

April 20, 2001: Commission Revisits China-Bond Issue with President Bush

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The U.S. Commission on International Religious Freedom announced today that it has written to President Bush to ask whether he agrees with its analysis that the President has the authority, under the International Religious Freedom Act, to bar U.S. financial institutions from purchasing Chinese government bonds. Last October, reports indicated the government of the People's Republic of China was planning to offer sovereign bonds in the total amount of \$1 billion on international markets, including possibly the U.S. market. After the Commission publicly wrote President Clinton regarding this matter, the Chinese government postponed the offering. However, the offering could be floated at any time. The Commission is considering recommending that the President bar any such offering until China makes substantial improvements in religious freedom and guarantees that no proceeds are used to support religious persecution. Following is the text of the letter and an attached background paper:

March 9, 2001 Dear Mr. President: I am writing on behalf of the U.S. Commission on International Religious Freedom to ask for your views on a matter of some urgency. According to press reports last October, the government of the People's Republic of China is planning to offer sovereign bonds in the total amount of \$1 billion on international markets, including possibly the U.S. market. After the Commission publicly wrote President Clinton regarding this matter, the PRC government postponed the offering. However, the offering could be floated at any time. The Commission is considering whether to recommend that you bar any such offering until China meets two conditions: (1) it makes substantial improvements in respect for religious freedom, and (2) it provides sufficient assurances to guarantee that the proceeds are never used to support religious persecution. Last week the State Department released its annual report on human rights, in which it stated that the Chinese "Government's poor human rights record worsened:". . . (T)housands of unregistered religious institutions had been either closed or destroyed, hundreds of Falun Gong leaders had been imprisoned, and thousands of Falun Gong practitioners remained in detention or were sentenced to reeducation-through-labor camps or incarcerated in mental institutions. . . . Controls on religious practice and freedom of expression also were intensified in Tibet and remained tight in Xinjiang. Consequently, President Clinton formally determined for the past two years that the government of China has been engaging in systematic, ongoing, and egregious violations of religious freedom within the meaning of the International Religious Freedom Act of 1998 (IRFA), 22 U.S.C. §§ 6401 et seq. Consequently, in the Commission's view, IRFA gives you power now to bar the purchase of China bonds by U.S. financial institutions such as underwriters, pension plans or mutual funds. Section 405(a)(14), read in conjunction with sections 401 and 402 of IRFA, authorizes you to prohibit "any United States financial institution from making loans or providing credits totaling more than \$10,000,000 in any 12-month period to the specific foreign government, agency, instrumentality, or official" determined to be responsible for such violations. 22 U.S.C. § 6445(a)(14). The Commission, however, wishes to have the benefit of your thoughts before it makes a final decision. We therefore respectfully ask (1) whether you agree that IRFA vests your office with power to bar U.S. financial institutions from purchasing China bonds and 2) if so, whether you would exercise that power so as to prevent China from offering bonds on the U.S. market until it meets the two conditions listed above. Attached is a background paper reflecting our thinking on this matter. President Clinton replied that he did not favor impeding the offering; but he did not address the first question (whether he agreed with our legal analysis that the President has such power). Mr. Clinton's reply is enclosed. Thank you very much for your time, attention and earliest reply. Respectfully yours, Elliott Abrams

Chairman Attachment: Background Paper BACKGROUND PAPER A. CHRONOLOGY

1. Fall 1999: Determinations by the Secretary of State under IRFA By a letter to Congress dated October 22, 1999, the Secretary of State on behalf of the President designated China, together with Burma, Iran, Iraq and Sudan, as "countries of particular concern" (CPCs) pursuant to section 402(b) of IRFA, 22 U.S.C. § 6442(b). The Secretary determined that the government of China, as well as the governments of those other countries, had engaged in or tolerated particularly severe violations of religious freedom. Specifically, she found that China had engaged in systematic, ongoing, egregious violations of religious freedom, including "arbitrary prolonged detention, imprisonment, 'reform through labor' and 'reeducation,' and even instances of torture." Memorandum of Justification, at 4 (attachment to letter of October 22, 1999). Despite that finding, the Secretary chose not to augment the sanctions that the United States had imposed almost a decade earlier in the wake of the Tiananmen Square massacre, even though IRFA provided ample authority to do so.

