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From: Macmanus, Joseph E
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From: McKellogg, Kelly E
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Subject: Remarks by Senator John Cornyn (R-TX) Subject: The China Challenge: Mixing Economics and Security Location: Heritage Foundation, Washington, D.C. Time: 9:09 a.m. EDT Date: Wednesday, June 29, 2011

All,
I'll send the Reuters email separately, but here is the transcript from the Heritage Foundation, with the excerpt on Taiwan pasted here:

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Well, like I said, it's 16 months overdue. I talked to Secretary Clinton yesterday because I had put a hold on a nominee, which is one of the rare points of leverage a senator has to try to get the attention of executive branch departments. And she tells me that it's now in the interagency review process and may take another three months or so before they're completed.

Well, we're keeping the conversation going. The administration has also failed to accept Taiwan's letter of request, as Dr. Holmes, I believe, mentioned earlier, for the purchase of new F-16s. That's not to say that they have to accept it, but -- or they have to actually sell them yet, but at least they should accept the letter of request.

UNOFFICIAL TRANSCRIPT, not for distribution outside the USG.

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(Applause.)

SENATOR JOHN CORNYN (R-TX): Well, Dr. Holmes, thank you very much. It's great to be back at Heritage. I feel very much at home with an organization that is pro-defense and pro-market. That describes my orientation precisely. And I wanted to say how good it is to be the beneficiary of the great work product produced by Heritage's scholars and leaders who have done so much to advance the cause of freedom.

The last time I was here at Heritage speaking at a program like this, we had the fewest numbers of Republican senators in the Senate since 1964. That was -- that would be 40. And that meant that there was nothing that we could do to stop the things that Nancy Pelosi and Harry Reid and President Barack Obama wanted to send from the White House.

Well, we watched in -- aghast, as we saw our country lurch in a direction that we -- and become something, frankly, we did not recognize and that I think most of Americans rebelled against -- certainly in the 2010 election, when we saw another big shift, with the rise of the Tea Party movement and other unaffiliated voters who got off the couch, went to town hall meetings, and indeed Tea Party meetings.

So today, our caucus in the Senate has 47 Republicans, and we're in a much stronger position. As one pundit put it, the voters issued a restraining order on the Obama legislative agenda. But still, there's the regulatory agencies which continue their overreach in so many areas, which continue to terrorize the job creators and entrepreneurs, exacerbating our high unemployment rates.

There's so many issues that remain to be resolved, and today we're here to talk about one of those, and that is the challenge of China. It's my job to talk about the link between our national debt and our national security. This is an interesting nexus between a major domestic policy issue, with our debt at \$14.3 trillion -- about 70 percent of our gross domestic product -- and a -- and a national security issue, as I will explain.

Of course, our national debt would be an issue even if it weren't a national security issue, as the chairman of the Joint Chiefs of Staff, Admiral Mullen, said. He said the debt is our single greatest threat to our national security. So if you think about the countries that depend on the United States and our ability to spend 4 (percent), 5 percent of our gross domestic product for national security, the debt and our economy -- were we unable to spend at that level, there would be not only a threat to the United States' national security, but also to the countries that depend on it. Secretary of State Hillary Clinton has said that the debt sends a message of weakness internationally.

The American people intuitively understand that we're spending too much money that we don't have, and that intuition would be exactly right. But the new numbers that come out every week confirm those worst fears. This last week, the Congressional Budget Office issued its long-term budget outlook, which projects that our national debt, as I indicated a moment ago, will reach roughly 70 percent of our gross domestic product -- 70 percent of our economy -- by the end of this year. That's up from 40 percent just three years ago -- from 40 (percent) to 70 percent of our gross domestic product in just three years. CBO called our nation's budget outlook daunting. I can think of other words to use, but that's a perfectly fine one: daunting. Among other things, I think you would have to agree, though, that CBO's analysts are the masters of understatement. It is a potential crisis in the making.

So every child that's born into America every day comes into this world not only living in the greatest country in the world, but also with about \$46,000 in bills, in debt that they owe for their share, their per capita share of the national debt, \$46,000. And it's getting bigger. As Washington continues to spend about 43 cents out of every dollar in borrowed money, that raises our national deficit -- that being our annual shortfall between how much money we bring in and how much money we spend. That would be around \$1.5 trillion just this year. That's about 10 percent of our entire economy.

