield, you're right. There is skiing in China. And yes, you are right, it is an area

open to foreigners. But we are very sorry to tell you now there is no snow. You may go if you like, but please do not take your skis."

Well, it was February. This was too much for me. I agreed to their conditions. They gave me permission. I went without my skis and when I got off the plane at Harbin, a major city nearby, there was a very nice guide from the Travel Service who met me and we were looking at the snow on the ground, it was up to about my knees and he said, "Gee, Mr. Butterfield, it's too bad you didn't bring your skis."

Well, if there is a moral to this story, it is that nobody beats the Chinese bureaucracy, certainly not foreigners.

Mr. Newton: Our next speaker is David Aikman from *Time* magazine. Dr. Aikman has a Ph.D. in Chinese and Russian history from the University of Washington. He's been a *Time* magazine correspondent for fourteen years, and he's currently in the Washington Bureau covering the communist world. From 1983 until early 1985, he was *Time* magazine's Bureau Chief in Beijing.

Dr. Aikman: I'd just like to say that there's a happy sequel to Fox's skiing story. The successor to Fox, Christopher Wrenn, the *New York Times* correspondent and I, took a skiing trip to Jilin Province. We had a very enjoyable time, but I have to say we did get the very last day of skiing in the year, and I think that was something like February 2nd. So the Foreign Ministry was probably not too far off when they said there was no snow.

The interesting thing about covering China is that the stories of the correspondents who go there vary enormously from one month to another in terms of what you can do, where you can get to, and what the general conditions are for reporting. I remember following, with great envy, the period when Fox and my own predecessor, Richard Bernstein, were in China. It was a time of tremendous political and intellectual excitement.

Fox is quite right. There was an unusual opportunity then for access to some very interesting ordinary Chinese, and the curious thing is, about being in China as a correspondent, is that there seems to be something of an up and a down, but on the whole over a long period, an up. And I have to say that, for me as a reporter, it's far more important how much access you get to ordinary people than it is how much access you get to high officials.

As to access to high officials, when I was in China (and I don't think this was true when Fox was there), the Foreign Ministry gave weekly briefings at which questions could not be asked except in advance by telephone, and then you could not be sure that they would be answered. In

fact, I remember once calling up dutifully about a day before one of the weekly briefings and saying, "I have a question about the issue of Pan American's landing rights," which was very hot on the agenda then. And he said, "Thank you very much. We'll take your question."

So I eagerly listened to the very last comment of the briefing on the following day, not a word on the subject. I then approached the official spokesman, and I said, "Excuse me, what about Pan American?" And he looked at me as though I'd asked a really rather rude question, and he said, "When we have something to say, you will be told."

There was, however, once a month, a question and answer session which could be useful. Most of the time, however, it was not useful. There is an interesting psychological phenomenon attached to this, I think. If you are in an environment, let's say Washington, where every reporter asks any question he wants at any time whether it's convenient or inconvenient to the sources, you tend to get caught up in a rather aggressive reporting way of life. If you are only really allowed to ask questions once a month, by the time this long-awaited weekly question and answer session shows up, you are somewhat psychologically intimidated.

It's not that anybody is going to say something rude to you if you ask the wrong question. It's just that it has been conveyed to you that there is a place for journalists in the society, but not a very prominent one, and please do remember that.

Nevertheless, I have to say that the Chinese Foreign Ministry made considerable efforts to satisfy our permanently unsatisfied desire for information. For example, one of the most useful things of all was an informal dinner about twice a year, sometimes three times a year, with the Vice Foreign Minister and several senior Foreign Ministry officials familiar with U.S.-China issues. There was a sort of semi-formal briefing at the end of the dinner, but during the dinner and beforehand, there was a remarkably useful and I would say very candid free-for-all on a lot of issues. I found that very helpful.

Now, one could argue, of course, that journalists should have better access than once every five or six months. But, nevertheless, such a thing is unheard of in the Soviet Union and, as a veteran of Eastern Europe, it's similarly unheard of there. So, in that sense, things have been getting better.

As for travel, it got progressively better during my time in China. The list of places to which one could go without specifically asking permission grew and the Foreign Ministry did make efforts to take us to places that normally they didn't want any journalists to visit, but which we, after much clamor, eventually forced them to take us. I regret I never got to

Tibet. There was one organized trip during my two-year period there, and unfortunately, I was out of the country for it.

As to regular, reliable access to high-level government sources, for my part, no. Occasional reliable access, yes, but a great deal of the time was spent, for me, attending official receptions of Third World countries when it was actually possible to buttonhole senior Chinese officials and ask them very direct questions, and sometimes they would actually respond. But it was not an easy place to get official access to the news.

Similarly when I was there, we had gone through a trough in the extent to which ordinary Chinese were allowed to associate with foreigners. After the Democracy Wall period, there was a fairly stiff crackdown. A lot of the sons of senior cadres who had mingled relatively freely before that with foreign correspondents ceased to call or come by.

There are additional inhibitions. Except for a few people living in hotels, the majority of resident foreigners in Beijing live in special foreign compounds which are guarded by representatives of the People's Armed Police, who are armed with a pistol and an electrified truncheon which, on occasion, they do threaten to use. On one occasion, a foreign colleague, Titiano Turzani, was thrown out of China on, unfortunately, a completely trumped-up charge of smuggling antiques. His real offense was that he was very outspoken, in a rather abrasive way, and finally the authorities had too much of it.

I did, nevertheless, manage to have some wonderful friendships with a handful of individual Chinese, although I have to say that, in each of these cases, I had to be extremely careful. Not for myself, because nothing would have happened to me, but because, at the time I first arrived in China and shortly after that when the spiritual pollution campaign started, it was really quite tense for Chinese seen with foreigners, particularly with foreign reporters.

Towards the end of my time, a number of what you might call senior Chinese cultural figures did make a point of accepting invitations to private homes and, in turn, inviting foreigners into their homes. But I always felt, in these cases, there was a price that they were paying in terms of probably reporting the rough content of the conversation afterwards.

In any event, let's suppose you did invite somebody into your home in the foreign compound. You would have to drive them in your car. The guard at the gate would not stop you, but unless your guest was hiding on the floor of the car the guard probably would see that there was a Chinese guest in the car. Every apartment block had an elevator lady, or occasionally an elevator gentleman. This person operated the elevator until 10:00

or 11:00 at night, and made a point of observing what Chinese guests were coming up to which apartments.

And, of course, as far as I'm aware, all of the apartments in the foreign compounds were equipped with bugging devices, although not all of them were listened to all of the time, nor were all of the phone calls listened to all of the time. But the Public Security Bureau has the resources to focus on individual people at individual times in a way which could be very inhibiting. I mean, you knew that the bug was there. You didn't know whether it was activated or not, and that made it a little bit uncomfortable, to put it mildly.

I have been asked whether I feel the conventional journalistic attitudes toward Taiwan, towards the mainlands, are romanticized and if there's a double standard toward Taiwan. Did I encounter, for example, any inhibitions on the part of my editors to print uncritical or critical material on either country?

I'm happy to say I didn't have any problem with my editors at all. I was delighted with the fact that they published a number of stories that might have been marginal but got published because of my particular senior editor's strong interest in China. We got quite a lot of material in the magazine, from my point of view, at a time when there's wasn't much "news."

The question is, though, do editors as a whole in this country—I think this is a larger question I might very briefly address—have something of a double standard toward bad news coming out on the PRC, or good news? To some extent, they probably do.

I agree with Fox that there is, perhaps, an uncritical response to what you might call good news of an official nature coming out of the PRC. I don't think in the coverage of Taiwan there is a double standard. At least, I don't think people expect Taiwan to be more liberal in its attitudes towards dissidents then they expect the mainland.

I do think, in the case of the two Koreas, there is an outrageous double standard. I think Korea—I have been there, by the way—is one of the most lunatically repressive countries in the entire universe, bar none, and anybody who expects South Korea to perform like a Jeffersonian democracy vis-à-vis a nation led by a madman with a 40 percent larger army just 25 miles from their capital is expecting the ridiculous. And I take strong issue with some of my colleagues who think that you can start rearranging people in a boat which is already overloaded and which may easily tip over.

Finally, have our expectations of China changed? Yes, in a rather opportunistic way. I have always felt that a Marxist-Leninist system, once

imposed, is virtually impossible to remove, unless from outside by superior military force, as in the case of the proto-Marxist-Leninist system in Grenada. There is simply no example in history of a Marxist-Leninist regime being changed from within to a regime which allows a genuine form of pluralism.

I think, however, that in the case of China the degree of belief in Marxism-Leninism is very small—I have to say that, in my entire two years in China, I met just three people who believed in Marxism-Leninism. Now, there were a lot of people who believed in Leninism; they wanted a Party to control the country. But nobody believes that the State is going to wither away, and very few people believe that socialism is a more efficient way of accumulating economic capital than capitalism is.

In that sense, I think that, in the long run, the Marxist period in Chinese history will be a rather smaller episode that it seems to be at this point, and I met Chinese officials who privately admitted this to me. At any rate, historically speaking, Marxism-Leninism will probably be something of an excursion of a longer nature, but not a great deal longer, in the manner of the Qing Dynasty before the Han Dynasty, and I don't rule out the possibility that the PRC, a long, long time down the road may evolve pluralistic institutions which could eventually—I won't say lead to capitalism, but lead to authoritarian, and then perhaps ultimately even a democratic, society.

I don't rule out in the case of China, but I would rule it out right now in the case of any other Communist country.

Mr. Newton: Thank you, David. The floor is now open for questions.

Unidentified Guest: I'm about to go on a journalistic trip to China. How do they treat junketing reporters who are there for maybe a week or so, in contrast to the resident correspondents?

Dr. Aikman: The rule in China is applicable to many other countries. They treat junketing correspondents to all sorts of goodies that resident correspondents seldom, if ever, get. This is not only true in China, by the way. It's true in almost any country.

If you are the editor-in-chief who knows nothing about Ruritania and you get an invitation from the Ruritanian Foreign Ministry, you will be taken to places that the resident Ruritanian Bureau Chief has been trying for months and years to get to. And, of course, when he gets there, your editor-in-chief hasn't a clue to what he is seeing anyway.

Unidentified Guest: How distorted of an image do you see?

Dr. Aikman: Well, I don't think it's distorted in the sense that they are

showing you things that don't really exist. Clearly, you'll be seeing the best of what is available to be seen, and they won't be taking you to see failed projects. But you can learn an enormous amount simply by asking intelligent questions, because China is no longer as tightly controlled as it was in the '70s.

Mr. Butterfield: If I could add just one little bit. One point that's worth remembering for anybody who goes now: The Chinese are so candid—or seem to be so candid—that it catches you off-guard. But they are not being as candid as you think, because they talk about what happened in the past. They will say, "We can now tell you the truth," and they will then list some really terrible things that happened five years ago. And you say, "My God. Anyone who could say those things must really be telling me the truth." They're not talking about today; they're talking about five years ago.

That is one caveat that I would add. Ask the people that you're talking to, "What about today?" Will they say anything bad about the situation today? Will they be critical of leaders today, or are they just being critical of people a little bit into the past whom it's now officially okay to be critical of?

Hugh Chrisman: I'd like to ask each panelist what he foresees for Hong Kong.

Mr. Butterfield: David has been there more recently. I think the schools of thought about the future of Hong Kong range all the way up and down from very optimistic to very pessimistic, and I can only offer my personal view, which is on the more skeptical side. Despite all of the promises that have been made, it seems to me it would be very hard for the Chinese communists, once they get their hands on Hong Kong in 1997, not to try to exercise more power. Once they start doing that, they start to change the place. I think you can see examples of that already happening. I think what you are going to find is that China is going to impose the system from outside.

Whoever is chosen or selected as Governor, and the people who are going to run the place, are going to be beholden to Beijing. What I think will happen is that Hong Kong will gradually be more incorporated into China and will be less oriented toward the outside world. Hong Kong will still continue to exist, it will still be, in some ways, a free port, but it will function more as a free port for China than as the major international center that it is now.

I think the key thing to watch for is what happens to the middle class in

Hong Kong. The very wealthy people already have enough money outside the country. They've got their green cards and their passports. They are not in trouble. They can also do business with the Communists. But it's the lawyers, the doctors, the factory managers, the accountants who have some money, some education, some aspirations, and who don't want to be part of the Communist system. They are worried and a lot of them are very nervous about what is going to happen.

Dr. Aikman: I share the concern that Fox has expressed. The problem is that Hong Kong is a society based upon the rule of law. Now, it's not a perfect law; there are many inequities in Hong Kong society. But the principle is understood that law is above politics, politics in this case being the rule of the British Governor, ultimately the Privy Council.

As long as you have a society which believes that the rule of law can protect not just basic civil liberties but the rights of society as a whole to be protected from the state, you can do quite a lot of flexible things with an economy and with international relations. But I don't think more than a tiny handful of people in Beijing have the slightest notion how capitalism really works: how do currency markets work? How does capital move in and out of places? Why is it that the stock market tends to reflect an equilibrium involving an intangible thing like confidence?

Now, that's not an intellectual failure; it's a failure of something else. It's a failure of philosophical concept, and if Hong Kong could indeed survive the way it has survived so far, as a brilliant economic success, as an entity that does not threaten China in any way, that would be absolutely marvelous and I, for one, would be the first to send a note of congratulations to the Chinese Foreign Ministry if they could do it. But I don't think they can, because I don't think they understand a society that functions on the basis fundamentally of freedom. It's as simple as that.

Mr. Newton: Thank you, gentlemen.

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Dr. Feulner: Ladies and gentlemen, welcome back to the next session of our day-long seminar. Richard Allen and I have a proposal we would like to share with this distinguished audience in the hope that it might generate some interest in the trade discussions in the months ahead.

It' is no secret to anyone in this room that there are strong pressures at this time to restrict American markets to foreign goods and services. These pressures are probably stronger now than at any tine since the end of the Second World War. The economically destructive protectionist policies are recommended by Congressmen and Senators as a response to

real or imagined threats from imports, unfair trade practices, *et cetera.*

As the current issue of *U.S. News & World Report* points out, American consumers will pay $4.5 billion more for cars in 1984 and $1 billion more for footwear because of protectionism. Today, the average family of four pays between $1,500 and $2,000 a year because of protectionism, more than most families pay in federal income taxes.

Despite the added cost to the American consumer, it is very clear that those of us who advocate free trade are somewhat on the defensive, at least in terms of the political dynamics here in Washington.

Therefore, what Mr. Allen and I propose today is a serious discussion, in Washington and throughout Asia, of Free Trade Areas. We believe that Free Trade Areas (FTAs) offer a positive alternative to protectionist measures. Basically, a Free Trade Area means that two countries remove substantially all barriers to trade, such as tariffs, quotas, and various other nontariff barriers. Technical certification requirements can be standardized or self-certification can be allowed. Capital or investment policies are substantially liberalized in FTAs.

In effect, FTA is customized to the actual situation in each country involved in the bilateral negotiation. The first time that the United States successfully produced a Free Trade Area was with Israel. We are now negotiating a Free Trade Area with Canada.

The economic benefits from Free Trade Areas are many, and they are all outlined in classic economic theory. The international division of labor occurs more intensively, meaning that each country specializes in areas where they are marginally more efficient. Capital and labor are freed up in each country to go from lesser valued to higher valued areas of production, and overall wealth increases.

Employment also usually increases, because the ability of an economy to employ more workers at a rising standard of living depends on increased economic productivity, such as what would result from a Free Trade Area, rather than trade protectionism. Protectionism, in fact, might preserve some jobs for a short time, but by postponing innovation, it leads to lower employment levels in the future. Textiles in the United States, for instance, have been protected for twenty-five years and the textile industry still cannot provide secure livelihoods for those employed in that industry.

I should emphasize that Free Trade Areas are legal under GATT, and, in effect, complement the multilateral trade liberalization process that we, and others, have been advocating. If two countries wish to benefit from free trade immediately and do not wish to forego those benefits as they wait for other countries to come along—in effect, the slowest one

dragging the train down—they can liberalize bilaterally under the GATT provisions.

Our Free Trade Area with Israel is now being phased in. It will take ten years before it is fully implemented. As I said, we are now negotiating with Canada. President Reagan has notified Congress of his intention to negotiate such an agreement. It seems to me that the Canadian example is a particularly significant one because the United States and Canada have the world's largest bilateral trade, totalling more than $112 billion in 1984, with Canada taking 21 percent of American exports and the United States 75 percent of Canadian exports.

I say it is particularly significant because a Free Trade Area between the United States and Canada will focus the attention of some of our Asian allies and trading partners on the potential of still more free trade between the United States and Canada. The U.S.-Canada FTA will affect, for example, the terms of entry of Japanese and Taiwan products into the U.S. and the Canadian markets.