2. May 2000: Recommendations of the Commission under IRFA Six months later, in May of this year, the Commission issued its own recommendations on how the United States should respond to China's violations, focusing particularly on the trading relationship between the United States and China. The Commission recommended that the United States should grant Permanent Normal Trade Relations (PNTR) status to China only if and when China made substantial improvements in respect of religious freedom, as measured by some or all of the following indicators: Agreement by China to (1) establish a high-level and ongoing dialogue with the U.S. on religious-freedom issues, (2) ratify the International Covenant on Civil and Political Rights, and (3) permit unhindered access by the Commission and respected international human rights organizations to religious leaders in China, especially those leaders under arrest; A detailed accounting of the status and welfare of individuals whom the government has put under arrest for reasons of religion or belief; and Immediate release of all such persons. Report of the United States Commission on International Religious Freedom, May 1, 2000, at 40-48. The Commission explained that "[t]he government of China and the Communist Party of China ... discriminate, harass, incarcerate, and torture people on the basis of their religion and beliefs" and "unconditional grant of PNTR at this moment

may be taken as a signal of American indifference to religious freedom." *Id.*, at 40, 42. 3. Early September 2000: Annual Report on Religious Freedom In September of this year, the Department of State issued its Annual Report on International Religious Freedom 2000. In the summary for the section on China, the Department stated that: "During the beginning of the period covered by this report (the last 6 months of 1999), the Government's respect for religious freedom deteriorated markedly, especially for the Falun Gong and Tibetan Buddhists, and the Government's repression and abuses continued during the first 6 months of 2000. [Emphasis added.]" Thus, since the events that gave rise to the Secretary's October 1999 designation of China as a CPC, China's behavior worsened substantially and has continued at that worsened level since then. 4. September-October 2000: Reports of Imminent Offering of China Bonds In September and October, the press reported that the government of China may offer sovereign bonds in a total amount of \$1 billion in November, at least in part to U.S. investors. According to an October 17 report by Dow Jones Newswires, a spokesman for China's Ministry of Finance confirmed earlier that day that China is planning to offer such bonds, saying that the Ministry was actively trying to determine what timing would be best. When China offered sovereign bonds to U.S. investors in 1998 on a similar scale, it gave in the registration statement for that offering only a single sentence disclosing how it planned to use the proceeds, as follows: "[T]he net proceeds from the sale of the Securities will be used by China for general governmental purposes, including infrastructure projects. "Prospectus Supplement dated December 9, 1998, Registration Statement No. 333-9664 (emphasis added). For all an investor knows, China may have used some of the proceeds to support its efforts to suppress religious freedom. Likewise, it is possible that China used some of the money to buy crime control equipment from non-U.S. sources. At present, there are no U.S. laws that prevent the government of China from offering its debt securities on the U.S. market, nor any that require any more specific disclosure about the use of proceeds than a single sentence like that in the 1998 registration statement. 5. Late September 2000: CPC Designations and Selection of Remedies By a letter to Congress dated September 26, 2000, the Secretary recently re-designated China, as well as Burma, Iran, Iraq and Sudan, as CPCs. She determined that each of them is still engaging in systematic, ongoing, egregious violations of religious freedom, including torture, disappearances, or prolonged detentions. While she referenced the Annual Report 2000, she decided once again not to augment pre-existing sanctions, even though she had the power to do so and, in the case of China, had determined that persecution had increased "markedly." 6. October 2000: China's 10th Five-Year Plan The 15th Central Committee of the Communist Party of China met on October 9-11. According to a communiqué of the Central Committee which appeared in China's official press, the Committee examined and approved a preliminary outline of the core elements of China's 10th five-year plan (2001-2005), agreeing that economic "development is the overriding principle and the key to resolving all problems facing China." According to the communiqué, a core goal of the plan is to lay a foundation over the coming five years for doubling China's gross domestic product (GDP) within 10 years (2010). In giving an explanatory speech at the meeting, Premier Zhu Rongji emphasized the vital importance of both accession to the WTO and increased usage of foreign capital in the same breath. With respect to the latter, he stated: "The forms of foreign capital used should be more varied. In addition to existing forms, new forms such as purchasing, mergers, investment funds and securities investment should also be utilized to make use of medium- and long-term foreign investment." A recent edition of *Business Week* (No. 3704, October 23, 2000) reported that state-run Chinese companies have raised \$18 billion on exchanges outside of China so far this year and hope to raise an additional \$50 billion by 2003. Indeed, China Petroleum & Chemical Corporation (Sinopec) currently is offering equity shares on U.S. and other markets in hopes of raising approximately \$4 billion. PetroChina Company Limited garnered approximately \$2.3 billion on U.S. and other markets in April 2000. B. POLICY CONSIDERATIONS The Department of State deserves praise for its success in describing the status of religious freedom in its 1999 and 2000 annual reports and in giving religious freedom greater priority in its policy deliberations. However, the Secretary's response on September 26 of this year to the religious freedom violations of the Chinese government was disappointing, for it might be seen as evidence of American indifference to the increasingly severe religious persecution occurring in China. In the Commission's view, the prospect of a new offering by China of debt securities may provide an opportunity to let the government of China and those it is persecuting know that we as a nation do care and do regard the persecution as a gross violation of international law to which China is a signatory. Moreover, it is troubling that the proceeds of such an offering might end up supporting further religious persecution - for example, in the purchase of police supplies or surveillance equipment or payment of security force salaries. The sale of sovereign bonds is starkly different from the trading of goods or even the sale of debt or equity securities by a Chinese corporation. It results in the direct transfer of cash into the hands of the government, without any constraints on the use of that cash whatsoever. Also, the value of the sale to China lies not only in the cash received, but also in collateral benefits, most particularly: "benchmarking." That is, the sale provides empirical information about market conditions and helps to set the terms for and otherwise facilitate future offerings, not only by the government but also by Chinese corporations generally. Indeed, the sale may be serving in the mind of the Chinese government as the vanguard of a much larger post-PNTR campaign to raise capital for economic expansion and modernization. China's need for capital is massive, particularly as measured against its goal of doubling the GDP in ten years. Thus, the significance of the upcoming offering goes far beyond that of a single transaction. C. IMPLEMENTATIONS As shown by existing sanctions for other CPCs (e.g., Iranian Transactions Regulations, 31 CFR §§ 560.207, 560.316 & 560.317), the President has broad authority to prevent such offerings under the International Emergency Economic Powers Act, 50 U.S.C. §§ 1701 et seq. However, section 405(a)(14) of IRFA, 22 U.S.C. § 6445(a)(14), appears to be tailor-made for this purpose. It gives the President authority primarily on the strength of the Secretary's recent designation of China as a CPC to "[p]rohibit any United States financial institution from making