The astonishing thing to me, really, is that none of these numbers, including the very commission that the president of the United States appointed, the Simpson-Bowles commission, with the, I would say, daunting, to use the words of the CBO's -- report called "The Moment of Truth" -- none of those have seemed to change the world view of the president and the leaders of his party.

We see that the president in his proposed budget wants even more spending. And they call that, in Washington-speak that George Orwell would love -- they call that investment to support nation-building here at home. And they want higher taxes, which are euphemistically referred to as mere revenue, as if that were somehow something different.

And really, the most irresponsible thing of all is that it's been about two years now since our Democratic friends, who have been in control of both houses of Congress -- it's been two years since they've actually proposed a budget. Senator Harry Reid, the Senate majority leader, said it was -- it would not be wise for Democrats to propose a budget because then they would have to vote on amendments that would be inconvenient for them, leading up to the 2012 election.

Well, this is not acceptable conduct from people who have sworn to uphold and defend the Constitution and laws of the United States, and to represent our constituents in a responsible manner.

We don't control the Senate, obviously, as I mentioned a moment ago, but we do have some leverage. And today, one of the things we're going to do, as Dr. Holmes mentioned, we will be rolling out the balanced-budget amendment to the Constitution that's co-sponsored by all 47 Republicans in the Republican Conference.

This is a -- reflects a compromise between a proposal that Senator Hatch and I made, and one that was introduced by Senator Mike Lee, but all of us are on the same page, and that's a good thing. And you know, it is kind of sad in a way that we are having to make this proposal, this common-sense proposal, when Washington is the only entity, really, I can think of that doesn't have a balanced-budget requirement. We each do, as individuals in our home. If you're a small business, you can't spend more money than you have, continuously run up the kind of unsustainable debt that the federal government has; nor can you print the money; nor do you have a Federal Reserve that can initiate a QE2 and buy debt to try to keep interest rates at historic lows.

So we all, more or less, have to deal with spending what comes in the front door -- no more than what comes in the front door -- unless, of course, you're the United States government. But a balanced-budget amendment would change all that. Just to give you some context, in 1997, when the balanced-budget amendment passed the House of Representatives and lost by one vote in the Senate, the national debt was about \$5 trillion. Today, it's \$14.3 trillion. The deficit, as I mentioned, today is roughly \$1 1/2 trillion; then it was \$107 billion. So if the -- if the balanced-budget amendment was a pretty compelling thing back in 1997 and lost by one vote in the Senate, how much more compelling is it today?

Well, I think this is important because it would permanently change Washington's behavior, no matter who's in charge, Republicans or Democrats, and it would permanently reduce our vulnerability and exposure to foreign creditors like China.

Well, just as our national debt is a huge challenge regardless of the Chinese connection, we know that China represents a challenge to our country above and beyond its investment in our debt. Many of China's neighbors remain concerned about its military build-up and its territorial ambitions. China's official press agency reported in March that the People's Republic of China will increase its military budget this year by more than 12 percent. That's an increase of last year of 7 1/2 percent. But the facts of the matter are that the official estimates are wrong. The Chinese repeatedly underestimate the extent of their defense spending. The Pentagon estimates the Chinese budget -- official budget of some \$90 billion is far less than the \$150 billion that they will actually spend. So it's off by \$60 billion, the Pentagon estimates.

Now, who does China intend to intimidate by this growing military power? Well, the list is growing. Last year, the Chinese claimed the South China Sea as a core interest that unsettled their neighbors in Vietnam, the Philippines, Indonesia and a lot of other nations.

China renewed a long-running dispute with India over the borders of the Arunachal Pradesh region. China continues to be an enabler, as we know, of the regime in North Korea. And earlier this month, Google publicly reported that a Chinese entity had been targeting the personal email accounts of U.S. and South Korean government employees.

And Pakistan's defense minister publicly discussed the possibility of China building a naval base at Gwadar, Pakistan, which is already home to a new, strategically important port at the gulf -- at the mouth of the Gulf of Oman.