The political fall-out is something that I intend to emphasize for a moment before I turn the podium over to Mr. Allen. It seems to me that the most exciting aspect of FTAs is that they change the dynamics of the debate over free trade. Rather than focusing on protectionism, FTAs promote more free trade.

One of the reasons the United States entered into a Free Trade Area with Israel was because Israel had agreed to a trade liberalization package with the European Community. We thus found ourselves at disadvantage to the European Community. We decided to get one step ahead by negotiating the FTA with Israel.

The conclusions are that politically and economically, the dynamics of FTAs cause a promotion of free trade policies. It's encouraging to be moving in this direction. The Free Trade Area is a positive alternative to protectionism. It is something that should be studied, and eventually implemented by policymakers in capitals on both sides of the Pacific.

Now I will turn the discussion over to my colleague, Mr. Allen.

Mr. Allen: It's very clear that 1986 is going to be a very interesting year in the Congress, particularly in the context of trade. In a nation that typically has not taken trade seriously, but from time to time has reacted only to certain sectoral problems, we've now come to a situation in which a very profound understanding of the importance of American competitiveness abroad has been brought home to the American people and to their representatives. It's no longer a backburner subject, put only in the rear sections of the newspapers.

Members of Congress are in an increasingly protectionist mood. This will result in inevitable pressures upon the President and, of course, means that in election year of 1986, and particularly the election year of 1988, the size of trade deficit will become an increasingly hot topic.

It is not the Republic of China on Taiwan or the Republic of Korea that caused this problem of imbalanced trade, but rather Japan. And, in its eagerness to respond to what is considers to be a very pervasive threat from Japan, the Congress will inevitably seek to retaliate or respond. That's not good for the American consumer; it's not good for our national interests, and it certainly does not contribute to international harmony. But, nonetheless, most observers in Washington see this surge of protectionism as a fatal inevitability.

As the Congress begins to shape the mechanism of response, it will not be possible to limit the damage to Japan. It is inevitable that the effects will be felt in the Republic of Korea and in Taiwan. It is, therefore, of vital importance that we take steps now in a positive way to address this looming problem. It is virtually impossible that Japan would consent to the negotiation of a Free Trade Area with the United States. It is similarly unlikely that the Republic of Korea would be able politically to sustain the internal consensus required for such a free trade agreement, at least at this time. But in the Republic of China on Taiwan, which I visited again recently, there is a very great interest to reduce trade friction before things get out of hand.

There is an interest in taking positive steps, as well, and that is why Ed Feulner and I have chose this forum to make the proposal that a Free Trade Area be negotiated as rapidly as possible between the United States and Taiwan. The political conditions exist. After all, the relationship between Washington and Taipei is governed by the Taiwan Relations Act, which mandates that the Congress and the President make sure that Taiwan's economy is able to function effectively in the modern world.

The FTA is not something that will happen overnight, but it would, as Ed Feulner pointed out in the case of Israel, be phased in over a period of ten years. The adjustment would be easy, pressure for a more dramatic, and more protectionist, response to the bilateral trading relationship.

So rather than simply reduce tariffs, which in the case of Taiwan would increase benefits for Japan, a negotiated Free Trade Area agreement would provide enormous access potential for the United States.

The Republic of China has a history of cooperating with the United States on questions of trade, especially those pertaining to its large surplus. The Republic of China on Taiwan has cooperated with the U.S. Special Trade Representative in seeking solutions to areas of intense

friction, including the thorny question of intellectual property rights. ROC purchasing missions have been sent to the United States to purchase billions of dollars in U.S. products, and the Republic of China has also been cooperative on the monetary front by keeping its assets in U.S. dollars.

So, in my view, there are several specific benefits to a FTA between the United States and Taiwan. Economically, a free trade agreement would open major opportunities for U.S. exports. And it would create additional jobs here in the United States.

Politically, it would clearly demonstrate that the United States and our good friends, the 19 million people on Taiwan, maintain close ties.

Strategically, it poses no threat whatsoever to the mainland, or to anyone else in the region, but may, in fact, be a leading stimulus in creating greater cooperation in U.S. relations with the entire Pacific Basin complex.

Domestically, it sends a message that Washington is committed now to take positive steps to rectify the trade balance and that would be a very salutory effect here at home.

Dr. Feulner and I will be happy to answer any questions you might have following our next panel on the economic modernization of Taiwan and the mainland.

We are fortunate to have with us today two people who are highly qualified to discuss this topic. Our first speaker, Dr. Joseph Kyle, Corporate Secretary of the American Institute in Taiwan. The American Institute in Taiwan handles and conducts the relationship between the United States and Taiwan under the Taiwan Relations Act. Dr. Kyle has a Ph.D. in economics from Duke University, was a Foreign Service Officer from 1954 to 1979, and has been Director of International Commodities.

Dr. Kyle: In 1985 Taiwan's GNP increased by 4.7 percent in real terms over 1984. For 1984 the growth rate was 10.9 percent and the average annual real growth between 1952 and 1983 was 9.2 percent. In 1985 Taiwan registered an U.S. $11 billion trade surplus, up 29.5 percent over 1984. However, that surplus was not due to a large increase in exports, the value of which increased by only 1.7 percent over 1984, but to a large decline in imports, the value of which fell by 9.1 percent compared with 1984. Faced by a slackening of export demand, tight credit, and cash flow problems many importers deferred purchases in the hope that the economic situation would improve. At the end of the third quarter of 1985 the official unemployment rate was 3.7 percent, the highest in twenty years, but that figure may well be too low by several percentage points because of the way the data are compiled.

A number of major Taiwan companies experienced serious financial problems in 1985 owing to cash flow problems. In some cases they were saved only by the intervention of the government, which authorized additional credit and/or arranged for debt rescheduling. Many other companies fell by the wayside as the number of bankruptcies reported in the press increased precipitously. The viability of many companies was also affected by their inability to obtain funds from the banking system due to the fallout from the 10th Credit Cooperative scandal and the public censure of twenty local bankers for approving bad loans. Bankers were, and for that matter still are, reluctant to approve new loans, either because no one is willing to bet on the financial viability of any firm or because no banker wants to take responsibility for approving what may turn out to be a bad loan.

On August 1, 1984, Taiwan's Labor Standards Law went into effect. This law was widely hailed as a progressive piece of legislation. Since it was enacted, however, it has generated considerable controversy, particularly the section dealing with the establishment of pension funds. Under the law, employers are to deposit a certain percentage of their payroll regularly to cover lump sum pension requirements for employees. At best, this is a burden on most local firms, which are under-capitalized to begin with. When coupled with the current financial difficulties and the decision to make the pension plan retroactive, the burden has been increased. Inevitably, the Labor Standards Law is blamed for at least part of the economic slowdown and has provided a convenient scapegoat for economic problems which should more appropriately be attributed to other causes. There were indications in 1985 that many companies began paring down the size of their workforces in order to minimize the effects of the law. This also could be a reason for the rise in the unemployment rate.

In late December 1985 the Council for Economic Development predicted an average annual GNP real growth rate of 6.5 percent over the next fifteen years. Assuming that the Council's predictions contain an element of wishful thinking, it is possible that the 4.7 percent growth registered in 1985 was not an aberration but a portent as Taiwan enters a period of slower economic growth. There are fundamental reasons for this slowdown.

First, the labor-intensive industries which led Taiwan's economic development over the past twenty-five years, e.g., textiles, footwear, consumer electronics products, are losing ground. Rising wage rates and a decline in productivity have eroded Taiwan't competitive edge in those products. Second, Taiwan's efforts to replace traditional exports with products emanating from high-technology industries, particularly the information industry, have yet to bear fruit. The competition among high-tech compa-

nies worldwide is intense as newer and more sophisticated products enter the market. Taiwan as yet lags behind in developing these new products. There is still an over-reliance on imported technology, which may be out of date by the time it is applied to production processes. Third, the service sector is in urgent need of enlightenment, reform and modernization if it is to support Taiwan's efforts to enter the high-tech age. The banking system, the insurance industry, the accounting industry, the data processing industry, and the securities industry are considered by many to be not making the contribution they could or should to Taiwan's economic development.

The fourth reason is that Taiwan is overly dependent on a single market for its exports: the United States. We take almost 50 percent of the products of Taiwan's farms and factories. When our economy slows down and consumer spending declines, the effect in Taiwan can be calamitous. Recent efforts to limit the importation into our market of textile mill products, footwear, mushrooms, and other products of which Taiwan is a major supplier would, if these efforts had been successful, have been equally damaging to Taiwan's economy. The problem is exacerbated by the fact that Taiwan is slowly but surely losing the benefits it has enjoyed under the Generalized System of Preferences.

Taiwan is not happy about its dependence on the United States market, but there is little it can do reduce that dependence. Its efforts to expand markets in Africa, Latin America, the Middle East, South Asia and ASEAN have not been notably successful. Trade with Western Europe and Japan is substantial but is growing slowly. Many of the countries in which it is trying to develop markets have tariff and non-tariff barriers which make such development difficult. The absence of political relations obviously makes the problem even more difficult in a number of cases.

The concerns I have expressed about Taiwan's economic health do not mean that the economy is doomed to an inexorable decline. A growth rate in the GNP of 5 or 6 percent a year will, if attained, indicate a steady, albeit slower, rate of growth than in the past. Taiwan's overall financial position is sound. Foreign exchange reserves at the end of 1985 exceeded U.S. $22 billion, an amount equal to more than thirteen months of imports. The debt service ratio is approximately 7 percent. Time and savings deposits at the end of 1985 exceeded U.S. $40 billion. Per capita GNP exceeded U.S. $3,150 and the rate of inflation was only 3 percent. Nor are the authorities standing idly by, watching the economic machine sputter. As a means of priming the economy, fourteen key infrastructure projects have been announced, with funding of U.S. $19 billion to be provided by

the central and provincial authorities. These projects include additional steel making capacity, additional power plants, additional petroleum refining capacity, modernization of the telecommunications system, expansion of the railroad network, new highways, a mass transit system for Taipei, flood control and drainage projects, additional water storage capacity, rural development projects, tourist facilities, waste disposal systems, medical care programs, and projects to clean up the environment.

In 1985 the Premier announced the formation of an Economic Reform Committee. Drawn from the ranks of senior government officials, the business community and academic institutions, the committee had a mandate to make recommendations for improving the economy. While there were reports that some of the committee sessions were less than harmonious, it produced by the end of its tenure in November 1985 a number of recommendations, some of which have already been implemented. Others are still under consideration. Efforts to constitute the committee as a permanent advisory body were rejected by the government, but what is important about the committee is the fact that it was established in the first place. To my knowledge, this is the first time that the authorities have been willing to utilize the considerable talents available in the business and academic communities in determining the direction the economy should be going, and it could presage closer cooperation in the future.

A bright spot in the economic picture in 1985 was the continued growth of foreign investment in Taiwan. For the first eleven months, 149 investment applications were approved with a total value of U.S. $531 million. This was a 7.5 percent increase over 1984. Of the U.S. $531 million, U.S. $283 million or 53 percent came from the United States and U.S. $137 million or 25.6 percent from Japan. In addition 167 technical cooperation agreements between Taiwan and foreign companies were signed. Thirty-five of the agreements were with U.S. companies and 28 with Japanese companies. A number of changes in investment regulations were made, two of which have long been sought by U.S. companies. The first eliminated the export performance requirements or market share limitations on investments by U.S. firms except in the case of automobiles and video recorders. The second provides that foreign invested companies may perform trading functions by importing goods manufactured by the parent company but not by the local operation.

Let us now look at the U.S.-Taiwan economic relationship. According to preliminary data made available by the U.S. Department of Commerce, total bilateral trade in 1985 was valued at U.S. $22.8 billion,

which was an increase of 7.4 percent over 1984. Of that amount, Taiwan's exports to the United States were valued at U.S. $18.15 billion while our exports were valued at U.S. $4.65 billion. Taiwan's trade surplus was a record U.S. $13.5 billion, which exceeded the previous record set in 1984 by U.S. $3.5 billion. In 1985 only our trade deficit with Japan and Canada exceeded the deficit with Taiwan. The preliminary data for 1985 indicate that we imported 8 percent more from Taiwan than we did in 1984 but that we exported 7 percent less.

Data released by Taiwan's Ministry of Finance for the period January through November 1985 also are interesting. They reveal that almost 95 percent of Taiwan's global trade surplus of U.S. $9.7 billion was accounted for by its trade surplus with the United States. We took almost 50 percent of Taiwan's exports but provided only 23.5 percent of its imports. On the other hand, Japan, which is Taiwan's second largest trading partner, took only 11 percent of Taiwan's exports but contributed 28 percent of its imports. For 1985 as a whole Taiwan's trade deficit with Japan exceeded U.S. $2 billion.

Although our large and increasing trade deficit with Taiwan—and it has increased at a 30 percent average annual rate since 1981—has not drawn the attention that our deficit with Japan has drawn, it has become a major irritant in our bilateral economic relationship. We claim, rightly or not, that the deck is stacked in Taiwan's favor. While the United States is a relatively open market distinguished by low tariffs and few non-tariff barriers, Taiwan is guilty of practices and policies that constitute significant barriers to exports of U.S. goods and services. These barriers include high tariffs and other import charges, quantitative restrictions, customs barriers, and a host of non-tariff barriers.

Through a series of bilateral discussions beginning in 1979 we have obtained tariff reductions on several thousands of items. During the most recent discussions held in October 1985, Taiwan agreed to reduce tariffs on 192 items, 80 of which we have a 25 percent or larger share of the market. Taiwan has also abolished the 5 percent customs uplift to the price of all imports before calculating import duties and has agreed to assess duties on the transaction value as provided for under the GATT Customs Valuation Code instead of applying artificial duty-paying schedules. In the recent discussions we also obtained agreement to permit the sale of U.S. wines, beers, and tobacco products through retail outlets. Heretofore, the sale of such products was rigidly controlled and heavily taxed by the Tobacco and Wine Monopoly Bureau. Little by little the imposing wall of tariffs which has effectively served to limit U.S. exports to the Taiwan market is being dismantled. Many tariffs are, however, still

too high on goods in which the United States is competitive and they will be the focus of future bilateral discussions.

The following question is often asked: Would U.S. exports to Taiwan increase dramatically if Taiwan were to reduce all tariffs to zero? The answer is, of course, no. Taiwan cannot reduce or eliminate duties to benefit just the United States. In many products we are not competitive regardless of the tariff because of price and other considerations such as availability. In other products we are already the dominant supplier and additional market penetration is unlikely. There is a third category of products, which are primarily in the area of consumer goods, which is available but only to the most competitive supplier, which we may not be. We often rather piously tell Taiwan that we only want the opportunity to compete, only to find out that we are unable to.

One way to reduce our trade deficit with Taiwan by sizeable increments would be to sell so-called big ticket items. These refer to such purchases as nuclear and conventional power installations, commercial aircraft, complete industrial plants, and ground transportation systems. Several years ago Taiwan announced a "Buy America" policy for offshore purchases by state-owned companies and state agencies.

Regardless of the policy, our track record in obtaining orders is spotty. The Central Trust of China, the official procurement agency, does not purchase for the major state corporations such as China Steel Corporation, Chinese Petroleum Corporation, and Taiwan Power Company. U.S. companies received less than 10 percent of the contracts for equipment and services under the China Steel Corporation's most recent expansion program.

Our companies have fared much better with Taipower. They were awarded contracts for the nuclear steam supply systems, turbine generators and engineering services for the first six nuclear power units and it is likely that they will receive similar contracts on units 7 and 8 when they are built. U.S. companies also have been awarded large contracts for equipment and services on the oil and coal-fired plants which Taipower has built and is building.

U.S. companies have also been awarded sizeable contracts by the Chinese Petroleum Corporation in the construction of refineries and down-stream facilities. Until a few years ago the jet fleet of China Airlines, the official flag carrier, was exclusively of U.S. origin and our manufacturers believe they have an excellent opportunity for additional sales as China Airlines modernizes and expands its fleet. With regard to purchases handled through the Central Trust of China, U.S. companies have done particularly well in products such as computers, medical equip-

ment, production and testing equipment, and ground transportation equipment.

While the authorities encourage companies in the private sector to adhere to the "Buy America" policy, they are not required to do so. As a result, our exports face stiff competition from Western Europe and Japan. While there are instances recorded where U.S. companies lost sales because of their inability to meet delivery dates, poor records of post-sales service, and unwillingness to tailor products to the buyer's specifications, the major hurdle our companies face is meeting the financial terms offered by competitors. Why this is so would be an interesting subject for investigation.

