CHINA RISING:
ASSESSING CHINA’S ECONOMIC AND MILITARY POWER

An FPRI Conference Report
By Jacques Delisle

The Chinese Communist Party holds its Seventeenth National Congress this month. That congress and the session of China’s national legislature next March mark the midway point and the reconfirmation in power of the Hu Jintao-Wen Jiabao leadership and provide occasions for assessing China’s recent rise and its road ahead. In anticipation of these two congresses, FPRI convened a group of experts to consider the extent and implications of China’s rise as a military and economic power.

CHINA’S MILITARY CAPABILITIES AND GRAND STRATEGY

Jonathan Pollack (U.S. Naval War College), June Teufel Dreyer (University of Miami and FPRI) and Avery Goldstein (University of Pennsylvania and FPRI) assessed the significance of China’s growing military capacity, including what it indicates about PRC grand strategy and U.S.-China relations.

Pollack noted several schools of thought concerning the impact of China’s ascension. These range from pessimistic projections by those who see an ascendant China inevitably challenging the U.S., including the risk of military conflict; to more sanguine forecasts that see hope for less adversarial relations arising from shared economic interests, fear of the risks of strategic competition, and political leaders’ commitment to good relations.

Pollack argued that adversarial relations are not inevitable but are a substantial risk that surely will be influenced by defense planning processes in both states. Defense planning tends to be dominated by bureaucratic processes that focus on preparing for potential conflict, with little regard to how such preparations affect the potential adversary’s foreign policy calculations. In the 1950s-60s, American defense planning regarded China as the primary U.S. adversary in Asia, and it was the target of many mutual defense pacts in the region. Sino-American rapprochement in the 1970s and the United States’ realization of China’s military backwardness brought a reclassification of China as a tacit ally whose defense capability advancement served U.S. interests during the final decades of the Cold War. On the Chinese side, post-rapprochement energies were focused on economic development and reducing threats from its neighbors. Military modernization was a secondary goal for China, and U.S. military development was a peripheral concern, except for arms sales to Taiwan.

In the 1990s, the Tiananmen Incident suspended Washington’s willingness to pursue defense cooperation with China, reduced the perceived value of Sino-American cooperation, and opened the way to increased arms sales to Taiwan. The Soviet Union’s collapse also reoriented U.S. defense planning toward a scenario of “open-ended American predominance” in which no single country figured prominently. On the PRC side, the demise of military cooperation with the U.S led to a resumption of arms purchases from the Soviet Union/Russia, including missiles capable of reaching Taiwan, and to increased weapons sales to Pakistan. The U.S. success in 1991 in Iraq shocked PLA strategists into recognizing the severity of their technological deficiencies. Chinese defense planners began to conceive of national security in broader terms, including developing military capabilities beyond those needed to defend/deter an attack on the Chinese homeland or to address a crisis in the Taiwan Strait.

Taiwanese President Lee Teng-hui’s 1995 visit to the U.S. and its aftermath galvanized this reorientation. PRC defense planning increasingly emphasized scenarios of possible conflict with the U.S. over Taiwan. Aims included developing means to limit U.S. forward-deployed forces’ access to the region and to deter Taiwan from pursuing formal independence. China’s accelerating economic growth provided new resources for military modernization efforts. While top political leaders sought to defuse cross-Strait crises, the door had been opened to give defense planners on both sides greater latitude to plan for contingencies of conflict over Taiwan.
George W. Bush's presidency has not increased tensions in the U.S.-PRC security relationship, as many had feared. U.S. policymakers have worked to maintain good relations with Beijing, not least in order to secure cooperation on terrorism, North Korea and other issues. Chinese policymakers have pursued a “low volume” strategy in addressing differences with the U.S. and have worked to rebuild bilateral ties, including military-to-military relations. Nonetheless, Pollack argued, more adversarial relations remain a strong possibility, and defense planning processes are a principal source of that risk. China's Defense White Papers have tried to reassure other states that China remains preoccupied with domestic affairs and military modernization for defensive, non-threatening purposes, but such statements have failed to assuage U.S. concerns, given the limited transparency of Chinese military policy, doctrine and spending, and the PLA’s stated goals of greatly increasing force-projection capabilities.

China has similar reasons for concern about U.S. defense planning’s ostensibly non-threat-based, capability-based analyses, and defense assessments that clearly regard China as the principal potential military rival. Pollack concluded that the impact on U.S.-PRC relations of these defense planning patterns depends on broader mutual perceptions and strategic judgments that remain unsettled.