Yet the activity that draws the most attention to China is its ownership of huge percentage of our national debt. The Treasury Department reports that a few weeks ago -- reported a few weeks ago that China now owns about \$1.1 trillion of our -- of U.S. securities, which makes it the largest single holder of our publicly held debt.

In fact, China holds more than a third of all the foreign holdings of U.S. publicly held debt. Some folks say, no cause for alarm, nothing to look at here, just keep walking. Still, it's clear that many voices in China want the United States to be nervous about what it might do with its investment portfolio. Last year, for example, a retired Chinese general publicly suggested that dumping U.S. bonds could be one way that China could retaliate for policies that the Chinese government didn't like.

Some of this talk from Chinese officials has already influenced our national security policy. During the development of the 2010 Quadrennial Defense Review is one example. According to one report within the Pentagon, Obama administration officials, quote, deleted several passages and softened others about Chinese -- China's military build-up, close quote.

They did this to avoid, in the words of the QDR -- words in the QDR that, quote, might upset Chinese officials at a time when the United States and China are economically intertwined.

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Well, we're keeping the conversation going. The administration has also failed to accept Taiwan's letter of request, as Dr. Holmes, I believe, mentioned earlier, for the purchase of new F-16s. That's not to say that they have to accept it, but -- or they have to actually sell them yet, but at least they should accept the letter of request.

So these were another couple of ways where you can see that China has in some ways intimidated U.S. defense policy and foreign policy because of concerns about irritating the Chinese.

And then we know China continues to be on the march economically. There's a story in the New York Times today, "China Opens Oil Field in Iraq." So the Chinese are reaping the benefits of Iraq's relative stability, courtesy of the U.S. of A.

Question is, do the Chinese actually have leverage over the United States through their investments in our debt or do they just want us to think that they do? Either way, I believe we need greater transparency on which foreign -- on which foreign investors are holding our debt. I mentioned the Treasury Department estimates of \$1.1 trillion of those securities, but those are just estimates.

The Chinese don't exactly tell us what their holdings are, and they frequently purchase that debt through intermediaries in order to mask the facts.

Simon Johnson, who's a former chief economist for the International Monetary Fund, testified last year that U.S. Treasury data underestimates Chinese holdings of U.S. government debt and do not reveal the ultimate country of ownership when debt instruments are held through an intermediary in another jurisdiction.

For example, he said that a great deal of the U.S. -- the United Kingdom's increase in United States Treasury securities may be due to China placing offshore dollars in London-based banks, which are then used to purchase U.S. Treasury securities.

Or consider the Cayman Islands, which has a population of only 55,000 people but which the Treasury Department said last year holds more than \$730 billion in U.S. securities.

Well, I think we need to do a whole lot better in getting accurate information for Congress and for the American people. And that's why Senator Kyl and I have introduced -- have -- actually, we've reintroduced the Foreign-Held Debt Transparency and Threat Assessment Act of 2011.

This bill requires the president to provide the Congress with quarterly risk assessments, both classified and unclassified, on the national security and economic hazards posed by the current levels of foreign holdings of U.S. government debt instruments.

Our bill instructs the General Accounting Office to provide Congress with an annual risk assessment on national security and the economic hazards posed by our national debt, as well as recommendations for reducing federal spending.

The bill requires the president at the -- in the event that any heightened risks are found to exist, to address those risks and to implement a plan of action to reduce federal spending.

Several people in this room have had feedback on this legislation, and we're grateful for that: Derek Scissors, Walter Lohman and Dean Cheng. And while Secretary Geithner expressed concerns about the bill in the Finance Committee, it nevertheless passed the Senate last June in an amendment to the unemployment compensation bill. But unfortunately, it got stalled in the House.

So Senator Kyl and I have reintroduced it, and the bill is now -- enjoys a companion House bill. And we're hopeful we can get this on the president's desk soon. It just seems like common sense to me, but as we've all heard, common sense is not all that common, sometimes, in the nation's capital.