I would make three additional comments on the trade deficit issue. First, the authorities on Taiwan have attempted to partially defuse it by sending 11 special purchasing missions to the United States since 1978. These missions, which have been composed of buyers from both the public and private sectors, have signed contracts worth almost U.S. $8 billion. Some of the goods purchased by the missions, particularly agricultural products, probably would have been purchased in any case, but that does not detract from the public relations benefit which Taiwan reaps from the presence of the missions.

Second, in March 1986 the Board of Foreign Trade, in cooperation with the American Institute in Taiwan, will sponsor "USPRO '86" in Taipei. More than 200 U.S. companies will take part in the multi-theme exhibition, selling their products and seeking agents and distributors. In addition, more than 30 state governments will have representatives present to tout the products from and the investment climate in those states. This will be the first exhibition of this nature and size ever held in Taiwan.

Third, the Board of Foreign Trade pays the rent for the American Trade Center in Taipei. This facility, which is operated by the American Institute in Taiwan, stages annually six to eight on-site, major, single-theme exhibitions of U.S. products as well as staging annual multi-theme exhibitions either in Kaohsiung or Taichung. Sales from these several exhibitions amount to over U.S. $50 million annually.

A second major irritant in our bilateral economic relationship with Taiwan is in the area of services. Twenty U.S. banks are active in Taiwan, fourteen of them with one branch each and six with a representative office. The branches are denied national treatment; they must operate within a restricted scope of business that puts them at a serious disadvantage compared to their Taiwan counterparts. No foreign banks may have more than one branch. Equity participation in a domestic bank is prohibited and numerous restrictions are imposed on investments in local

leasing and investment and trust companies. Foreign banks are also subject to numerous operational constraints. Savings deposits cannot be accepted except for demand passbook accounts, and public corporations may not open checking accounts. Foreign banks are ineligible to take deposits from the postal saving system and are denied Central Bank refinancing privileges tied to trade in essential commodities, such as agricultural products. The foreign banks have been granted access to Central Bank rediscount facilities for short-term credit to meet minimum reserve requirements but they are denied access to other rediscount services. They are also prohibited from extending individual loans, which means they cannot participate in the growing consumer credit market. Regulations also make it very difficult for them to extend commercial real estate loans.

These restrictions have been the subject of several bilateral discussions between the American Institute in Taiwan and the Coordination Council for North American Affairs and their advisers. In August 1985 we requested that foreign banks be allowed to establish more than one branch and to conduct foreign exchange operations in the three export processing zones. We also requested broader access to local currency funding and permission for foreign banks to extend loans with maturation exceeding seven years.

During the most recent discussions held in October 1985, the spokesman for Taiwan announced only that a decision had been made to let foreign banks conduct business in the export processing zones. I would add that whether due to our prodding or the influence exerted in the U.S. banking community itself, other tangible progress was realized in 1985 in reaching the goal of national treatment. There were regulatory changes which removed the arbitrary limitations on local currency deposits which foreign banks can hold and the legal prohibition against consumer financing was lifted, although a source of funding is impossible until the banks can establish savings departments. Foreign banks can also now belong to the Taipei Bankers Association, which is influential in determining interest rates.

A second issue of contention in the services area is insurance. We are of the opinion that Taiwan could be a significant market for U.S. insurers. Although it currently ranks only 20th in size among world insurance markets, it is at a stage where demand is growing faster than the GNP. In 1981 U.S. insurance companies were granted permission to open branch offices in Taiwan. However, their operations were restricted to insuring only U.S. citizens or 100 percent U.S.-owned companies. During the October 1985 consultations between the American Institute in Taiwan

and the Coordination Council for North American Affairs and their advisors, the spokesman from Taiwan announced that a decision had been made to permit foreign insurance companies to offer property, casualty and marine cargo insurance to joint venture companies, with no minimum foreign participation required.

A third issue in the service area is national treatment in shipping. At present, U.S. flag carriers are not permitted to engage in intermodal container-related and freight transportation operations. Regulations issued by Taiwan's Ministry of Communications prohibit foreign companies from engaging in trucking operations or from being major shareholders in companies acting as shipping agents, container terminal operators or sea cargo operators. These restrictions place U.S. carriers at a serious disadvantage compared to local flag carriers. The latter can provide intermodal services directly or through integrated subsidiaries. These restrictions also place U.S. flag carriers at a price disadvantage since they are subject to a business tax which is not applied to local shipping companies. During the October 1985 consultations our concerns about discriminatory shipping practices were raised but a response has not been forthcoming.

A fourth area of dispute is the treatment accorded U.S. motion picture producers and distributors in Taiwan. Annual import quotas limit film imports. Higher theater admission taxes are imposed on foreign films than domestic films. In Taipei, for example, foreign films are subject to a 35 percent admission tax while domestic films are taxed at 6 percent. Imported films are also subject to a contribution for the development of the domestic film industry. Finally, there are restrictions on the number of theaters at which a foreign film can be shown. We have requested the Taiwan authorities to eliminate the restrictions but as of now a response has not been received to our requests.

The final area of dispute in our bilateral economic relationship is intellectual property rights. No subject has received more attention on both sides in the past several years owing to the efforts of the International Anti-Counterfeiting Coalition and to a series of bilateral consultations chaired by the American Institute in Taiwan and the Coordination Council for North American Affairs. The authorities on Taiwan are fully aware of the negative impact of counterfeiting and they are determined to eliminate it insofar as they can. The Ministry of Economic Affairs has promulgated new regulations to tighten export requirements such as the indication of place of origin and compliance with intellectual property regulations. Administrative penalties have also been increased. The Board of Foreign Trade has the authority to repeal export registrations for

infringers of intellectual property rights. An educational program designed to arouse awareness of counterfeiting among the public has been implemented. I would add that the Judicial Yuan has requested the courts to pay special attention to trademark, patent, and copyright infringers. A Judicial Training Institute has been established to train judges who have been appointed to deal exclusively with intellectual property rights cases.

We have had a detailed and continuing dialogue with Taiwan since 1983 on intellectual property rights and this dialogue will continue. It should be noted, however, that several important measures to alleviate this irritant to our relations have been taken by the Taiwan authorities. In 1985 a new trademark law passed which provides stiffer and more certain penalties for infringement and a new copyright law was passed which provides explicit protection for software. A fair trade law is now waiting passage in the Legislative Yuan. Taiwan is to be commended for the actions it has taken in this area and it is hoped that the remaining issues will be resolved expeditiously.

Regarding trademarks, Taiwan still lacks both a defined discovery process and evidence code. This impedes successful trademark infringement case prosecution. As for patents, Taiwan limits its patent protection for chemicals and pharmaceuticals to process patents. Protection for methods of use and compounds are not yet available. Also, Taiwan's law lacks an equivalency doctrine. Criteria do not exist for determining whether two inventions or operations are identical. The passage of an effective fair trade law will make it easier to handle cases in which labeling and packaging are similar to those identified with other goods. This is probably the most widespread form of counterfeiting in Taiwan at this time.

In 1973 Taiwan's GNP increased by 12.8 percent. In 1974 the growth rate plummeted to 1.1 percent and the economy grew by only 4.3 percent in 1975. In 1981 the growth rate was 5.7 percent but it declined to 3.3 percent in 1982. These downturns in the economy were attributed largely to exogenous factors, namely, the precipitous rise in oil prices in 1974 and the world recession in 1981-1982. While the relatively slow growth rate in 1985 may also be attributable to factors over which Taiwan had no control, concern has been expressed that there are internal reasons as well for the poor performance of the economy, reasons which may in the long run spell serious consequences for sustained economic growth.

The 10th Credit Cooperative scandal revealed the necessity of a regulatory environment which will prevent such scandals from happening again. The commercial banking system is perhaps not attuned to meeting the

capital requirements of an expanding economy. In their lending practices they may rely too heavily on collateral which is inflated in value. Company financial statements are often of little worth. There are too many accountants who are poorly trained. The banks also lack the expertise to evaluate properly loan applications. Many companies, including a number of the larger ones, are not well-managed and are undercapitalized. It may also be that there are too many companies in the same product line. There is also concern about the slow growth of productivity in relation to labor costs. Data for the decade 1974-1984 indicate that labor costs increased approximately 15.8 percent per year while productivity grew by only 8.7 percent per year.

The fiscal authorities in Taiwan have been justifiably proud of their record in controlling the inflation rate. In 1985 it was approximately 3 percent. There are factors at work, however, which may push the rate considerably higher in 1986 and ensuing years. Companies will undoubtedly try to raise the prices of their products to compensate for increased costs resulting from implementation of the Labor Standards Law. In 1986 a value-added tax (VAT) will go into effect. The authorities intend that the VAT will be revenue neutral by replacing the commodity tax, part of the stamp tax and the general business revenue tax. They have also indicated that as the VAT is introduced it will offset duty reductions.

Nevertheless, there is concern that imposition of the VAT will cause prices to rise substantially. The VAT will also have a negative impact on imports, particularly those which are not being imported for ultimate re-export. One of the major problems to be faced is the collection of the VAT, which is largely dependent upon the keeping of accurate financial records. In an economy where 95 percent of the businesses are small, family-owned operations, with financial records ranging from poor to nonexistent, it will be very difficult to track down delinquent taxpayers and accurately assess their tax liability. It is ironic that U.S. firms operating in Taiwan are likely to be most affected by the VAT since they take regulations seriously. Not only will they have their own taxes to deal with but they also may be liable for the taxes of their customers if the latter refuse to pay. Also, they may not be able to raise prices to recoup their added costs due to price inelasticity or pressure to keep prices stable. An additional problem will arise if evasion of the VAT results in lower than anticipated revenue. As the general rate can easily be adjusted by the Executive Yuan, noncompliance can be quickly remedied by upward adjustment of the tax rate. This will place an additional burden on the honest company. On the other hand, companies which are importing only parts and raw materials for assembly and re-export will have no VAT

liability and thus will not be affected by the tax. Many U.S. firms fall into this category.

It was mentioned earlier that at the end of 1985 Taiwan had in excess of U.S. $22 billion in foreign exchange reserves. There is considerable pressure on the authorities to use at least part of those assets to stimulate the economy by accelerating spending on infrastructure projects, by stimulating investment in high-tech industries, and by assisting in the modernization of traditional industries. If this is not done there will be added upward pressure on prices because of an increase in the money supply since exporters who are paid in foreign currencies must exchange those currencies for NT dollars. Although the Central Bank does not release precise information about the composition of its foreign-exchange holdings, it is likely that the Bank has most of the reserves in U.S. securities, which pay substantial rates of interest, but deny the Central Bank the opportunity to make market profits as the U.S. dollar loses ground against other major currencies. Earnings from the interest on the foreign exchange reserves is running at roughly U.S. $500 million every three months. Using even a portion of the reserves for productive purposes could be far more beneficial than letting them accumulate.

One development which could have far-reaching consequences was the decision of the Central Bank in December 1985 to permit investment in foreign government securities and bank financial instruments. For the nonce, the new policy will benefit primarily the trust and investment companies since the individual investor lacks knowledge of foreign security markets. Also, the decision of the Central Bank to keep the amount of funds involved under U.S. $3 billion during the first six months of the plan will limit its impact. Nevertheless, the announcement of the plan has set off a rush among foreign banks and fund managers who hope to have a role in handling potentially large sums of money. There are, of course, restrictions which may limit the impact of the plan. For example, there is a minimum two-year wait before funds can be redeemed. Investors may be reluctant to commit funds for such a period given the dangers of foreign exchange losses. So far, the Central Bank has not mentioned anything about a secondary market although this could change if local investors show little interest in the plan.

Another way by which the authorities could utilize the foreign exchange reserves would be to encourage outward investment, particularly in the United States. Such investment would not only reduce the upward pressure on prices but would also contribute to a lessening of the tensions which exist in our bilateral economic relationship. Many Taiwan companies are, of course, too deficient in capital and management to be inter-

ested in investing in this country, but there are many others which could invest profitably if they were aware of the investment climate and investment opportunities and if the foreign exchange were available.

It has been mentioned that more than 30 state governments will be participating in "USPRO '86" in March 1986, and one of the reasons for their participation is to publicize the investment potential in those states. Later on in 1986 the American Institute in Taiwan, in cooperation with the Coordination Council for North American Affairs, hopes to sponsor a series of reverse investment seminars in selected U.S. localities. Participants will include Taiwan businessmen who have expressed interest in investing in state and local economic development agencies, and specialists who can explain the laws and regulations governing foreign investment in the United States. It will, of course, be the responsibility of the potential investor to obtain the necessary foreign exchange from the authorities and to comply with Taiwan laws and regulations governing outward investment. While there is no way of knowing if our efforts to attract investment will be successful, it is obvious that a major effort will be required. The Ministry of Economic Affairs approved only U.S. $38.8 million in outward investment in the first eleven months of 1985. Of that amount, U.S. $33 million was approved for investment in the United States but only U.S. $10.6 million was in new investments. The rest was for additional investment in existing facilities.

Since I am not omniscient I have no way of knowing what Taiwan's economy will look like five or ten years from now. But I can predict that it will be different if Taiwan is to prosper as a viable economic entity. With few natural resources and with a population too small to support an industrial establishment producing primarily for a domestic market, Taiwan will have to continue to rely on exports if sustained economic growth is to be realized. But the policies and practices which served Taiwan so well in the past will not work in the future. Its labor-intensive industries are becoming less and less competitive and those that survive will do so only if they become more productive.

Taiwan's best hope is to expand and develop those industries which rely on a mix of capital and advanced technology. But certain conditions must be met if this next stage in Taiwan's development is to become a reality. Entrepreneurs are needed who have embraced the techniques of good management and who are willing to devote resources to research and development. Financial institutions are required which are themselves technologically advanced and which are willing to take a chance on the entrepreneur who may be short of capital but who is long on ideas and

enthusiasm. An educational system is needed which provides opportunities and facilities for the talented student to develop his/her potential. An officialdom is required which is receptive to innovation and is less concerned about breaking rice bowls than it is in the general welfare. Finally, bold and imaginative leadership is required.

Restructuring the economy will be a herculean task which will challenge the wit and imagination of all elements of society. The task will be made more difficult because of external economic factors over which Taiwan has little or no control. Its international position is under and will remain under the threat of constant erosion. In the not too distant future a change will occur in the political leadership. This may lead to a period of uncertainty as new leaders establish their prerogatives to govern. Taiwan is also facing the inevitable and not necessarily wholesome results of its past success: rapid and uncontrolled urbanization, a breakdown of traditional social values, and an increasingly vocal population which demands that the quality of life be respected.

In 1952 the GNP of Taiwan was U.S. $430 million and the per capita income was less than U.S. $50. Thirty-three years later the GNP was U.S. $57 billion and the per capita income exceeded U.S. $3,000. These results were obtained through a combination of intelligent and innovative leadership, a highly-productive labor force, and an entrepreneurial class which was capable of taking advantage of opportunities for profit. If the economy of Taiwan is to continue to prosper, this same combination of elements must be present.

Mr. Allen: Thank you very much, Dr. Kyle. It's a pleasure to welcome back to the forum of The Heritage Foundation Dr. Jan Prybyla, who is a Professor of Economics at Penn State University. Dr. Prybyla is a well-known specialist on China's economy and the problems of modernizing socialist economies in general. His topic today addresses the prospects for mainland China's changed economy.

Dr. Prybyla: Born of Stalin's centrally planned administrative command economy and subjected to contradictory pulls (in Soviet Russian, *zigzagobraznost*), mainland China's economy at Mao's death was an economy in search of a system. It had neither market nor plan. The market had been killed by the plan back in the 1950s, and the plan had been killed by Mao in the Cultural Revolution. Since to do the job of resource allocation an economy needs a market or a plan or both (with one of the two being dominant) the mainland economy ca. 1976 was a Kafkaesque affair notable mainly for its dynamics of stagnation (which did not

deter certain intellectual circles in the West from admiring it as "the Chinese road to socialism").[1]

During the short reign of "With-you-in-charge-I-am-at-ease" Hua, the bureaucratic prerequisites and heavy metal priorities of the old Stalinist plan were partly reconstructed. This short-lived, partial return to the Stalin plan was followed in 1979 by a turn to the right, first in agriculture, later also in industry. With the popularization in 1981 of the family production responsibility system in the countryside and the launching (albeit rough) in 1985 of a similar but not identical scheme in industry, the question could legitimately be posed whether the turn to the right had not turned into a U-turn. In other words, the economic changes of 1981-1985, which involved a rather far-reaching (certainly by socialist standards) marketization of the economy's information, coordination, and incentive systems, and a quite extensive de facto privatization of property rights, are seen by some (both in China and in the West) as the opening wedge of capitalist restoration.

