Statement of
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Asia and the Pacific
House Committee on Foreign Affairs

A New Era of U.S.-China Relations?

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Chairman Chabot, Ranking Member Faleomavaega, and distinguished Members of the Committee:

It is a privilege for me to appear before you today, and I thank you for this opportunity.

My name is Gordon Guthrie Chang. I am a writer and live in Bedminster, New Jersey. I worked as a lawyer in Hong Kong from 1981-1991 and Shanghai from 1996-2001. Between these two periods, I frequently traveled to Asia from California. I regularly go there now.

I am the author of *The Coming Collapse of China* (Random House, 2001) and *Nuclear Showdown: North Korea Takes On the World* (Random House, 2006). I write regularly about China's economy and politics for Forbes and other publications.

China's Long-Term Campaign Against Foreign Companies

During what is known as the "reform era"—the period beginning at the end of 1978 until now—the People's Republic of China sought the technology, expertise, and know-how of foreign companies. Reformist leaders realized that, to obtain what they wanted, they would have to allow these companies to have access to the Chinese market.

Now, however, Chinese leaders, often pressed by politically powerful state enterprises, believe they have enough leverage to take back their market from foreign competitors. Severe turmoil in Beijing political circles aggravates the plight of foreigners as do the regressive political campaigns of China's current ruler, Xi Jinping. This process of

undermining foreign companies will eventually work to the detriment of China, but these businesses will be wounded, some grievously.

The discriminatory treatment of foreign companies is bound to get worse over time, complicating already deteriorating relations between Washington and Beijing. There are many grievances that American companies have in China, and the obviously unfair application of the competition laws, the topic of the moment, illustrates important themes common to most of them.

The leaders of the People's Republic have always exhibited some hostility toward foreign companies, but the campaign to undermine them became especially apparent during the rule of Hu Jintao, who stepped down as Communist Party general secretary in November 2012. During his tenure, officials cited various concerns, including those relating to competition, to block high-profile foreign acquisitions, especially beginning in 2007 with Microsoft's attempt to take a stake in Sichuan Changhong Electric and Goldman Sachs's moves on Midea Electric and Fuyao Group. Carlyle Group, the investment firm, at around that time was frustrated in its long pursuit of Xugong Group Construction Machinery.

Anti-Monopoly Law

Beijing's efforts really got into high gear, however, when the Anti-Monopoly Law came into effect in 2008. The central government didn't waste time using its new club, stopping Coca-Cola from buying Huiyuan Juice Group in 2009.

China's campaign escalated still further in July of last year. Then, the powerful National Development and Reform Commission brought together representatives from about 30 foreign companies—including Microsoft, GE, IBM, Intel, and Qualcomm—and tried to force them to write confessions of violations of the Anti-Monopoly Law. Chinese officials, incredibly, showed the multinationals the "self-criticisms" of other companies as a means of pressuring them to follow suit.

NDRC officials, during the two-day meeting, also browbeat and threatened the foreign firms and warned them not to defend themselves. "The message was: if you put up a fight, I could double or triple your fines," said one participant at the session, reporting the remarks of the NDRC's Xu Xinyu, a division chief in the antitrust bureau.

Since then, Beijing has gone after one multinational after another. Recent American targets include Chrysler, fined last week, and General Motors. Moreover, regulators have investigated non-American firms as well. The offensive against foreign companies of all stripes has become so notorious that it has become a part of the global discourse. *Time* at the end of July asked this: "Is no famous foreign brand safe in China?"

With the Chinese government going on an unmistakable anti-foreign bender, the answer to *Time*'s question is obviously no. China's most egregious anti-trust violators are its

large state enterprises, but they have escaped the attention of the NDRC and Beijing's two other competition enforcers, the State Administration for Industry and Commerce and the Ministry of Commerce. And that uneven focus raises concerns Beijing is openly violating its World Trade Organization obligations, especially its promise to provide "national treatment"—nondiscriminatory administration of its laws—to foreign companies. These days, arrogant Chinese officials are making less and less pretense of honoring international trade obligations.

"Xi's 'China Dream' has become 'China First,' " writes Richard Harris of Port Shelter Investment Management, referring to the signature campaign of Xi Jinping. "But for now the strategy is to keep tilting the playing field in your favor until someone notices."

Now, many are noticing. In the past month, the U.S. Chamber of Commerce, the American Chamber of Commerce in China, the U.S.-China Business Council, and the European Union Chamber of Commerce have issued reports complaining of discriminatory treatment and intimidation in connection with the Anti-Monopoly Law. Moreover, the U.S. government has begun to take an interest. On the 10th of this month, for instance, Edith Ramirez, chairwoman of the U.S. Federal Trade Commission, voiced concerns about Beijing's move against Qualcomm. On the 14th, the *Wall Street Journal* reported that Treasury Secretary Jacob Lew had written to Vice Premier Wang Yang about the anti-monopoly investigations.

The Chinese government has now felt compelled to answer critics. On the 9th of this month, Chinese Premier Li Keqiang told business executives that his government ran anti-monopoly investigations "legally, transparently and fairly," and two days later China's three anti-monopoly regulators banded together to defend their conduct at an unusual joint press conference. "Our anti-trust enforcement work is strictly conducted according to regulations," said the NDRC's Xu Kunlin of the Price Supervision and Inspection and Anti-Monopoly Bureau. "It is fair and transparent. It is not targeting any market player, and of course, it is not targeting any foreign invested or foreign enterprise."