Let me leave you with a quote from another member of the United States Senate, but this is back in 2006. This senator said, increasing America's debt weakens us domestically and internationally. He also said, it's a sign that we now depend on ongoing assistance from foreign countries to finance our government's reckless fiscal policies.

Well, you may have guessed who that senator was back in 2006. His name was Senator Barack Obama back then, now known as the president of the United States. Five years ago, when he spoke those words, our public debt was just under 5 trillion (dollars), compared to what it is today. Our public debt as a share of GDP at that time was just 36 percent, which means it will have nearly doubled by the end of this year.

Back then, China's holdings were roughly 319 billion (dollars), or less than a third of what they are today. And China wasn't even our biggest foreign creditor back then. They were a distant second, behind Japan.

I quote the president's words as a senator not just to point out the hypocrisy between his call for leadership then and his lack of leadership now. I quote him because the challenge has grown dramatically over the last five years, and so has our imperative for action.

So thank all of -- thank you for coming this morning and thank you for inviting me. I'd be glad, as time permits, Dr. Holmes, to answer or dodge a few questions. Thank you. (Laughter, applause.)

KIM R. HOLMES (vice president, Foreign and Defense Policy Studies, The Heritage Foundation): OK. I think we have time for maybe just one question, but perhaps more. We'll see. Who would like to start? OK, we have a microphone. And please identify yourself when you ask a question.

Q: Yeah, Chao Chen (ph) -- (inaudible). Thank you for your coming.

SEN. CORNYN: Thank you.

Q: If I may, I would like to ask you a couple question. You talk about nation or economy security risk assessment. And I think that's very important, because many national action and policy depend on it. Will that assessment be semi-annual or annual?

And second is, you talk about balanced budgets proposal. Budget study is very important, and that's -- (inaudible) -- to have a nation live within its means. What's a key element in the proposal?

x x proposal. And your committee will someday to have a national budget on time?

Thank you.

SEN. CORNYN: The risk assessment, I think, should be an annual one. And the balanced budget amendment that we, all 47 Republicans, have cosponsored, and that we will vote on sometime during the week of July the 18th, according to Senator Mitch McConnell, and the House also plans to vote on a balanced budget amendment -- our balanced budget amendment restricts us to no more spending than 18 percent of the gross domestic product. Today it's about -- we're spending about 25 percent of our GDP.

It does provide a relief valve, not easy to reach, but in the event of a national emergency, roughly -- I think it's two-thirds vote to override that on any given basis. But the idea is simply to start the process of bending the spending curve.

But as you know, it requires ratification. If it passes the House and the Senate by two-thirds vote, it has to be ratified by seventy -- by 38 states, and it is going to take a few years. So in the meantime, there have been a number of good proposals, one of which was -- is Senator Bob Corker's proposal -- he calls it the CAP Act -- which would begin the process of bending the spending curve to getting us down to a point that when the balanced budget amendment kicks in, we can realistically, and without a convulsive shock to our economy, meet that balanced budget requirement.

But I would say the first step has got to be the negotiations over the debt limit, that are going on right now. I'm very pleased that finally, after ignoring his own fiscal commission report that came down in December, the Bowles-Simpson -- Bowles report in December, called The Moment of Truth, and in his -- both at his budget and in his State of the Union speech, the president is finally at the table, because he's the only person who can cut the deal.

And as you know the balanced budget -- excuse me, the debt ceiling increase is a very unpopular idea. But the reality is that we are -- as I said, we're spending 43 cents out of every dollar that we don't have, and if we were to go immediately to a balanced budget -- that's spending 43 cents less than we do now -- you can imagine the shock to our economy. So I think what we need to do is get a significant down payment on that in this balanced budget amendment and then also listen to the president's own Cabinet members, who sit on the Medicare trustees, who said that Medicare is going to be insolvent in 2024, and to get that on a path to greater solvency. So a lot of challenges we have.

And Dr. Holmes, I, again, appreciate your allowing me to come, and Heritage, for all the great work you do. And I hope you'll have me back again soon.

MR. HOLMES: Yes, Senator. Thank you very much.

(Applause.)

END.

Kelly McKellogg
Bureau of East Asian and Pacific Affairs
Office of Public Affairs (EAP/P)
202-647-1028

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