On this view the Dengist operation has gone beyond merely coping with the plan (intrasystemic "adjustment"), which is what the Soviets and most East Europeans have done for the last thirty years with no visible positive results, and is now engaged in changing the very vitals of the plan (intersystemic "reform"). The Chinese, it is said, made a long march to socialism and when they got there they found there was nothing there, so now they are marching back. At the least, it is argued, the Dengists are probing the outer limits of the planned system to see how much more marketizing and privatizing it can take without losing its redness and turning a counterrevolutionary white. For reasons that require no elaboration, the Dengists deny this assertion and talk about building "socialism with Chinese characteristics," the precise outlines of which remain to be traced by practical experience. In Deng's catchy phrase: "It doesn't matter whether the cat is black or white so long as it catches mice."

Agriculture

Let us see what can be agreed on. The agricultural price system has been significantly marketized; one estimate points to about 60 percent of farm prices (mainly nonstaples) as no longer being subject to government regulation.[2] There is also no doubt that the post-1978 changes have involved a significant expansion of the de facto and legal rights of the user

[1] E. L. Wheelwright and Bruce McFarlane, *The Chinese Road to Socialism: Economics of the Cultural Revolution* (New York: Monthly Review Press, 1970).
[2] Richard Critchfield, "China's Agricultural Success Story," *The Wall Street Journal*, January 13, 1986, p. 25.

of assets to the assets he uses (privatization of property rights). This process of deregulation has been most advanced and has lasted the longest in agriculture, where the most spectacular quantitative and qualitative results have been obtained. The data are generally known and need not be belabored. However, mention should be made of the signal improvement in agricultural labor productivity, which has released millions of formerly underemployed peasants for other work—most of it apparently in the mushrooming village industries. By the end of 1985, 60 million peasants (20 percent of the agricultural labor force) have been so released and reabsorbed in gainful employment.[3]

In the five-year period 1981-85 the gross agricultural output value rose at an average annual rate of 10 percent. These gratifying results are traceable in large measure to the positive motivational effects of marketization and privatization (decollectivization) of agriculture. Privatization of property rights in agriculture (including the introduction of 15 to 30 year-long land leases and the legally-sanctioned ownership of some other means of production) has been to the family unit, which is a private unit in the pristine sense of the word. However, the peasant's property right to his own labor has not been fully privatized. Admittedly the peasant can make broader decisions than previously as regards the disposition of his labor. But he is still not permitted to leave the countryside and settle and work in any city he chooses: he can leave farming without leaving the countryside. This administrative restriction on the mobility of labor (which, what with the huge rural labor surplus, is now under considerable strain) should caution against drawing the conclusion that what has happened in the countryside amounts to a systemic crossing of the borders. There is still some way to go.[4]

Industry

In urban industry and commerce, marketization and privatization have been more modest and the results have been, not unexpectedly, more mixed. The industrial price system remains government controlled and allocatively dumb. The partial freeing of industrial prices, which took the form of floating prices for some products and market-determined prices for other lesser industrial goods, has introduced two-tier pricing for a number of products (including key inputs such as coal and steel), lessened the rationalizing impact of profit as a leading determinant of managerial action, and generally did not much improve economic calculation. In sum,

[3] Lin Wusun, "1985, 1986 and Beyond . . . ," *Beijing Review*, January 6, 1986, p. 4.
[4] See my "The Chinese Economy: Adjustment of the System or Systemic Reform?" *Asian Survey*, Vol. 25, No. 5, May 1985, pp. 553-586.

while the agricultural price system has been significantly marketized, so far mostly relative industrial prices (including wages) have been changed, but the industrial price system remains by and large untouched. In such a setting, giving managers of state enterprises greater decision-making latitude (among others by allowing them to keep and spend on their own about 45 percent of their profits), does not really move things off dead center, and remains an intrasystemic measure of adjustment, the sort of thing the Soviets stalled on long ago and never managed to start up.

Privatization of property rights in the urban industrial economy has been carried to the level of the state firm—to a socialized, bureaucratic unit, not to a private one, as in the family unit in farming. It amounts, therefore, to destatization or collectivization of state-owned firms, a systematically less radical measure than the decollectivization of the rural people's commune. Instead of being taken by higher-level bureaucrats, some production, investment, and sales decisions are now made by lower-level bureaucrats (managers of firms). Instead of basing decisions exclusively on administrative criteria, some decisions are now based on a still wonky price system.

In those circumstances the widely advertized movement away from mandatory toward "guidance" planning does not amount to much in terms of economic calculation. Guidance is now exercised by monoparty authorities through the manipulation of financial indicators such as taxes, interest rates, wages, relative prices, profits, profitability rates, and rates of exchange—most, if not all of them, allocatively arbitrary. Second, guidance planning—which has involved devolution of authority for a good deal of such planning from the center to lower administrative levels (mainly the provinces)—has been interpreted by many local authorities as mandating guidance at their level.[5] Despite changes designed to professionalize managerial hiring practices, *nomenklatura*-type managerial appointments are still the rule. Most workers are assigned to their *danwei* (workplaces) by labor bureaus. Free mobility of industrial labor remains a distant prospect. In sum, on the industrial front there is, as of now, little reason to speak of systemic reform.

Open Door

Another component of the economic changes should be mentioned. It is the policy of the "open door." This means opening up to the outside, mainly capitalist, world accomplished through increased trade, foreign

[5] Abram Bergson, "A Visit to China's Economic Reforms," *Comparative Economic Studies*, Vol. 27, No. 2, Summer 1985, p. 76.

investment in China, all kinds of ventures and coproduction arrangements, special economic zones, importation of know-how, and other contacts and exchanges. As against Maoist self-reliance and no indebtedness on foreign account (much prized and praised at the time by some Western China watchers as evidence of spunk), the emphasis now is on short-circuiting the development process by importing rather than inventing at home what had long been invented elsewhere.

If economists are fascinated mainly by the systemic implications of China's economic changes, the open door has caused considerable excitement and anticipation in Western governmental, banking, and business communities, and has spawned a vast cottage industry in trade-boosting and China-consulting. The premise on the basis of which the Chinese opened the door was that Western engineering technology and more importantly, capitalist business techniques or social technology (such as profit-making, actually having to sell the goods you produce, and paying people in some rough concordance with their marginal productivity) could be used to improve the working of the planned system without transforming it into a market economy and having the new socialist man catch the hedonistic Hong Kong flu.

I think that by now every policy-maker in China understands that this is not so, that capitalist business techniques are not systemically or culturally neutral, that they cannot be divorced from their natural free-wheeling competitive environment and grafted onto a system of central administrative command planning without the loss of those very attributes of efficiency for which they were imported in the first place. You have to buy the whole package: freedom to choose, private property, capitalist ethics, and all. That is a very sobering discovery that will inevitably affect the future course of China's economic changes.

And what of those changes? Will they last and grow in a market and private property direction, or will they be rolled back and subordinated to a resurgent plan? It is a question to which increasingly people in and out of China are addressing themselves.[6]

Prospects for Economic Change

Economics is not known for the reliability of its predictions. Moreover, economics is not the only issue in China's economic changes. Politics (including factional politics) and ideology intrude to an inordinate degree.

[6] A good recent example of such questioning is John F. Burns, "China on the Move: Will the Changes Last?" *The New York Times Magazine*, December 8, 1985, pp. 38-42, 86-94.

Will The Changes Last?

In answer to the question: "Will the changes last?" Chinese officials invariably answer in the affirmative, as one would expect. It is the present intent of those presently in power that the changes should last, indeed, that they should progress into hitherto unexplored territories. The suggestion that the changes have tended in a nonsocialist (not to say capitalist) direction is rejected on three grounds. First, it is said, the key means of production (land included) are socially owned by either the state (ownership "by the whole people") or by collectives. This is certainly true in law (with a few exceptions, like some trucks, draft animals, and hand tractors). However, it is less true in a non-legalistic, de facto sense of delegating wide use rights in assets to the actual, grassroots users of the assets: peasant families in the countryside and enterprise managers in the urban areas.

Second, while the current slogan "It is glorious to be rich" entails some rather stark income disparities, these disparities result from differences in labor inputs, not from ownership of property. They are, therefore, in complete accord with the Marxist distributive principle of "to each according to his work." This may sound a little specious in view of the considerable income derived by some petty and not so petty officials from what used to be called "squeeze," made possible by the officials' monopolistic access to information and their all-in-the-family administration of nominally public property. Third, the economy, it is said, is still predominantly planned, even if planning is now increasingly of the guidance rather than the mandatory variety. There is truth in that, the more so since a good deal of the guidance is, as we have seen, mandatory.

Despite these official reassurances as to the essentially socialist drift of the economic changes, doubts persist, particularly it would seem in the minds of some conservative skeptics and opponents of the Dengist changes, people like Chen Yun, Deng Liqun, Wang Zhen, Hu Qiaomu, Mao Zhiyong, and other influential leaders in and out of the Politbureau and the military, men equipped with an intricate but effective network of personal patronage connections (*guangxi*).[7]

Why Should the Changes Last?

To the complementary question: "Why should the changes last?" the official answer is that they will last because they are beneficial to the

[7]See Lu Keng Interview with Hu Yaobang, *Pai hsing* (Hong Kong), No. 97, June 1985, pp. 3-16, in *Foreign Broadcast Information Service-China*, June 3, 1985, pp. W19-W34.

country's modernization; the great majority of the people want them; and steps have been taken to make sure that after Deng goes to see Marx (and what a meeting that will be!) the changes will not be undone by left or right deviationists.

All three answers are formally true. The changes are beneficial to China's modernization. In fact, to become fully effective they should be pushed beyond their present limits in a more determinedly capitalist direction. The trouble with this answer is that is posits the supremacy of economic rationality within China's decision-making circles, which is at best a wobbly proposition. If economic rationality were the decisive determinant of China's policy, the PRC would have let the British run Hong Kong for the next hundred years. It is also true that the changes have brought significant improvement into the lives of most (but not all) ordinary people after decades of privation. But what the majority of people in China want is not, as experience has shown, the really important issue. The Chinese peasants did not want to be collectivized or communized, but they were, almost overnight. In other words, however popular, the changes are not irreversible simply by reason of their popularity. It is true, too, that steps have been taken to send many influential opponents of the changes out to pasture. At least three echelons of leadership have been so secured. But the security may be more apparent than real. People have been helicoptered into leadership positions in the past and they have been as quickly shot down. Deng himself has gone under three times, yet his power base at all times has been more elaborate and impressive than those of this leading appointees who, he hopes, will succeed him and carry on his labors.

Is Systemic Transition Possible?

Let me stake out a conceptual claim at this point, and then see how likely it is to occur in contemporary mainland China. Conceptually, a systemic transition from plan to market (from socialism to capitalism) is possible, as is the transformation of market into plan. In simple but accurate terms, capitalism is what people do when you leave them alone. Deregulation of the plan's information, coordination, and incentive mechanisms, and the privatization of property rights would, if carried far enough, lead to such a condition. What constitutes far enough cannot be determined (yet) with mathematical precision, though there are people working on it. However, it is undoubtedly true that at some point in the marketization and privatization process, markets and private property relations come to dominate the system, while the plan and socialized property recede into a subsidiary and subservient position. What is con-

ceptually flawed and impractical is market socialism, a fanciful halfway house in which market and plan, private and public property peacefully coexist in equal proportions. If applied, it would be a condition of pronounced instability.[8]

Is Systemic Transition Probable?

Although conceptually the evolution of mainland China into a fully fledged modern market economy is possible, is it a realistic prospect? Perhaps the best way to tackle this question is to review some of the problems that would have to be overcome for the transition to materialize. These problems are of three kinds: economic, political, and ideological.

Economic Problems: China's bold affair with the market came about as a reaction to the qualitative results achieved under the regime not only of Maoist pseudoeconomics but of the Stalinist and neo-Stalinist plan of the 1950s, early 1960s, and the post-Mao, Hua interlude. Resort to markets and privatized property rights was seen as providing the best chance to improve the efficiency of the economy's operations: to raise factor productivity and stimulate invention and innovation. This was a correct conclusion, but there is a catch, and the catch has three parts.

First, the market system is not a panacea. It is certainly capable of releasing enormous energies and improving productivity, as shown in the performance of Chinese agriculture since some capitalism had been injected into it. The market mechanism is very good at equilibrating supply and demand in particular product markets and incidentally resolving conflicts at a fairly "low" systemic level—the level of the individual buyer and seller. It is also an excellent motivator of entrepreneurial ingenuity and of more simple labor. But the market is less adept at bringing about macro stability. What this means is that the introduction of markets and privatized property rights is likely to be accompanied by fluctuation in the price level, open unemployment, booms and recessions, balance of payments disequilibria, and wide differentials in the distribution of income, and perhaps over time of wealth as well.

Now, these phenomena are also present in a planned economy *à la russe*, but there they are suppressed and disguised. Unemployment, for example, manifests itself mainly as underemployment and inflation translates itself into empty shelves and lines outside stores. When markets are introduced, these warts, blisters, and bunions burst into the open. There is no more pretence. A subtle mechanism of backlash-rollback begins to

[8] The theoretical deficiencies of the model of market socialism are examined in Chapter 1 of my *Market and Plan Under Socialism: The Bird in the Cage* (Stanford, CA: Hoover Institution Press, 1986).

operate. Inflation, unemployment, booms, busts, and the rest, provide opponents of marketization with excellent issues around which to mobilize resistance to the changes. A "we told you so" attitude quickly emerges and becomes rapidly politicized, putting reformers on the defensive. The same can happen, indeed already has happened, when markets begin to restructure the economy, favoring some lines of activity and discarding others. At the September 1985 national meeting of the Communist Party of China there was a big flap over the shift away from grain production into more profitable cash crops, and away from farming into nonfarming occupations in the countryside. Such a shift is in large part the result of market decisions taken by the newly emancipated rural producers in response to consumer signals, and is an integral part of agricultural modernization. But it has quickly been seized upon by the plan faction within the leadership who warn of grave political consequences that can flow from neglecting grain production: "grain shortages," Chen Yun has said, "will lead to social disorder."[9]

Second, the existing economic arrangement in China is not systemically well defined. There is plan and there is market, mostly the former. The two do not mesh well. During the "transitional" period such mismatch tends to produce new problems (associated with truncated markets) on top of the old (associated with the plan). There is an institutional working-at-odds that produces distortions never heard of before, which can be very effective in subverting the reformist drive. It has done so in the USSR (where the drive was never very strong) and in places like Hungary and Yugoslavia (where it was). The transitional period then becomes permanent.

Third, there is a question of the intellectual and temperamental qualities required by the market of those who operate within it. These qualities are quite different from those demanded of government and party bureaucrats who administer the plan. Among bureaucratic attributes unsuited to the market system are risk aversion, blurring of the locus of responsibility, a hierarchical mentality, elaborate sycophancy, and a gift of bending administrative rules ("formalism"). This together with the very imperfect integration of market and plan—a situation in which party and government bureaucrats still have a privileged access to certain markets—produces a black marketeer pattern of behavior. What emerges is a species of Mercantilism with corrupt characteristics. China seems

[9] "Chen Yun's Speech" at the CPC National Conference, *Beijing Review*, September 30, 1985, pp. 18-20. See also, John F. Burns, "Facing a Decline in Its Grain Fields, China Retreats on Policy," *The New York Times*, January 1, 1986, p. A2 and *idem.*, "China Grain Crop Dips; Setback Seen for Policy," *ibid.*, December 23, 1985, p. A4.

currently to be going through such a phase to the undisguised dismay of many who blame it, erroneously, on market ethics.

Political Problems: There are important social strata within the formerly planned economy who for various reasons do not adapt well to the market environment, do not benefit from it, or are threatened by it in their former privileges. Resistance to marketization and privatization can come from such diverse groups as workers who formerly enjoyed guaranteed life-long employment and sleeping money on the job, consumers whose money illusion is shattered by rising prices, factory managers expected to play according to new rules (that, as we saw, include the ability to sell one's product), nonentreprenurial peasants, farm families with few or no able bodied workers, and those functionaries of the Party and state who do not have the opportunity to put the emergent markets and new property rights to their nepotistic advancement.

The market is a labor-saving device which does the job of resource allocation at a comparatively low transactions cost. All it takes is for the buyer and seller to come together and bargain about price. Vast sections of the bureaucracy are thus threatened in their functions as "producers": planners, supervisors, and enforcers under the plan. Their jobs become redundant under the regime of the market. They are also threatened in their capacity as "consumers" of special politically-linked privileges: access to stores where they can obtain goods unavailable to the common herd, and other prequisites of office. In the market system what matters is money, not political privilege. So reform endangers the bureaucrats on both counts. They may be expected to respond appropriately with measures of active and passive resistance. Market-type changes in the urban industrial sector are particularly susceptible to this kind of resistance since the industrial sector of the cities is dominated by the entrenched ministerial bureaucracies of the state.