No one believes the blanket denials, but many now hope China will stop persecuting American and other multinationals. Will Beijing relent? Analysts ascribe Beijing's blatantly discriminatory treatment to temporary or non-structural factors.

First, many say the campaign against foreign companies is largely a squabble about market share, that increasingly powerful state enterprises are using their political clout to take business opportunities from these successful outside competitors. Beijing, after all, has been going after Microsoft's competitive practices—and banning Windows 8 this year as well as attacking its OneDrive cloud storage service—in anticipation of the central government's attempt to introduce its own operating system, perhaps as early as this year.

Second, some argue that anti-foreign enforcement will essentially end when the campaign hits China in the pocketbook. Foreign direct investment plunged 17.0% in July from the

same month in 2013 and was down 0.35% for the first seven months of this year from the corresponding period in 2013. Many attribute the fall partly to Beijing's unwelcoming attitude to foreign business, and a few think Chinese bureaucrats will let up on anti-monopoly investigations to stem the downturn in FDI.

Third, there are indications that Chinese leaders are targeting foreign business as the economy continues to slide, and many analysts see it reviving later. The National Bureau of Statistics claims growth around 7.5%, but independent data, private surveys, and even government numbers indicate the economy stumbling badly, with growth already in the low single digits. Foreign companies would make the perfect villain if growth disappears, as it may by the end of this year.

There is truth in all of these contentions, but there are powerful factors suggesting that the long-term effort against foreign companies will continue because it is rooted in the country's corrosive politics.

Fundamental Political Problem

Communist Party politics will likely remain unfavorable to multinationals for the long term. The campaign against them is almost certainly directed from the top of the Chinese political system, the Party's seven-member Politburo Standing Committee, because nothing this important could be maintained without approval from the highest levels of the one-party state.

That approval is evidenced by both the length of the campaign—going back more than a half decade—and the breath of the effort. While Beijing goes after multinationals for violations of competition law, it has also been harassing them in other ways, such as its highly discriminatory enforcement of bribery laws, most noticeable in the pharmaceutical sector. This is, for instance, more than just a squabble about the market share of state enterprises.

Unfortunately, the frontal attack on foreign business brings to mind the xenophobia of Mao's era. Xi Jinping has been conducting a series of Maoist-inspired "rectification" and "mass line" campaigns since he took over as China's leader. The use of Cultural Revolution-style methods against multinationals suggests that his Maoist rhetoric is already affecting Chinese governance.

Worse, Xi is now taking the country backward in another important respect. China prospered when it opened up its economy after the horrible Maoist years. Now, however, he is reversing course. He talks positive change but has, on important matters, sponsored regressive economic moves. Whether or not Xi has abandoned Deng Xiaoping's transformational policies—encapsulated by the phrase "reform and opening up"—he is on balance moving China's economy in an unproductive direction.

As Arthur Waldron of the University of Pennsylvania points out, the Chinese are often thought of as pragmatists but at this moment their leaders are not acting pragmatically. There are many reasons why this is so, but the most important of them relates to the nature of the Chinese system. As James Zimmerman, former chairman of the American Chamber of Commerce in China, points out, “Despite all of the reform and progress to date, China is still a command economy driven by a political agenda that seeks to first and foremost legitimize the party in power.”

Xi Jinping is trying to legitimize the Communist Party by attacking foreigners. The narrative is that they charge too much for their goods and services in the country, so Xi is using coercive tactics to make them reduce prices. It does not matter that their prices are high largely because of the Party’s abnormal economic system; Microsoft and others make perfect targets.

So political incentives are pushing Chinese officials to go after foreigners. In all likelihood, the seemingly unrelenting campaign is bound to intensify, if not in the months ahead then at least in the longer term. As Zimmerman suggests, the fault is in the nature of China’s one-party state, something that no Chinese leader is willing to change.

Foreign business has to be concerned that political turmoil will worsen in coming months. Although most analysts believe Xi Jinping consolidated power quickly, there are more and more signs of disunity in senior Party circles. For instance, the continual purges and loyalty oaths are indications of substantial resistance to his rule and dissension at the top. And Xi’s own words of being stalemated, reportedly uttered at a June 26 Politburo meeting, indicate continued trouble ahead. In this environment, it’s not entirely clear that Beijing is able to deal fairly with foreign companies operating on its own soil, whether in the anti-monopoly area or others of contention.

No country today can prosper for long by retreating from the globalized economy. Ultimately, China will be the biggest victim of its hostility to foreign business, but before then multinationals—and especially American ones—will be hurt.

Solutions

It’s clear, considering everything, that Xi will not stop the offensive against American multinationals until the costs that the U.S. government imposes on China exceeds the substantial benefits it derives from disadvantaging them.

Treasury Secretary Lew’s letter to Beijing warned that discriminatory treatment could have, in the words of the *Wall Street Journal*, “serious implications for relations between the two countries.” Those words are a step in the right direction, but they have to be backed up by action if Chinese authorities do not relent. Washington in the past has been loath to impose real costs on China, and Beijing surely senses that reluctance.

With China's growing reliance on exports, Washington has the leverage to stop Beijing in its tracks. For instance, last year the country's merchandise trade surplus against America was a record $318.7 billion, a stunning 122.7% of its overall merchandise surplus. We can find other locations to manufacture goods—a process that is already occurring—but Beijing cannot find other markets.

We can protect our companies by limiting China's access to our market through special tariffs and other mechanisms. The only question is whether the U.S. government has the will to do so.