loans or providing credits totaling more than \$10,000,000 in any 12-month period to the specific foreign government"In the context of the sanctions regulations administered by Treasury's Office of Foreign Assets Control (OFAC), the term "United States financial institution" has commonly referred over the past decade to any U.S. person who is engaged in the business of providing financial services or making investments, including underwriters, pension plans and mutual funds. See, e.g., Kuwaiti Assets Control Regulations, 55 Fed. Reg. 49856 (November 30, 1990) (former 31 CFR § 570.320); E.O. 12817, § 5, 57 Fed. Reg. 48433 (October 21, 1992) (Iraq); Sudanese Sanctions Regulations, 63 Fed. Reg. 35809 (July 1, 1998) (definition then and now codified at 31 CFR § 538.316); and Foreign Narcotics Kingpin Sanctions Regulations, 65 Fed. Reg. 41334 (July 5, 2000) (definition to be codified at 31 CFR § 598.319). In addition, in the OFAC context, the terms "loan" and "credit" have long encompassed the purchase of debt securities. A definition to that effect has appeared in the Libyan Sanctions Regulations since 1986 and in the Iranian Transactions Regulations since 1995. See 51 Fed. Reg. 1354 (January 10, 1986) (31 CFR §§ 550.206 & 550.312); 60 Fed. Reg. 47061 (September 11, 1995) (31 CFR §§ 560.207, 560.316 & 560.317). Moreover, the language of section 405(a)(14) of IRFA is virtually identical to section 6(3) of the Iran and Libya Sanctions Act of 1996 (ILSA), 104 P.L. 172 (August 5, 1996) (50 U.S.C. § 1701 note). This fact is strong evidence that the drafters of IRFA, in using the terms "loan" and "credit" in section 405(a)(14), intended them to have the same meaning that they had in the context of the Libya and Iran sanctions regulations prior to the enactment of ILSA. Finally, it bears emphasis that section 410 of IRFA, 22 U.S.C. § 6450, explicitly states that "[n]o court shall have jurisdiction to review any Presidential determination or agency action under this Act or any amendment made by this Act."

Hon. Elliott Abrams, Chair

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