Ideological Problems: Ideological dangers to reform come from two doctrinal sources: Marxism and Leninism. From the standpoint of Marxism, there are two issues connected with economic reform.

Clinging to Marxism are socialist ethical codes (developed mostly after Stalin's death) which include security, or the right to employment interpreted in the state sector as the right to a lifetime job. Other rights associated with the Marxist ethos are access to basic necessities of life at low (subsidized) prices, equality, stability, and the priority of the general interest, as defined by the planners, over individual or partial interest. The quest for market efficiency inevitably comes in conflict with these ethical desiderata and suscitates resistance in the adversely affected quarters. The codes are part of an implicit social contract between the monoparty

state and the citizenry. The citizens receive these economic guarantees in exchange for a slow increase in living standards, lack of locational mobility, chronic shortages of desired goods and services, low quality of products, and other consumer frustrations, and also, indeed especially, for keeping their mouths shut. Economic reform with its competition, high risk quotient, and short response time to rapidly changing market conditions, breaks the contract. Some firms have to close, some people have to be dismissed from their jobs, rents rise, and so on.

The second issue connected with Marxism and affected by economic reform is that of social classes. Marketization and de facto privatization of the economic system benefit not one class but many, and these are not the ones chosen as "progressive" by Marx's Laws of History. Although in the long run reform rewards the urban proletariat—in fact, transforms it into a middle class—the short and medium term benefits, and some of the longer term ones as well, accrue primarily to the entrepreneurial, utility- and profit-maximizing, money-oriented, quick-footed and independent segments of urban and rural society: the "rich" peasant, the shopkeeper, the enterprising businessman, the broker, and the venture capitalist. Reform changes not only the output structure of the economy but its class structure as well, and in the process redefines class in a non-Maxist sense.

If Marxism is associated with the socialist ethical code, Leninism is identified—much more accurately—with party control over all spheres of life. Marketization and privatization reforms diffuse economic power among many centers; production, exchange, and distribution relations tend toward the horizontal; control mechanisms are diversified, and are made more indicative and indirect. All of which goes against the Leninist imperative of absolute power absolutely concentrated. On this Leninist issue of control, economics, politics, and ideology converge. Marketization and privatization, the opponents of reform argue, cause not only macroeconomic woes and aberrant behavior ("spiritual pollution"). They threaten the planning, supervisory, and managerial elites both as "producers" and consumers; they are ethically repugnant on a Marxist interpretation; and, above all, they are a menace to unified monopolistic control by the Leninist party. These are serious counts that have to be carefully considered in arriving at a perception of the odds for and against the reformist movement in China.

One could argue that if Marxism can be reinterpreted and adapted to suit changing conditions and the marketizing and privatizing temper of those in charge of policy, so can Leninism.[10] In fact, Leninism has been

[10] "... Let it be emphasized that Marxism is not a dogma but a guide to action." *Beijing Review*, January 13, 1986, p. 2.

revised in China in the last several years in two ways. The first has been conscious and deliberate, mandated by the Party leadership. It has involved a very discreet shift from Leninism's natural totalitarian perspective toward an authoritarian one.[11] The arbitrariness and party terror of former days have been lessened and to a degree replaced by formal, party-dictated law. There has been a marginally greater toleration of religious expression and a slightly softened attitude toward the special needs and aspirations of national minorities. The activities of united front organizations have been resurrected. The cultural censorship has been a bit relaxed, not much, but a little; for a while small "unofficial" magazines of popular fiction proliferated.

The second way in which Leninist control has been relaxed was not intended, planned, or desired by the party leaders. It just happened as part of economic liberalization and the greater opportunities for personal gain which accompanied the economic changes. The party lost control over many of its members, high and low, as they engaged in activities that had little connection with the Four Basic Principles and Leninist discipline.

Conclusion

The future course of economic changes in China will be influenced by both the positive and the negative results of the changes, by political considerations that involve complex and shifting factional and personal alliances about which we really do not know enough, and by ideological factors which in a socialist society—whatever the degree of ideological putrefaction—remain a powerful force. In view of all these uncertainties and unknowns, and socialist China's long history of *zigzagobraznost*, prediction is a foolhardy enterprise. "It is difficult to estimate depth of well by size of bucket."

However, a very cautious opinion can be expressed. An analysis of the economic, political, and ideological dangers lurking in the path of economic reform would suggest, I think, that the odds against further significant expansion of markets and privatized property rights in China are formidable. The mainland economy has perhaps gone about as far as it

[11] "Consultative authoritarianism," as Harding puts it. Harry Harding, "Political Development in Post-Mao China," in A. Doak Barnett and Ralph H. Clough (Eds.), *Modernizing China: Post Mao Reform and Development* (Boulder, CO: Westview Press, 1986), pp. 13-37.

can on the U-turn, and chances of its crossing systemic borders are slim. The odds in favor of another U-turn, this one back toward the plan are, I think, greater. What has been done so far has benefited many ordinary people (as well as some party fat cats). It has been the economically rational, popular, and the right thing to do. But economic rationality, popularity, and rightness are not, on historical evidence, communist China's *forte*. In the background there always lurks the danger which markets and privatized property rights present to the party's monpolistic control over an important segment of life. And so Deng's opponents can turn his phrase against him: "It doesn't matter whether the cat catches the mice or not, so long as it remains a cat."

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Dr. Feulner: We are delighted to welcome Senator Frank Murkowski back to The Heritage Foundation today. Senator Murkowski brings to his position in the United States Senate a distinguished career both in state government and in the private sector. He is, I think it's fair to say, a man of the Pacific, having both been born and educated on the West Coast.

He served, for many years, as the president of the Alaska National Bank of the North in Fairbanks. He served for a period of about four years in state government on the Commission for Economic Development. He has served in the United States Senate now for more than five years where he is not only Chairman of the Veterans' Affairs Committee but, most interestingly for this audience, Chairman of the East Asian and Pacific Affairs Subcommittee of the Senate Foreign Relations Committee.

Senator Murkowski, it is a pleasure to welcome you back to The Heritage Foundation.

Senator Murkowski: Thank you, Ed. I am very pleased to participate in your seminar on U.S./China relations. The emerging role of China is one of the most intriguing subjects we can speculate on as we stand on the threshold of the 21st century—a century which our Ambassador to Japan Mike Mansfield has called "the Century of the Pacific".

During my last visit to the People's Republic of China in 1984, when I joined a group led by Georgetown University's Center for Strategic and International Studies, Chairman Deng Xiaoping made a very significant statement about capitalism and socialism that warrants reflection. He said: "There shall be only one China, but there can be two systems—capitalism for Hong Kong and Taiwan and socialism for China." Little did I dream that within two years the wheels of capitalism would be put into motion in China.

Deng's willingness to abide with, and even promote capitalism is now a reality. The enormity of the movement of one-fifth of the world's population, grasping for the incentive rewards of the free enterprise system, is by far the most significant socio-economic development of our century. As China moves forward there can be no turning back.

It's clear that a more secure, modernizing and friendly China—with a foreign policy and economic system increasingly inclined toward the West—can make a significant contribution to peace and stability in Asia. At the same time, we have obligations and interests in Taiwan that must be maintained as well. In short, we have a real tightrope to walk.

While China's economic transformation is well underway, our economic relationship with the PRC is still being formulated. Some facts are useful:

—U.S./PRC two-way trade for the months of January to November 1985 reached a record level of $7.3 billion. This surpasses all of 1984 and represents a 25 percent increase over the first eleven months of 1984.

—Over the same first eleven months of 1985, U.S. exports to the PRC were $3.4 billion (up 29 percent), while imports from the PRC were $3.9 billion (up 24 percent).

By contrast, our two-way trade with Taiwan exceeded $20 billion in 1985. Unfortunately, the trade with Taiwan is not nearly so balanced as our trade with the PRC, having a deficit of over $12 billion. In fact, our exports to Taiwan declined by $175 million in the first nine months of 1985, compared with the first nine months of 1984.

Although the U.S. suffers a modest trade deficit with China, the trading relationship is generally healthy. But there's other news as well—China is emerging as a significant competitor to the U.S. both in our domestic market and in third country markets. Chinese textile exports to the U.S. and other nations are well known. Less well known are China's increasing coal exports to Japan, some of which have come in return for Japanese mining equipment sales.

Many years ago there was a book about China trade called *Oil for the Lamps of China*. Now the trade goes the other way. In the first nine months of 1985, the U.S. imported $556 million worth of Chinese crude oil, a 350 percent increase over the same period in 1984 ($124 million). Previously, U.S. imports of petroleum products exceeded our imports of Chinese crude oil. However, as the demand for leaded gasoline has fallen, Chinese imports of that product have fallen from $245 million in the first

nine months of 1984 to $144 million in the first nine months of 1985—a 70 percent drop.

On the agricultural front, China has begun to export grain to both Japan and the Soviet Union—developments which are not welcomed by the American farmer.

The biggest news on the infrastructure front is the Three Gorges Dam Project on the Yangtze River. Just last week a respected Hong Kong newspaper with excellent connections reported that the PRC intends to create an entirely new province called San Hsia (Three Gorges) to handle the project administratively. Such a mammoth project would cost at least $10 billion and represent major opportunities for U.S. exporters of machinery, equipment and construction services.

U.S. export of machinery and equipment have shown the most gains in exports to the PRC. Over the period of January to November 1985, U.S. machinery exports totaled $1.6 billion—a 120 percent increase over the $724 million in exports over the same period in 1984.

Another potential export market for U.S. producers is China's nuclear power industry. Congress has just approved the U.S.-PRC nuclear cooperation agreement which will allow U.S. firms to bid for up to $6 billion worth of nuclear projects over the next 15 years.

The amount of these purchases is material evidence of Deng's determination to build his nation. Mao claimed that "China has stood up," but Deng is making it stand tall.

In order to pay for these large purchases of expensive machinery and equipment, China must protect its exports. Witness the textile war of 1983 which cost the U.S. economy $1 billion in lost exports. Since the Japanese market is essentially closed to the kinds of low wage manufactured exports, such as textiles, in which China can specialize, China must inevitably look to the U.S. market.

If the effect of China's efforts to export is to displace other exporters to the U.S., then the problems of adjustment will be relatively minor. If, as in textiles, Chinese exports represent additional competition for domestic industries which are already under pressure, (and this appears to be the case), there is potential for significant trade problems.

Perhaps most worrisome is Chinese raw material and commodity exports to third markets. We are all pleased by the sale of U.S. mining equipment to China. But if China's intent is to become a major exporter of coal, it will have an adverse impact on my own state of Alaska as well as the rest of the western states that hope to enter those same markets. This may indeed be where the PRC is headed. Consider, as I've already mentioned, China's recent arrangement to purchase mining equipment

from Japan, which in turn agreed to purchase its coal. Watching these developments, we can't help but ask the question: what is Chairman Deng really doing on the economic front, and how is it going to affect us?

It is interesting to reflect on China's attention to secure foreign exchange (currency). China has spent millions on a major offshore fishing program, hoping to sell fisheries products on world markets at prices far above what a domestic Chinese market could bear.

Deng says that he is not restoring competition to China. But looking at China's economic transformation, I'm reminded of the old Chinese saying: "if it's black like a crow, and flies like a crow, and acts like a crow, it's a crow."

So what is the economic bottom line? Incredible economic transformations are underway today in China—from the countryside to the major cities. Many of the old China hands are stunned to see these dramatic changes, but I believe that we're only seeing the beginning—North Korea and Vietnam are increasingly frustrated with their own economic performance. All of Southeast Asia is ripe for the spread of capitalism.

The Chinese economic transformation is undoubtedly in our best interest. A poverty stricken China surrounded by rich, vulnerable neighbors would be an unstabilizing situation which the Soviets could easily exploit. A China which is raising the standard of living of its peoples by leaving the Soviet economic model is a positive development which should promote peace and the continued spread of capitalism in the region.

Through normalization, the United States has been a significant role model in China's emergence as a world power. While China has the potential to give us some trade fits in the future, we must not forget that the U.S. is a diversified exporter with products on the world market ranging from super computers to agricultural commodities and raw materials that can be marketed in China.

As our economic relationship with the PRC continues to develop, we must continue to consider the effects of our actions on Taiwan. That's a subject I'll talk more about after considering our emerging military and security relationship with China.

We share a common security concern with China—the growing threat posed to both our nations by the Soviet Union. Consequently, it has been our policy to attempt to build an enduring military relationship which would support China's national development and maintain China as a counterweight to Soviet power.

Needless to say, our developing military relationship cannot be blind to the interests and concerns of Taiwan, Japan, Korea, or any of the other

countries of Southeast Asia—all of which have had their own historical experiences with the Middle Kingdom.

To illustrate this, let me share a point that was driven home to me during my recent visit to Vietnam, Thailand, and Laos. Consider the fact that there are an estimated half million Soviet troops on the border with China; and up to one million Chinese troops facing them. There are also an estimated 700,000 Chinese troops on or near the Vietnamese border, who are mindful of the 150,000 Vietnamese troops in Cambodia/Kampuchea. As we articulate our policy goals in this region of the world, we have to remain mindful of the complex interrelationships which have resulted from the mutual and historical mistrust among these nations.

In pursuing a military relationship with China, the U.S. has emphasized balanced progress in three essential elements: high level dialogue and visits; functional military exchanges; and technological cooperation.

Secretary Weinberger's visit to China in September 1983 was the watershed event in this regard. That visit established a framework for expansion of military-to-military contacts and led to an agreement to conduct a series of reciprocal training and logistics exchanges. The Secretary's visit identified and articulated to the Chinese leadership several military mission areas, keyed to Chinese requests, which could provide the basis for future military technology cooperation programs. Finally, the visit also stimulated the creation of a U.S. inter-agency review process designed to track military technology cooperation programs and to ensure that such cooperation is supportive of fundamental U.S. interests in Asia and the Pacific—including our relationship with Taiwan.

Over the past several years, we have engaged in discussions with representatives of the PRC's Army (the People's Liberation Army) on the subject of military technology cooperation. These discussions have focused on possible U.S. Foreign Military Sales (FMS) assistance to the PRC in defensive mission areas including anti-tank guided missiles, artillery shell manufacture, and antisubmarine warfare weapons.

We have also been considering assisting the PRC in avionics modernization—a pursuit that I feel needs closer examination in the context of our relationship with Taiwan.

Although site surveys have been conducted and survey reports have been presented to the Chinese in all four of these mission areas, no military hardware has yet been sold or transferred under FMS channels.

The Administration feels an avionics upgrade for F-8 and F-8-2 interception fighters will only modestly improve China's ability to defend against Soviet attack, and will not alter the air balance in the Strait.

I'm skeptical; Taiwan's F-5E's lack the all-weather capability that improved avionics could give the PRC—a factor which could very easily alter the balance with Taiwan.

The question over advanced avionics may well be an area where we may see some differences between Congress and the Administration. The avionics debate underscores the congressional interest in seeing that Taiwan's security interests are not seriously compromised. Just as we have to walk a tightrope with regard to our economic relationships with the PRC and Taiwan, we must do the same with regard to military and security relationships with the two nations. And I think that the concern for the future of Taiwan may be one area where Congress and the Administration may come to disagree in the future.

The efforts of several presidential administrations to move closer to the PRC over the past ten or so years have been successful in holding Soviet intentions in East Asia at bay while moderating the process of change in Southeast Asia. Nevertheless, Congress is intent upon providing for continued good relations between the U.S. and Taiwan, pursuant to the provisions of the Taiwan Relations Act of 1979. We will continue to walk the tightrope that will enable us to maintain our "One China/One Taiwan" policy for the foreseeable future.

I think that both China and the United States have agreed that cooperation and understanding can best be achieved by abiding to an unwritten policy to pursue with intelligence those areas where agreement can be reached, while setting aside areas of difference for a later resolve. A truly unique and mature point of view—but one that seems to be working.

Mr. Allen: Thank you very much, Senator Murkowski.

I would now like to invite some questions from our audience. I think there certainly should be no shortage of them.

Unidentified Guest: I wonder if one of our panelists might fit his thoughts on the future of Hong Kong into these perspectives on Taiwan, the impulse for capitalism and U.S.-China relations.

Dr. Prybyla: The British have a saying that it's easy to muck up Hong Kong. The Chinese will inevitably muck up Hong Kong, not because they want to do it, but because they don't know better.