Pollack and Goldstein noted possible sources of crisis in China’s still undeveloped skills in interacting with U.S. and allied military craft, as evidenced by its submarine encroachments into Japanese waters and the collision of a PLA aircraft with a U.S. EP-3 reconnaissance plane in 2001; and inadequate central management of military activities, as seen in the anti-satellite weapon test of 2007, which may have come as a surprise to some of China’s top leaders. Goldstein commented that, while Pollack overstated the general significance of China’s opacity on defense issues, the anti-satellite weapon test was a case where lack of transparency mattered. Such surprises contribute to unhealthy oscillation between excessive pessimism and optimism in American assessments of Chinese intentions.

Dreyer argued that China has greatly expanded its military capacity despite not facing any major security threat and despite the large opportunity costs of allocating to the military resources that could be used to address serious domestic economic problems. Beijing admits double-digit growth in its defense budget, but the official figures underestimate true spending by not adjusting for purchasing power parity and excluding foreign weapons purchases, state subsidies to defense industries, funding for the People’s Armed Police and militia, and some defense-related construction and personnel expenses. These expenditures have brought important increases in capabilities useful in scenarios that include Taiwan, other territorial disputes, and blunting the effectiveness of potential U.S. intervention in the region.

As to the security implications of economic developments, Dreyer pointed to China’s mushrooming economic prowess and its economic importance to numerous states in Asia, Latin America, and Africa. The political leverage such economic relationships provide gives Beijing newfound power well beyond its immediate region. China’s expanding global economic ties also give it new and far-flung economic interests—most notably maintaining access to energy and raw materials—that Beijing also sees as security interests. Many of China’s economic relationships abroad are sources of conflict in relations with the U.S. and with China’s trade and investment partners in the developing world, where worries are rising about Chinese neocolonialism or displacement of local businesses.

PRC efforts to assuage concerns raised by its rise include asserting that it will pursue a “peaceful rise” or “peaceful development”; using soft power to promote a favorable image; arguing that its economic development is helpful to countries that cooperate; and seeking to advance its standing as a responsible global citizen by hosting the six-party talks on North Korea, participating in UN peacekeeping activities, and similar actions.

Nonetheless, Dreyer argued, there are reasons to believe that China’s grand strategy is less benign. She quoted Deng Xiaoping’s early 1990s call to “hide our capabilities and bide our time” and Jiang Zemin’s similar advice that China must “dance with the wolf,” i.e., temporarily pursue good relations with the ultimately adversarial U.S. and its allies. The opacity of China’s intentions, and the significant signs of aggressive intentions, means that U.S. policy must hope for the best but plan for the worst.

Goldstein argued that “threat assessment” requires more than examining China’s capacities and inferring malign intent. He cited four possible explanations for China’s pursuit of military modernization: (1) a quest for regional and perhaps global hegemony; (2) the unremarkable need to update an obsolete military; (3) the Chinese military’s political ability to secure a good share of the growing resources made available by China’s rapid economic growth and increasing tax revenue; and (4) leadership perceptions that China does face serious security challenges, including Taiwan and the attendant possibility of conflict with the U.S., territorial disputes with neighboring states, unrest in China’s west, potentially troubled relations with Japan, Russia, and India, and the need to protect China’s increasingly far-flung economic interests.

Goldstein added that China’s international economic activities offer mixed evidence about its broader aims. In some respects, Chinese investment has been beneficial in developing countries. China has become more cooperative in using its leverage with Sudan to address Darfur. More than preparing for the worst, Goldstein concluded, U.S. policy should seek to encourage better outcomes.

TAIWAN AND U.S.-PRC RELATIONS

Panelists identified several U.S. security interests in preventing China from using force or coercion to achieve “reunification” of Taiwan. John Tkacik and Harvey Feldman (both of the Heritage Foundation) emphasized that although plagued by
than its own submarines. McDevitt replied that greater Taiwanese offensive capabilities would be of little use in deterring a military conflict, especially over distance and to impede U.S. military access to the region.

McDevitt argued that the U.S. interest in Taiwan’s security is also part of a broader U.S. interest in responding to China’s rise as a military power. He inventoried China’s rapidly expanding defense spending, and the capacities that such expenditures are creating, including a blue-water navy, quiet submarines, more advanced fighter aircraft, and greatly expanded missile forces that encompass ICBMs, numerous short-range rockets targeting Taiwan, and anti-satellite weapons.

Tkacik contended that these resources are being developed to serve Beijing’s non-status quo agenda and to acquire abilities to project offensive force over distance and to impede U.S. military access to the region. McDevitt responded that the PRC is not yet a military rival or threat to the U.S. and that U.S.-PRC relations are in many respects normal. But the U.S. still has an important deterrent mission in the region. At least since Taiwan began in the early 1990s to abandon the one-China principle, PLA planning has had to focus on deterring Taiwan from full formal independence and, failing that, capturing Taiwan. The multiple U.S. interests in an autonomous and secure Taiwan and the broader U.S. interest in maintaining military access to East Asia require the U.S. to deter or prevent China from using force against Taiwan.

Panelists warned that Taiwan’s security is deteriorating in several respects. China’s military modernization has given it means to interfere with the U.S.’s ability to come to Taiwan’s rescue, as well as to overcome Taiwan’s capacity to deter or defend against a PRC attack. Feldman expressed concern that China might be able to force Taiwan into disadvantageous negotiations for reunification without firing a shot. He added that Taiwan’s deep economic integration with and dependence on China makes it vulnerable to Beijing’s non-status quo agenda and to acquire abilities to project offensive force over distance and to impede U.S. military access to the region.

Tkacik and Feldman emphasized political sources of weaknesses in Taiwan’s defense posture. These include a budgeting process that is in disarray in an era of divided government and opposition party leaders who differ publicly with President Chen Shui-bian and take a more accommodating line on security relations with China and a more sanguine view of the China threat. Also, Taiwan’s defense readiness is poor, and its defense apparatus penetrated by PRC agents.

Tkacik argued that the U.S. insistence that Taiwan adopt a purely defensive doctrine makes Taiwan’s defense prohibitively expensive. Taiwan must invest in costly anti-missile defenses rather than offensive missiles, and anti-submarine planes rather than its own submarines. McDevitt replied that greater Taiwanese offensive capabilities would be of little use in deterring a PRC attack. If Beijing chose to go to war over Taiwan, it would have decided that it is willing to incur costs that would dwarf any damage Taiwan could hope to inflict on mainland targets.

Nonetheless, the participants concluded, Taiwan’s situation is far from hopeless. McDevitt explained that hardening its military installations and focusing on maintaining air superiority over the Strait could enhance Taiwan’s ability to hold out until American help arrives. Another participant noted that Chen has achieved a political success by shifting the aims of Beijing’s policy from “pursuing reunification” to “preventing independence”–a stance reflected in China’s Anti-Secession Law. Finally, the U.S. commitment to preventing reunification by force remains robust, underpinned by the American security interest in the cross-Strait status quo. This includes maintaining U.S. military access to the Western Pacific and credible commitments to allies in the region. It also means resisting any Chinese effort to assert control over Taiwan that might well be the first in a series of demands to alter a regional and global status quo that largely serves U.S. national interests.

OIL AND SECURITY ISSUES

Erica Downs (Brookings Institution), Felix Chang (Booz Allen Hamilton) and Jacques deLisle assessed China’s energy security issues and its participation in international energy markets. Panelists concurred that these issues are primarily about oil. Downs noted that China has vast coal reserves that provide more than two-thirds of its energy needs. Coal will continue to be the principal source despite environmental concerns and even though China recently became a net importer of coal. Technological and other constraints mean that natural gas, coal liquefaction, nuclear power, and green energy sources will contribute relatively little to meet China’s burgeoning energy needs any time soon.

China, the world’s second-largest consumer of oil, already relies heavily on imports to meet more than half its demand. Even including offshore production, prospects are limited for expanding domestic production. Gasoline price-control policies and weak investment in public transportation in many cities add to the demand increases associated with rapid growth in energy-intensive industries. Accordingly, China’s oil imports are likely to grow well beyond current levels that already make China the world’s third-largest importer. China’s state-owned national oil companies (NOCs) have been increasing investments and...
attempting acquisitions abroad. Such efforts have brought sharp political responses (most notably in the U.S. to CNOOC’s bid to buy Unocal) and appear to drive aspects of Chinese foreign policy that the U.S. and others find disconcerting (such as deepening ties to states that the West regards as states of concern).

In the panelists’ assessment, much of the evidence about Chinese NOCs’ international conduct is consistent with firm-level economic motivations. Downs explained that NOCs seek overseas assets for reasons that include replacing depleted reserves, seeking profit, becoming internationally competitive, and competition among themselves. NOCs are not mere puppets of the state; they drive the decisions to invest in oil resources abroad, with state organs often playing only reactive roles. NOCs also have considerable influence in an energy policymaking process characterized by powerful firms but fragmented state institutions. DeLisle observed that NOCs engage in market-augmenting behavior by developing resources in countries where many Western companies will not invest for reasons of politics or risk; and NOCs insist that they play by market rules and receive financing on terms that are not as state-subsidized as critics suspect. Also, like other Chinese state-owned enterprises (SOEs), NOCs face increasing pressures to become market-regarding as they “go out” to compete in international markets, as foreign-invested joint ventures enter Chinese markets, and as NOC subsidiaries list on stock exchanges abroad.