Hong Kong is the only example in the world of laissez-faire capitalism. It's the nearest approach to the model of perfectly competitive markets, and to place it in the hands of—I don't know, Harry Harding calls them "consultative authoritarians" nowadays—is to invite disaster.

I think the Chinese will muck up Hong Kong before 1997. They're on the way to doing it.

Mr. Allen: I've had the opportunity to be in Hong Kong at very interesting times, and it would be my view that, in the long run, the chances for trouble—that is, the Hong Kong agreement coming off the tracks—outweigh the prospects for a resolution of it. Dr. Copper?

Dr. Copper: This is a question I want to direct to you regarding the free trade association in the Pacific, and particularly in Taiwan. In attempting to realize this, how do we start? Do we think in terms of the Pacific Basin, or do you think in terms of one nation, then attracting another nation and another nation?

If so, with Taiwan first on the list, I'd like to ask the other people on the panel to comment on the free trade association.

Mr. Allen: Senator Murkowski, Ed Feulner and I just a few moments ago made a proposal that the United States consider a Free Trade Area arrangement with Taiwan similar to that which the Congress saw fit to approve for Israel and similar to that which we have prospectively discussed with Canada.

It would be a long and somewhat tedious negotiation, but it is a bilateral arrangement. It is provided for under GATT and it is specifically authorized under a so-called fast track procedure by the Trade Act of 1974.

There are elements of delicacy in that we do not maintain formal diplomatic relations with Taiwan, but we do have a vigorous and obviously expanding trade. As both Ed and I mentioned, such a Free Trade Area represents no threat to anyone. It does not carry with it any political implications of any kind. It is addressed exclusively to a burning trade issue, the disproportionate trade surplus on the part of Taiwan vis-à-vis the United States, which, based on the preliminary figures supplied by Dr. Kyle, amounted to $13.5 billion in 1985. On a per capita basis, it is the largest in the world.

We indicated there was no prospect whatsoever of any other nation taking the initiative. Japan certainly isn't going to negotiate a Free Trade Area with the United States; it is doubtful that Korea would. The appropriate vehicles for U.S.-Taiwan negotiations exist today in the CCNAA and the American Institute at Taiwan, just as other matters are handled and negotiated. Nor can we forget that the Taiwan Relations Act makes specific provision for the conduct of such undertakings.

Dr. Kyle?

Dr. Kyle: I'm well aware that the authorities on Taiwan from the Premier to the Minister of Economic Affairs on down have an interest in such an association. At times, they link it to the getting of oil from Alaska, which is another matter. But my understanding is that, while there is a great deal of interest expressed about this in Taiwan, that neither the authorities there nor the authorities here yet understand all the ramifications.

A cost-benefit analysis will be required. A lot of great preparatory study and analysis will have to go into place before this can be done. Also, it's my understanding that the Office of Special Trade Representative, who would be responsible for negotiating such agreements—in our case it would be done through our aegis—feels it is not a high-priority item. The FTA with Canada is on the front burner, and then the big problem will be to get through the important, upcoming GATT negotiations.

I'm not saying whether it's a good idea or a bad idea, but I think it will be a long time coming.

Mr. Allen: I would just say, with respect to what Dr. Kyle mentioned, that may be the present agenda. We think that the issue is of sufficient urgency that a constituency can be developed rapidly for a negotiated Free Trade Area between Taiwan and the United States. Priorities can and ought to be rearranged. Dr. Philip Chen?

Dr. Chen: Senator, are you personally being approached, or urged, to be a bridge between mainland China and Taiwan?

Senator Murkowski: No, I feel that the question of the system between the People's Republic of China and Taiwan, as is our official policy, is a matter for the Chinese to resolve. I have not been approached to act as a bridge.

Fred Kemp, The Wall Street Journal: I have a question on avionics.

You alluded to future disagreements that you could face with the Administration over this. I wonder if you could be a little bit more specific and tell me what the status is of these discussions?

Senator Murkowski: The point is if we provide advanced avionics to the PRC, it's my opinion that we have the same obligation to Taiwan, and it's really just that simple. You will get arguments from people much more qualified than I as to just what "all-weather capability" means, and the extreme particulars of the aircraft from the standpoint of an operational mission. But I think you have to boil it down to whether indeed we understand what the definition of "all-weather" is, and it's the ability to

go up in all weather and at night and operate with adequate avionics.

Unidentified Guest: This is addressed to Senator Murkowski. Alaska is obviously the state which is endowed with the greatest resources to provide the Pacific Basin with the energy and the fuel it needs to maintain its growth. On the other side, the Pacific countries, including the Republic of China, need the markets of the United States for their exports.

If there were to be conceived a plan which involved, say, a Free Trade Area and a preference for purchase of Alaskan energy, would you be interested in that concept?

Senator Murkowski: I think it's a very interesting concept. Whether it's a practical concept, and whether you can ever get agreement on what market share each country will have in an energy-consuming market, is another matter.

There are so many problems associated with getting agreements when traditionally everybody's been competing in a world market, I am just a little concerned about how we get an orderly agreement, and who is going to do what.

Kevin White, CNN: I find the free trade association idea a fascinating one, but I'm curious about the fact that it's being talked about in terms of those countries that have the closest, perhaps most dependent relationship with us: Israel, Canada, Taiwan. And I wonder if Free Trade Areas might, in the end, not promote free trade but trade blocs?

Mr. Allen: Well, in my view, it would not lead to bilateral blocs throughout the world. I think that a negotiated Free Trade Area agreement with Taiwan would have a very salutary effect on other nations in the region as well.

One of the things that Dr. Kyle noted in his splendid presentation was the degree of outright dependence of Taiwan on the United States. This dependence is much deeper than is the dependence of Canada on the U.S. market. Taiwan has a very heavy incentive to move to such an agreement.

The FTA could also substantially reduce the amount of pressure that is developing in the Congress on the Japanese issue, which inevitably is going to have some scatter effect. You're not going to be able to close the choke on that shotgun of response so tightly that it would hit only Japan.

So, theoretically, it is true that this would create an imperfect world for trading purposes. But, in the real world it is precisely what is needed to resolve a very serious problem that will result in Taiwan's being adversely affected unless some positive, dynamic, bold, new initiative is taken. After all, that is precisely the intent of the Trade Act of 1974. That's why a fast-

track provision was written into the legislation. Simply because it has been unused these many years is no reason for us to ignore such prospective trade agreements.

Unidentified Guest: Mr. Allen, how would you relate the FTA to the Free Economic Zones that China has set up? Would there be any interaction?

Mr. Allen: I would view it as highly unlikely that the People's Republic of China would be willing to enter into negotiations for a Free Trade Area with the United States, so I don't think it relates to the Special Economic Zones. However, I would see the successful conclusion of the FTA to have a very beneficial, even a felicitous, impact on our economic relationship with the People's Republic of China.

Again, I stress that this proposal injures no one's interest and it carries with it no political implications of any kind. It is an attempt to address a bilateral trade problem.

Unidentified Guest: I was wondering if Senator Murkowski could discuss the attempts of the Soviet Union to improve relations with China and Japan and what this holds for the future.

Senator Murkowski: Well, I'm sure everyone has an opinion on this, but my own observation is still one that the Soviet Union is very difficult to do business with. That's an observation I share with my colleagues who have done business directly with the Japanese in the timber industry, which I use as an example.

In Alaska, we have exported most of our timber products to Japan simply because there was no other market on the West Coast. Now, the Soviet Union has much closer accessibility to the markets of Japan and they have a wood that's very similar to ours from the standpoint of its tensile strength and so forth. But the reality is that it was very difficult for Japan to do business with the Soviets, who were just not geared up to make a significant penetration in the Japanese market.

This was also true in the Korean markets and it's been true in marketing timber products in the People's Republic of China. It's not that the potential isn't there; it's just that the Russians have not been able to get their act in order.

Similarly, the Soviets have not been able to deal effectively with the Japanese or Chinese politically either.

The continuing suspicions between the Soviet Union and China is evidenced by the large troop strength on both sides of the border. And the Soviets still occupy the northern islands off Japan.

The Japanese might see fit to go back into Sakhalin and explore for gas

and oil, but they still haven't forgotten the return of the northern islands.

Unidentified Guest: I wonder how long Dr. Prybyla gives the economic movement in the PRC.

Dr. Prybyla: One should not make predictions, but I am tempted in this euphoria to make predictions. I think the program will come to a grinding halt within a very few years for the following reasons: What Deng Xiaoping has done in China is deeply and profoundly non-Marxist and non-Leninist. It is counterrevolutionary. Chairman Mao was right: Deng Xiaoping is a capitalist roader. He was right, which is all for the better of China. I think it's all to the great benefit of the Chinese people.

There are more people now who have benefited from Deng Xiaoping. I'm sure he's a very, very popular man in China, but what the Chinese people want, and what will happen are not necessarily the same things. The Chinese peasants didn't want to be collectivized, yet they were. They didn't want to be communized, but they were communized in eight months. So these things are reversable, and I think that the forces of reversal are building up and they are building up on the fronts that I mentioned.

The capitalist experiments, or neocapitalist, half-capitalist experiments, so far have produced positive results, certainly in agriculture. But there are some negative results on the horizon. There is neglect of basic investment in the countryside, for example, large scale investment in retaining walls. There are problems with erosion, with soil degradation. If there should be a bad harvest; if there should be inflation a little bit more than it is now; if you have large scale unemployment; if suddenly the peasants—60 million of them are already released—break out of the restriction on migration to the cities and start pouring into the large cities; if the oil does not come; if income differentials rise, as they might under these conditions. If all these things come together, they present an enormous threat to the reforms. My hunch is that there will be a rollback, a reaction from the political constituencies who are not benefiting and from the ideologues who see this as being non-Marxist, non-Leninist, and non-Mao.

My prediction is that the number of factors coming together are such that the reformers may have to retreat within the next several years.

Mr. Allen: Well, with that, I would like to express our appreciation to all of the panelists, and to Senator Murkowski for giving us so much time.

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Dr. Lasater: The final session today addresses the critical question of whether the military balance in the Taiwan Straits can be maintained. As you know, this is a very complicated question which touches upon many political, economic and psychological factors as well as strictly military considerations.

The hour that we have remaining is far too short to consider all aspects of the problem. What we are going to do this afternoon is focus on one side of the equation: that is, the military capabilities of the PRC.

Dr. June Dreyer, who is the Director of East Asian Programs at the Graduate School of International Studies at the University of Miami will present an overview of the People's Liberation Army, noting especially the PLA's modernization program. Her presentation will be followed by that of Mr. Edward Ross of the Office of International Security Affairs of the Department of Defense. Mr. Ross coordinates Department of Defense policy for the People's Republic of China and Taiwan. His remarks will focus on the evolving U.S.-PRC military relationship and what that relationship might mean in terms of Taiwan's security.

Following both presentations, we will open the floor in what I anticipate will be a lively question and answer period. Dr. Dreyer?

Dr. Dreyer: Thank you. From the quantitative point of view, there is no military balance. Since the mid-1950s, the People's Republic of China (PRC) has had more ships and more planes than the Republic of China (ROC), often by factors of ten or more to one. It has had more manpower since virtually the day of its founding. The disparity in population between the two countries, sixty to one, makes it extremely unlikely that there could ever be a militarily significant narrowing of this quantitative imbalance.

What has kept peace in the Taiwan Straits for the past four decades has been the American presence. The U.S. commitment to the independence of the ROC, as embodied in the Mutual Security Treaty of 1954, allowed Taiwan access to sophisticated military technology which, combined with the ROC's own impressive scientific and engineering skills and the morale and capabilities of its armed forces, produced a qualitative advantage in favor of the Republic of China.

It is difficult to assess the relative weight of quantitative versus qualitative advantages in the military sphere. A recent attempt to do so with regard to America's own capabilities produced a major controversy within the United States defense community. It is, however, no longer a relevant question to ask about the military situation in the Taiwan Straits. In August 1982, the United States pledged that its arms sales to Taiwan would not exceed, either in qualitative or quantitative terms, their level

since 1979, and that the U.S. would gradually reduce its sales of arms to Taiwan. A few years earlier, in 1978, the PRC had embarked on a military modernization program. The combination of this attenuation of U.S. support and simultaneous upgrading of the PRC's own capabilities made it highly likely that the PRC would soon enjoy a qualitative as well as a quantitative advantage over the Republic of China.

Obviously, a great deal depends on the ROC's response to this situation. I shall not deal with the Taiwan side of the equation, leaving it entirely in the capable hands of my colleague Ed Ross. The remainder of my presentation will address the question of what effects China's military modernization program has had on the PRC's capabilities, and how these might affect the situation in the Taiwan Straits.

Basically, the reforms that Deng Xiaoping set into motion in 1978 have aimed at producing an armed force that is younger, better educated, better trained, and better equipped. The People's Liberation Army (PLA; the term includes naval and air as well as ground forces) is also supposed to be more loyal to the central leadership—in this case, to Deng—equipped with a better strategy, and involved in developing the country's economy.

There have been some real accomplishments. For one thing, the fighting force is definitely younger. Recently published sources state that the average age of regimental commanders is under 40, that of divisional commanders, under 45, and of army commanders, under 50. The average age of members of the three PLA General Departments (General Staff, Logistics, and Political Departments) and Military Region commands has been reduced from 64.9 to 56.7.

There are also new rules on education. Officers below the age of forty have been told that they must raise their educational levels gradually, to the equivalent of senior middle school or technical college. Those who refused to do so, or who could not pass the examination they were to be given, would be either demoted or demobilized.

There is a new doctrine to replace People's War, referred to as "People's War Under Modern Conditions" and described by Chief of the General Staff Yang Dezhi as "a tiger that has grown wings." While the details of the strategy have not yet been made explicit—and, given the obvious advantages of secrecy on these matters, may never be—certain features of the new doctrine seem clear. For one thing, there has been a decision to concentrate on combined arms operations. For another, there is less emphasis on luring deep and on mobile warfare than there was in old-style People's War. Positional warfare is considered more important than formerly. In addition to official statements noting that positional

warfare had been sanctioned by Mao Zedong himself, this is noticeable in the way the army has used its tanks on maneuvers, digging them in in many cases, and in sharp contrast to past practice. As for luring deep, there is now a much more realistic attitude about the consequences thereof—i.e., that in the process of luring an enemy in deeply, one has simultaneously surrendered a good deal of territory. Recent strategy has focused on guiding the invaders toward carefully selected battlefields of China's own choosing, and counterattacking in those locations.

There has also been a good deal of Chinese interest in developing their forces' ability to engage a front-line military offensive threat. In this regard, strategists have become very interested in the U.S. Army's concept of the Air-Land Battle. Both a National Defense University group and a delegation from the RAND Corporation were separately asked by their Chinese hosts to prepare lectures on this topic.

As for producing a force that is more loyal to Deng Xiaoping, every one of the commanders of the original eleven Military Regions have been replaced at least once since 1980. It is difficult to believe that adherence to Deng's programs was not an important criterion for selection. Military representation on the Party Central Committee is now down to twenty percent. A far-reaching reorganization plan has also been introduced. Its features include cutting the size of the armed forces by one million persons, a new conscription law, and a new military service law that establishes a reserve force and allows the re-establishment of a rank system. The number of Military Regions has been reduced from eleven to seven, and the right to command the different service arms has been transferred to the military regions. In the past, the service arms were placed under the command of headquarters established by the central authorities. For example, tank units were under the armored force command. Henceforth, with the exception of the Second Artillery Corps—China's missile forces—the service arms will be under Military Region command.

As for creating a better-equipped force, there has been an ambitious program both to acquire Western technology and to develop and produce better weapons in China. Among other developments, the PRC has produced nuclear submarines and launched missiles from them. It has been working on a fighter plane with all-weather capabilities, the F-8. In addition, various items have been procured from abroad, including, apparently, the *Shafir* missile from Israel. Shipborne radio systems and degaussing equipment have been purchased from Britain and optronic directors and Dauphin helicopters from France. The United States has agreed to sell the Raytheon 12E 1167 sonar and the Mark 46 Mod 2

torpedo. American authorities have also agreed to the sale of a munitions factory and five LM 2500 gas turbines for the Chinese navy's new destroyers. Reportedly, the two countries are about to conclude a half-billion dollar agreement for advanced avionics for the F-8 that would considerably enhance the plane's capabilities and definitely make it an all-weather plane. The Chinese have also looked at a wide range of other military technology and have reached fairly advanced stages of negotiation on several of the items.

Thus far, the Chinese military modernization effort has received high marks from western media—in some cases, higher than actual results would warrant. While substantial progress has certainly been made, the modernization process has come neither so far nor so fast as some reports might lead one to believe. For example, the recent campaign to lower the ages of officers has indeed succeeded in producing a younger officer corps. This was desirable in the sense that some of the people they replaced were in their seventies or even eighties. In the opinion of several U.S. military attaches, however, many of the individuals may be *too* young: they do not have the experience necessary to cope with the responsibility for units as large as those they now command.

The new educational requirements have produced on the one hand a feverish rush of activity to pass the examinations, and on the other hand, a thriving industry in cheating to get through them. There have also been instances on newly promoted better educated officers being harassed by others.

As for strategy, a former U.S. assistant secretary of defense who observed PLA maneuvers last spring described them as "Korean War vintage" and expressed doubt that they would have been effective even then. *Jane's Defence Weekly*'s July 1985 analysis of China's positional warfare techniques was far from optimistic. The periodical's commentator noted that even a tank regiment would be easily penetrated by a concerted Soviet attack, and concluded that this would be true whether the Chinese tanks were the older-style Type 59 or the newer Type 69.

The PLA's adoption of the Air-Land Battle concept is likely to fare no better. While there is an obvious Chinese interest in being able to deal with a front-line military offensive threat, they are very far from having the equipment to make it work. Indeed, there are doubts as to the ability of the much better-equipped U.S. army to carry out this strategy. The rationale for the Air-Land Battle is the belief that the overwhelming superiority the Warsaw Pact enjoys over NATO forces in tanks and other fighting vehicles can be compensated for by the extensive use of helicopters to enhance mobility and firepower. Some helicopters would be

equipped with anti-tank guided missiles to shoot enemy tanks, while others would land infantry behind enemy lines.

The Chinese have committed themselves to the Dauphin helicopter, and a few years ago signed a contract with France to co-produce the vehicle in a factory in Harbin. However, thus far they have been unable to actually manage the production line. Basically, the French have been supplying kits to the factory, which then assembles them. In addition, even if the PRC could turn out helicopters independently, the Dauphin is unsuited to a role in the Air-Land Battle; it is simply too small. The government has already discovered this with regard to other purposes. For example, the size of the helicopter has made it impossible to equip it with both a dipping sonar and a torpedo. Privately, some Chinese officials admit that they made a mistake in choosing to acquire the Dauphin. But it is clear that they intend to continue producing it.

Yet another problem would be maintaining the large number of helicopters needed for the Air-Land Battle. Helicopters require much servicing, and the PRC lacks the necessary number of trained field mechanics to provide this. A China that lacks the capacity to manufacture and maintain adequate numbers of tanks that are a match for the Soviet Union would be ill-advised to adopt a strategy that involves large numbers of vehicles that are still more difficult to manufacture and maintain.

Basically, the obstacle to the Chinese adopting the Air-Land Battle is that it would involve an attempt to compensate for the PRC's technological inferiority against the Soviet Union by employing a strategy that requires a still higher level of technology. The RAND delegation referred to above interpreted the attention devoted to the Air-Land Battle as evidence of an unrealistic attitude toward strategy in general.

Military re-organization plans have had their problems as well. The proposal to reduce the PLA by a million men was first made in 1982, and had some effects. The Railway Corps, the People's Armed Forces Police, and some of the units of the PLA's Capital Construction Corps were civilianized, resulting in a reduction of several hundred thousand men. Enlisted personnel were doubtless quite enthusiastic over this aspect of the re-organization, since Deng Xiaoping's economic reforms had made it more profitable to stay at home than to join the military. But there were difficulties within the officer corps. Perhaps the most startling was the formation of disgruntled groups of men who had been demobilized against their will. Unable to find satisfactory employment while somehow managing to retain their weapons, several veterans groups, taking names like "The Disillusioned Army," turned to banditry.

The demobilization stopped short of completion, but was revived again

in early 1985 with renewed vigor. It has, however, been accompanied by renewed difficulties, since so many people have a vested interest in avoiding the effects. Chief of the General Staff Yang Dezhi recently complained that there were problems of officers leaving their posts even before their units were disbanded, saying that this and other "unhealthy practices" had caused disorder in the army's work.

There have also been reports of rush promotions so as to get higher retirement pay, improper recruitment of Party members within the army, and of soldiers who thought they might be demobilized dividing up military property amongst themselves. Others were reportedly denuding their barracks areas of trees and anything else remotely portable. Officers who were forced to retire because of age had used their contacts in the bureaucracy to have their children appointed to the jobs they were vacating.

Where units were merged or abolished, one unit would often refuse to accept officers transferred from another. The refusing units were suspicious of both the transferees' loyalties and of their competence. With regard to the former, they expressed unwillingness to work with a complete stranger whom one could not necessarily trust. As to the latter, the units feared that had the officer to be transferred been a good one, his original unit would not have agreed to part with him, reasoning that "no family would send its beloved child to the temple to serve as a monk." Clearly, such difficulties in transferring officers among units will severely constrain the development of a modernized professional army.

High-ranking members of the General Staff have also complained about continued factionalism and the bad effects it was having on the military. Despite the passage of a law in 1984 re-instituting the rank system, it has so far proved impossible to actually do so. Continued disagreement over who should be assigned which rank appears to be a principal cause. There are also potential problems with reducing the number of Military Regions and giving them the right to command the different service arms, since larger entities with greater resources at their command have concomitantly greater potential to become foci of resistance to the central government.

Moreover, while Deng has been able to get rid of any number of military commanders and commissars, he has yet to win the military's approval of his choice for head of the Central Military Commission, Hu Yaobang. Since Hu has for the past several years occupied the highest position in the Chinese Communist Party, it is conceivable that he may have trouble keeping the military in line after Deng Xiaoping passes from the scene.

The military's greater involvement in the development of the civilian economy has opened newer and more lucrative channels for corruption. Examples abound; one of the more spectacular recent cases resulted in the conviction of several division level officers in the Guangzhou Military Region, including both the commander and the commissar. The unit had been engaged in a profitable vehicle purchase and resale scheme, which was discovered only when one of their subordinates was robbed and murdered by the owner of a vehicle he was attempting to purchase. The scheme apparently came to light almost accidentally, since the officers were able to conceal information on their comrade's death for several weeks.

The development of advanced weapons and their acquisition from abroad are being held back by a number of factors. First, there is conflict between those Chinese who would like the PRC to develop its own weapons and those who would prefer to buy from abroad. The National Defense Science, Technology, & Industry Commission, better known as NDSTIC, which would prefer the latter strategy, has resorted to setting up several trading companies to try to get around the resistance from elsewhere in the bureaucracy. It has placed the children of several of China's highest-ranking leaders, including Deng Xiaoping and Nie Rongzhen, in key positions in these companies.

Second, there is conflict over what foreign systems to buy. Differing assessments over the military capabilities of different weapons are compounded by the international implications of buying from, say, Israel as opposed to France or Great Britain. Third, the PRC has a relatively limited defense budget, and foreign purchases are expensive.

Last, and perhaps most important, the PRC lacks an overarching strategy or unifying theme that it could use to judge which weapons systems would be suitable. The aforementioned RAND group reported in July 1985 that the inquiries it received amounted to "an indiscriminate shopping spree for technological targets of opportunity, with detailed discussion of specific menu items, but no overall strategy."

The implications of the PRC's military modernization program for the balance of power in the Taiwan Straits remain to be assessed. While there is cause for concern about what the long-term improvements in PRC military capabilities can do to give the PRC a qualitative edge over Taiwan in addition to the quantitative advantage it has always enjoyed, there is no immediate cause for panic. Some of the modifications of PRC strategy would have little relevance for a confrontation with Taiwan; the emphasis on positional warfare and tank maneuvers, for example, are clearly meant to cope with enemies like the Soviet Union and Vietnam.

Other aspects of the PRC's military modernization have proceeded so slowly that they call into question the efficacy of the finished product. China's nuclear submarine development program and its missile launchings have had repeated problems, and have cast doubt on the continued development of the program. A much-touted Chinese-made anti-tank missile displayed at the PRC's 1984 National Day celebration in October was deemed by Western experts "very much a developmental weapon and is not in production . . . [There are] a number of problems, the most serious of which is repeated breakage of the guidance wire at a range of about 1,500 meters."

As a further case in point, a recent article in the highly regarded *Jane's Defence Weekly* on the F-8 noted that the plane was supposed to be the answer to Taiwan's Tiger II's, but that it has already taken almost twenty years for the plane "to approach viability, and China cannot afford such tremendously protracted development." The article concluded that "time is not on China's side."

Jane's analysis is accurate as far as it goes: the difficulties of the PRC's development and engineering programs are quite real and well-known. What the article does not take into account, however, is the factor that has been responsible for the stability of the Taiwan Straits these past forty years—namely, the attitude of the United States. Were the contest simply between the technological systems of the PRC and the ROC, there can be little doubt that Taiwan, with its superior research and development programs and sophisticated production lines, would win. But if the United States continues to deny the sale of advanced weaponry to the ROC while helping the PRC to solve its technological problems—as is implicit in the negotiations for American defense contractors to upgrade the F-8 under the supervision of the United States Air Force—the terms of the competition are altered, albeit not quickly, in the PRC's favor. Given the PRC's consistent refusal to commit itself to a peaceful solution to the Taiwan question, the absence of a clear-cut American statement that it will permit no non-peaceful solutions portends ominous consequences.

Dr. Lasater: Thank you very much, June. Mr. Ross?

Mr. Ross: The development of U.S.-PRC military relations began soon after the normalization of diplomatic relations between the United States and the People's Republic of China on January 1, 1979. Secretary of Defense Harold Brown's visit to Beijing in January 1980, followed by then Deputy Chief of the General Staff Liu Huaqing's visit to the United

States in May 1980 and soon-to-be Minister of Defense Geng Biao's visit to the United States a month later, were the initial steps in opening a dialogue between the military establishments of the two countries. The evolution of U.S. policy with regard to a military relationship with the PRC was reflected in the announcement in 1981 that the United States would consider the sale, on a case-by-case basis, of defensive weapons and equipment to the PRC.

Development of the military relationship was hampered somewhat in 1981 and 1982, however, by several factors. Important among these were differences between the U.S. and China over Taiwan and an internal policy debate within China over the extent to which the PRC would seek foreign participation in its defense modernization. In August, 1982 the United States and China signed the Joint Communique concerning U.S. arms sales to Taiwan. By the latter half of 1983 a growing consensus within China paved the way for further development of U.S.-China military relations.

Two important events in 1983 also contributed to the advancement of the military relationship. First, was the liberalization of U.S. guidelines for the sale of seven categories of dual-use items to the PRC in August following Secretary of Commerce Baldrige's visit to China. Second, was the visit of Secretary of Defense Weinberger in September. These developments came at a time of significant growth in political and economic relations between the United States and China. Moreover, they signaled an acknowledgement by both sides that it was an appropriate time for further expansion of military contacts as a natural by-product of normal relations between friendly, non-allied countries.

Secretary Weinberger's visit was particularly significant because it established the framework for expansion of U.S.-China military-to-military contacts. The Secretary's visit resumed and expanded the high-level dialogue between senior U.S. and Chinese military leaders begun by Secretary Brown in 1980. It laid the groundwork for renewed functional military exchanges between the Services of the two country's armed forces. Finally, it identified and articulated to the Chinese military leadership several military mission areas, keyed to Chinese requests, which could provide the basis for future military technology cooperation between the two militaries. In addition it also energized a U.S. inter-agency review process designed to ensure consistency of U.S. policy in the military technology cooperation area.

Subsequent high-level exchange visits built on the foundation established during the Weinberger visit. Defense Minister Zhang Aiping visited the United States in June 1984. In addition to meeting Secretary

Weinberger, he had discussions with President Reagan, Secretary of State Shultz, Chairman of the Joint Chiefs of Staff General Vessey and other senior military officials. Secretary of the Navy Lehman visited China in August 1984 and opened the door to direct navy-to-navy contacts. General Vessey and USCINCPAC Admiral Crowe visited China in January 1985. General Vessey became the first U.S. military leader to observe a PLA combined-service training exercise. Chief of Staff of the Air Force, General Gabriel visited China in October 1985, and Commander of the PLA Navy, Liu Huaqing visited Washington in November 1985. These two most recent visits marked the beginning of dialogue and exchanges between senior uniformed military Service personnel.

In each case, visits by senior U.S. and Chinese military leaders have further improved communications and understanding between the two armed forces and have paved the way for increased contacts. Secretary of the Navy Lehman's visit in August 1984, for example, established a navy-to-navy dialogue which led to the recent PASSEX or "passing exercise" conducted between the two navies earlier this month in the South China Sea. While such courtesy passing exercises are conducted routinely between the U.S. Navy and the navies of numerous friendly and allied nations, the fact that China participated in such a routine activity is a small but noteworthy step in the military relationship. High-level and functional military exchanges will continue in 1986.

U.S. Policy Considerations

The slow but steady growth of U.S.-China military relations over the past three years is the result of a willingness on both sides to pursue policies toward each other which satisfy each country's basic interests for both the near- and long-term. Neither Beijing or Washington seek strategic partnership and numerous differences continue to exist between the two countries in their approach to political, economic, and other issues. Nevertheless, there is more than ample incentive for both sides to engage in military interaction and technology cooperation.

While Beijing articulates an independent foreign policy, China has found it in its interest to develop close technological and commercial relations with the West in order to obtain the technology and trade necessary for its national development. Similarly, China seeks reduced tensions and increased economic and cultural contacts with the Soviet Union, but also frequently has articulated the three obstacles to better relations with the U.S.S.R. and recognizes the difficulty in finding solutions to the Afghanistan, Cambodia, or Sino-Soviet border issues.

The willingness of the United States to develop a military relationship

with the PRC is founded on the assessment that the United States and the PRC share important parallel interests, both globally and regionally. Foremost among these is a common security concern—the growing threat posed by the Soviet Union. Thus, an objective of U.S. policy is to build an enduring military relationship with the PRC which would support China's national development and maintain China as a force for peace and stability in the Asia-Pacific region and the world. We believe a more secure, modernizing, and friendly China—with an independent foreign policy and economic system more compatible with the West—can make a significant contribution to peace and stability. One of our aims in strengthening our relationship is to support these healthy trends.

In this context, our goal is to play a positive role in China's military modernization—a role which not only serves our mutual interests, but which also takes into account the concerns and interests of our friends and allies in the region. Such a role also must take into consideration China's legitimate defense requirements and its own modernization objectives.

As in the case of its economic modernization, the acquisition of U.S. and Western technology is fundamental to Beijing's strategy for military modernization. Over the past several years, the PRC has sought to improve its military capabilities through a defense modernization program which ranks fourth in national priority behind industry, agriculture, and science and technology. Nevertheless, progress is geared to the long term and is contingent upon Chinese economic modernization. Due to the limited financial resources available to the PLA, primary emphasis in defense modernization has been placed on military education, training, and the restructuring of the military establishment. In the area of weapons and equipment modernization, Beijing's strategy is to acquire production technologies to modernize its own defense industries rather than the acquisition of quantities of foreign weapons and equipment. Given the present state of PRC defense industry and the economy, it will take a considerable period of time before the PRC is capable of producing modern weapons in sufficient quantities to satisfy PLA requirements.

U.S. Arms Sales to China

With this general background, I would like to focus the remainder of my remarks on the question of U.S. arms sales and military technology transfer to China. As I stated earlier in my presentation, United States willingness to sell defensive weapons and equipment to the PRC on a case-by-case basis dates back to 1981.

United States military sales to China fall into two general categories; dual-use equipment and technology, licensed by the Department of Com-

merce, and those end items and technologies controlled by the International Munitions List (IML), licensed by the Department of State. My comments will be limited to the latter category which includes actual weapon systems and related technologies.

Munitions list items can be sold to China on either a direct commercial basis by U.S. defense contractors who possess a valid munitions license or, on a government-to-government basis, through Foreign Military Sales (FMS) channels. Equipment already purchased from the United States through commercial channels includes S-70C helicopters, LM2500 gas turbine engines for naval ships, coastal defense radars, and communications equipment. Numerous U.S. defense contractors presently possess munitions licenses for a wide range of other defense items which they are attempting to market in China. In many cases, commercial negotiations for the sale of these items are ongoing.

Although the PRC was not declared eligible for FMS sales until June 1984, the United States and China began to explore military mission areas, based on Chinese defense requirements, that might serve as the basis for government-to-government sales of U.S. arms and military technology during Secretary Weinberger's visit to China in September 1983.

While it is not appropriate for me to reveal the substance of confidential discussions on arms and technology sales between the United States and China, I can characterize the nature of U.S.-China military technology cooperation and discuss some of the implications of these sales.

From the outset, discussions between the Department of Defense and China's Ministry of Defense have concentrated on defining mutually agreed areas for cooperation. Naturally, the Chinese seek to acquire production technologies and systems which will enable them to upgrade their own defense industries in order to be able to manufacture weapon systems and military equipment adequate to meet current and projected threats. Only in rare instances, where Chinese defense industry has no capability whatsoever or where current threats require immediate enhancement of their capability, will the Chinese procure complete end items in more than very small quantities. The United States, for its part, wants to assist China in meeting its legitimate defense requirements within existing weapons and technology transfer policies, consistent with the political-military environment in the region.

Over the two and one half years since Secretary Weinberger visited China, four military mission areas have emerged as the focal point of U.S.-China military technology cooperation. The four mission areas are: Anti-Tank; Artillery; Air Defense; and Surface-Ship Antisubmarine Warfare. Using these mission areas as the basis for discussion permitted both

sides to concentrate on developing cooperative programs keyed to specific Chinese defensive requirements and to identify systems and technologies which most appropriately met those requirements.

There has been a continuing series of discussions on matters related to cooperation in these mission areas and numerous visits by delegations of technical personnel from both countries. At every step, U.S. responses and proposals in military technology cooperation discussions with the Chinese have been fully coordinated and approved by appropriate officials of the Departments of State and Defense, the Joint Chiefs of Staff, and the Services. In each case, appropriate representatives of these departments actively participated in the discussions. In each mission area, U.S. willingness to release specific defensive weapons or technologies to the PRC is based on a thorough analysis of their utility for enhancing Chinese defensive capabilities, while taking into consideration the political-military environment and the interests of our other friends and allies in the region.

Let me add, that in addition to coordinating with appropriate offices and agencies of the Executive Branch of the government, we have periodically consulted with members of the Congress and their staffs on progress and developments in the U.S.-China military relationship, to include military technology cooperation and arms sales.

Reciprocal visits by Chinese and U.S. technical teams have been designed to establish a base of understanding of requirements and capabilities in order to define cooperative programs. Visits by Chinese technical teams to the United States have been to defense contractors and military installations which may be involved in implemented cooperative programs. Similar U.S. technical teams have visited China. In many cases, U.S. technical team visits to China have been paid for by the Chinese under approved FMS cases related to cooperative programs for the various agreed mission areas.

Following two years of discussions and technical visits on the four approved mission areas, the Chinese Government submitted eight Letters of Request (LORs) pertaining to the artillery mission area in August 1985. The LORs were for technical data packages, plant layout designs, and technical assistance for setting up large caliber artillery fuse and detonator plants. If the Chinese choose to purchase the plant equipment associated with these plants, the total value of the sale could amount to $98 million. Formal notification of the sale was made to COCOM and the U.S. Congress in September.

In 1986 there are other potential FMS sales for each of the three remaining mission areas. In the air-defense mission area there is the

avionics modernization for the F-8 high altitude interceptor. The F-8 is a Chinese developed, twin-engine, delta-wing, high-altitude interceptor designed to counter the Soviet bomber threat. In the anti-tank mission area there is the coproduction of the Improved-TOW anti-tank guided missile. In the surface-ship ASW mission area there is the co-production of the Mark 46, Mod-2 lightweight ASW torpedo. These programs are still under active discussion and it is difficult to say when these discussions may reach a conclusion. The program which appears most likely to be agreed upon in the near term is the F-8 Avionics Modernization project.

Avionics modernization for the F-8 interceptor involves the integration of releaseable avionics components into the F-8 aircraft by a U.S. prime defense contractor. The U.S. Air Force will supervise this effort as a Foreign Military Sales program. The estimated value of the program is approximately $500 million. The integration effort will require about six years to complete and will include an airborne radar, navigation equipment, a head-up display, a mission computer, an air data computer, and a data bus. Following successful integration of the avionics package, a total of 50 F-8 aircraft will be modified by the Chinese for installation of avionics kits in China. The program is an end-item sale and does not involve coassembly or co-production. There will be no transfer of design or production technologies. No weapons are included in the sale.

The Departments of State and Defense have thoroughly reviewed all aspects of the F-8 Avionics Modernization Program. This carefully developed program is consistent with both our policy objectives, set by President Reagan, and our releasability considerations. This modest upgrade of Chinese air-defense capability will contribute to China's ability to protect its sovereign air space. Moreover, by enhancing China's security against external threats, this program is in the national interest of the United States. In the next few weeks we will notify COCOM and the Congress of our intention to proceed with this sale, pending acceptance of a Letter of Offer and Acceptance by the Chinese.

Let me add at this point, that restrictions on third-country retransfer are an integral part of the Letter of Offer and Acceptance signed by the United States and the People's Republic of China. We have full confidence that the retransfer of our military technology will not be a problem.

Conclusion

The development of U.S.-China military relations has not been a short-term phenomenon responding to ad-hoc international political-military events. On the contrary, it has been, and continues to be, a fundamental element of overall United States China policy. U.S.-China military rela-

tions serve basic U.S. and Chinese strategic interests and contribute significantly to peace and stability in the Asia-Pacific region and the world.

The U.S.-China military relationship consists of three basic elements: High-level dialogues and visits, functional military exchanges, and military technology cooperation. The United States seeks balanced progress in each of these areas.

Military Technology cooperation between the United States and China has concentrated on meeting basic Chinese defensive requirements through cooperative programs within the mutually agreed mission areas of anti-tank, artillery, air-defense, and surface-ship ASW. Specific arms and technology sales to China, both commercial and FMS, continue to be approved on a case-by-case basis following thorough inter-agency review and approval.

The current trend in U.S.-China relations is a positive trend which ultimately will contribute to the security, not only of China and the United States, but of our friends and allies as well.

Dr. Lasater: I might point out that those remarks by Ed Ross have been the most comprehensive statement to date made on the U.S.-PRC military relationship and I definitely would like to thank Ed for bringing that to this forum today. I'd like to open it up to questions and answers, please. Yes?

Unidentified Guest: I'd like to direct a question to Dr. Dreyer. When the PRC attempted a punitive expedition against North Vietnam, the PLA proved ineffective. They had trouble coordinating their logistics and their tactical formations. All of that can be done without new avionics for the F-8 or antisubmarine capabilities. I wonder how important this technology really is as long as the People's Liberation Army simply cannot master basic tactical formations and movements?

Dr. Dreyer: Well, it's an interesting question, but it's like asking which is more important, the functioning of your brain or the functioning of your heart? The Chinese did have a lot of problems in Vietnam. One of the other things that caused problems was the breakdown of radios in the tanks. People had to hop out of tanks during combat and wave flags, and that sort of thing.

If the technology for their radios had been better, possibly the weaknesses in the logistical system wouldn't have shown up so badly. What I'm saying is, yes, logistics is something that has caused problems, and the PRC has been pretty frank about admitting it. But even if they get their

logistics in order, they're going to have to upgrade the technology, too.

Unidentified Guest: Mr. Ross, according to Senator Murkowski just a moment ago, the avionics that the United States wants to sell to the PRC is going to make the F-8 an all-weather fighter, which is a capability that Taiwan doesn't have. How do you assess the impact of the sale on the military balance in the Taiwan Straits?

Mr. Ross: It is correct that the proposed avionics package would provide the F-8 with an all-weather capability, but that aircraft is not intended for use in the Taiwan Straits environment. It is not designed for that; it is not well-suited for that. It is intended for use against the Soviet threat where an all-weather capability is a fundamental requirement if you're going to be able to deal with that threat at all. But your observation is correct.

Mr. Kemp: Fred Kemp from the *Wall Street Journal.* I wonder if you could tell me, first of all, why it's not suited for combat in the Straits and second of all, whether you foresee any problems getting this sale through Congress?

Mr. Ross: I'm not a fighter pilot, but I've been hanging around long enough to have learned that different aircraft are designed for different missions. Some aircraft are strictly interceptors designed to go up and intercept a high altitude or low altitude bomber penetrating an airspace. They fly out straight and level. They dispatch their ordnance and turn around and get out of there very fast.

This is what the F-8 is. The F-8 is an interceptor aircraft designed to fly out very fast and intercept. It is not an air superiority fighter. It is not intended to go out and perform dogfights, or to go out and test air space with other fighters.

As for the Congress, the process is that we deal with the Chinese and we proposed a sale. Then the responsibility of the executive branch of government is to seek the advice and consent of the Congress, which we do in informal briefings and which we will soon do formally in the notification process.

In our dealings with the Chinese over the past couple of years, we have been mindful of these considerations. We believe that when we go up on the Hill and sit down and lay all this out in detail with the appropriate Congressmen and their staffs, we will be able to demonstrate that the sale is in the U.S. national interest, that it is not a threat to Taiwan, and that it is something that we should go forward with.

Mr. Kemp: Will the same thing be offered to the Taiwanese?

Mr. Ross: We don't deal with China and Taiwan on the basis of whatever you sell to China has to be automatically sold to the other side.

Unidentified Guest: Ed, could you go a little further on the F-8 avionics in terms of defining it as "all-weather?" Does it provide an all-weather navigation capability or an all-weather fighting capability?

Mr. Ross: You caught me at a disadvantage. I wish I had someone here with a lot more technical details who could answer that question for you. But partly it's a capability of the navigation system and some inherent capability in the radar system.

Dr. Lasater: I have a question I'd like to ask June. Your point was that the United States was the primary force in protecting Taiwan over the last few years. If that is true, what role does the ROC armed forces have in Taiwan's defense?

Dr. Dreyer: I would say that the problem for the ROC, really, is not an air confrontation, but a naval blockade.

I think there is no doubt the PRC could carry out a successful naval blockade at this point. But for political and other reasons, they might not want to do so.

PRC capabilities are better in some areas than others. For example, the PRC is much better equipped to blockade the western side of Taiwan than it is the eastern side, and that's where Taiwan's three biggest ports are: Kaohsiung, Taichung, and Keelung. It might be well for the ROC to concentrate on building up the two east coast ports, Suao and Hualien, which are fairly small by comparison to the other three. Also, it's my recollection that the railroads serving those two ports are not doubletracked or electrified. Building up the size of the Taiwan-owned proportion of the fleet serving the island would also help.

None of these things would require military sales from foreign countries, which are getting more difficult for the ROC, as the example of the Dutch submarines a few years ago proved. And I believe they are working on a fighter plane and have had some successes with that.

Unidentified Guest: Mr. Ross, I know it's difficult for you to speak about the Taiwan side, but looking at the 1982 Communique, which, if taken literally, says that we would never sell to Taiwan anything they don't already have, with the F-5-G or the F-20, are we really outside the pale?

Mr. Ross: It's very difficult for me to comment on this. We have the Taiwan Relations Act. We have the August 17th Communique. I believe the United States can conduct an effective Chinese policy within the

parameters of those two, although it means as Senator Murkowski said, walking a tightrope.

Dr. Dreyer: And what about minesweepers? A minesweeper is clearly a defensive weapon, right? So, if the Taiwan Relations Act says it's our right to sell defensive weapons to the ROC and if the major danger from the PRC is, as most of us assume, a naval blockade including some mining of the ROC's ports, then would it not be all right to sell minesweepers?

Mr. Ross: I would leave interpretation of the TRA and the Communique to Secretary Shultz and Secretary Weinberger.

Dr. Lasater: One of the fundamental points you made, Ed, was the importance of the political and security environment in which the arms sales decisions are made. Can you define this political security environment? What indicators are you looking at?

Mr. Ross: Well, the United States obviously has global military and political interests and it has not been the style of this administration to act precipitously in the international arena. We always make sure that we take into consideration the interests and concerns of our allies.

We have regular consultative meetings with the Japanese defense establishment. These were just conducted in Hawaii a couple of weeks ago. We have regular forums in which we can listen to and exchange views with our allies on how they perceive the direction the United States may be going.

I think all of our Asian allies understand what we are attempting to do in our military relationship with China. We are not attempting to make any short-term gain, or trying to play this "China card" against the Soviet Union at the expense of any of our other relationships in the region.

One of the criticisms that has been levelled at the administration is that somehow our China policy has been ad hoc and the services are somehow competing with each other to sell things to China. This is just not the way that this administration functions. It functions in a deliberate, careful manner to make sure that all of our allies understand what's going on. And we have not received indications from our allies that they're in a state of panic over what we are doing.

Dr. Dreyer: Okay. I agree, they are not panicked. But I'm not sure they agree with the policies. A senior Malaysian official that I was talking to last year had a very clever metaphor for it. He said, "You know, we realize you Americans have global interests and that's why you want to arm the Chinese, and we think you're forgetting about our regional interests." Then he said, "To us, it looks like you've got a python in your

backyard. It's a little python, and you keep feeding it. You don't seem to understand that one day the python will get so large that you can't afford to feed it any more, and then it may come in from the backyard and bite you."

This is perhaps the most entertaining way I've heard the idea expressed, but I've heard it not only from Malaysians, but also Singaporians and Indonesians and people who live on Taiwan, and so on. And so while I think maybe they do understand, they don't necessarily agree with our China arms sales policy.

Unidentified Guest: Mr. Ross, listening to your presentation, I have the impression that you are really describing the F-8 as a straight, fast interceptor, whereas Taiwan's F-5E is an air superiority fighter. So they are two different types of airplanes. In this sense, the sale by the United States of the avionics to upgrade the F-8 does not really pose a threat to Taiwan. Am I correct in this assumption?

Mr. Ross: Let me take the opposite side, for a moment. One could argue that anything you do for China militarily will, in one sense or another, give them some better capability to do something against Taiwan. You could argue that in a philosophical sense.

But if you're going to do an objective military analysis, you've got to look at the mission, the functions, and the roles that the different systems play and what they're intended to do. And in agreeing to cooperate on the F-8 with the PRC, we looked at this aircraft. It was designed back in the 1960s to deal with what was then a very potent Soviet bomber threat. This particular aircraft is intended for that mission, and they need a better capability to deal with that threat.

We don't see this as an aircraft which is applicable to the Taiwan Straits environment. We don't see this as an aircraft that's even going to be stationed anywhere near the Taiwan Straits. It's going to be primarily used against a Soviet threat. We've been examining this question over a period of two years, and we would not go forward with the sale if it was not justified, it was not in the U.S.'s interest, and it was not going to pose a threat to Taiwan.

Unidentified Guest: Are there any assurances from the PRC that they will not station the aircraft near the Taiwan Straits?

Mr. Ross: It would be bad form to ask that of the Chinese. You know how the Chinese both in Taiwan and the PRC are about sovereignty questions. All I can say is that we have a high degree of confidence that this is not a problem.

Unidentified Guest: Was there serious disagreement within the administration, within the Pentagon or within the State Department on this decision to supply and modernize the F-8?

Mr. Ross: First of all, I would not characterize our discussions as disagreement. When this whole issue came up, there were many different bureaus and agencies throughout the government that asked legitimate and valid questions, many of which are going to be asked all over again, and rightly so.

Part of the process we went through was to address these questions in a way that was thorough and complete. There was nothing to hide. These questions were openly addressed, but there wasn't any factional dispute. It wasn't a case of one side being opposed and another side being for it. It was a case of legitimate questions about what impact this would have, exactly what involvement the United States would have, and all this.

The fact that we are getting closer to being ready to go forward on this is an indication that the Department of Defense, the Joint Chiefs, the Department of State and the National Security Council all have had these questions answered to their satisfaction. Right now there is interagency agreement that we ought to proceed.

Unidentified Guest: In line with the earlier question, could you tell me if the Director of Central Intelligence has an intelligence annex on the F-8 issue?

Mr. Ross: CIA and DIA have commented on many occasions on the entire range of our cooperation with China. We have not proceeded in any of this without appropriate intelligence input.

Dr. Lasater: I'd like to thank our panelists, June Dreyer and Ed Ross, as well as the audience, for attending today. Thank you, Dr. Chen, for cosponsoring today's forum. It's been a very useful and informative session. I hope we have another seminar soon. Thank you very much.

THE HERITAGE LECTURES

American policymakers have tended in recent years to focus attention almost exclusively on the growing relationship between the United States and the People's Republic of China. While understandable, this trend is unfortunate because of the many deep historical, economic, and cultural ties the U.S. enjoys with the Chinese people on Taiwan, the Republic of China.

To help remedy this imbalance, The Heritage Foundation's Asian Studies Center and the Asia and World Institute in Taipei assembled a panel of distinguished China experts to review the current political, economic, and military situation in the two Chinas. One result of the day-long conference was a major economic proposal for a Free Trade Area between the U.S. and the Republic of China that would go far toward redressing the current trade imbalance in the Pacific.

The conference has been hailed as one of the most interesting and informative recent discussions of U.S. China policy. These published proceedings should take their place in the "must read" section of China watchers' libraries on both sides of the Pacific.

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