Downs noted that a significant portion of NOCs’ foreign oil production is sold in nearby markets outside of China and that NOCs appear to have been unprepared for the political reaction abroad to their attempted acquisitions. Both of these phenomena fit with a view that NOCs are largely motivated by commercial concerns rather than by party-state policy agendas. Even the NOCs’ willingness to pay unusually high prices for assets abroad does not necessarily refute this interpretation. Panelists argued that possible “overpaying” may reflect NOCs’ inexperience in international markets, their over-reliance on foreign experts’ rosy depictions of investment opportunities, and their belief that most of the good assets already have been “locked up.” Also, finance and ownership patterns make a lower rate of return and higher risk acceptable, and a “lock-in” effect sometimes resulting from cumbersome project approval and financing processes can make it difficult to abandon one investment target for another.

On the other hand, energy and especially oil security are strategic issues for China. The overseas activity of NOCs also supports a more political explanation. Some NOC behavior abroad seems designed to win political influence with PRC state authorities. The PRC government has sought to limit direct competition among the NOCs, treating them to some extent as arms of a single, state-directed entity. The NOCs are also at the relatively unreformed end of the spectrum of contemporary Chinese enterprises. Financing for their international acquisitions remains opaque and possibly state-subsidized and state-directed, and major investments, particularly in Africa and Central Asia, are closely entwined with PRC diplomatic initiatives and aid packages.

While “ politicization” of Chinese activity in international oil trade and investment markets might be low now, deLisle argued that the potential for politicization remains high. Panelists agreed that the PRC regime—or at least significant elements therein—sees overseas acquisitions as “equity oil” supplies that China can direct to satisfying its needs even if market-responsive sales would lead to a different result. Panelists pointed to several indications that the Chinese regime is greatly concerned about energy insecurity, including the creation of an energy affairs “leading group” (something that is done only for issues of major national concern); the apparently growing importance of oil issues in relations with key oil-producing states; and the arguably market-inconsistent behavior of NOCs. This insecurity is fed by China’s current dependence on oil from the Middle East, which PRC policymakers see as unstable and under U.S. influence, and the unwelcoming reaction to attempted investments in Unocal in the U.S. and Slavneft in Russia.

China’s energy insecurity is creating friction in its relations with the U.S. and other Western powers. Those powers are troubled by China’s oil-driven strengthened relations with Sudan (which has resisted efforts to address the human rights crisis in Darfur), other repressive African states that receive Chinese aid and investment, Russia and Kazakhstan (both of which are members of the Shanghai Cooperation Organization, a group of mostly undemocratic states that threatens to reduce American influence in continental Asia), and Iran, which faces possible sanctions, or worse, over its nuclear programs. China’s pursuit of a blue-water navy, another point of tension in its external relations, is motivated partly by discomfort with potential U.S. control of sea lanes through which Middle Eastern oil flows to China.

Panelists agreed that some of China’s oil-related foreign policy actions were contrary to American interests, but cautioned against a zero-sum interpretation and confrontational response. Chang and Downs stressed that the NOCs’ activities expand global supplies and thus ameliorate the competition over supply and price pressures in international markets that China’s rising oil demand generates. Chang stressed the opportunities for the U.S. and others to encourage China to engage with the International Energy Agency, to integrate China as a partner in the broader global energy system, and to strengthen those within China who favor greater international engagement. Downs argued that the more promising U.S. approach lies not in condemning China’s ties to regimes like Sudan but in persuading Beijing to use its influence with those regimes.

ECONOMIC SUCCESSES, PROSPECTS AND IMPLICATIONS

Albert Keidel (Carnegie Endowment for International Peace) assessed China’s rapid economic growth during the post-Mao Reform Era and especially during the decade and half since Deng Xiaoping’s “southern tour” signaled reinvigoration of reform efforts. Keidel argued that China’s current stage of development and trajectory appear analogous to those of South Korea in the middle 1970s or Japan in the early 1950s. He noted the rapid structural transformation of the Chinese economy during the reform era and the many wrenching reforms implemented in a relatively short period, including: decollectivization...
of the rural economy, partial privatization and extensive marketization of the urban economy, urbanization of the population, modernization of the state’s revenue system, and vast construction of infrastructure. Equally striking is China’s engagement and integration into the international economy—specifically, its embrace of trade and inbound foreign investment, which has surpassed Japan’s and South Korea’s at similar stages in their development. Keidel’s positive assessment extended to the current decade: China’s extremely high growth rate has continued as policy corrections overcame the slowdown induced by policy errors in the later 1990s and the risk of overheating caused by excessive liquidity expansion in the early years of this decade.

Keidel attributed China’s extraordinary economic success primarily to solid domestic foundations: a government committed to economic development and capable of implementing bold policies; a high level of investment, and especially public investment in physical infrastructure and human capital; a financial system that mobilizes savings for investment in infrastructure; conversion of SOEs into profit-oriented firms that make economically sensible choices; and a self-confidence that China will succeed and regain some of the international stature it had enjoyed at the peak of its great dynasties. Thomas Rawski (University of Pittsburgh) agreed that a key to the PRC’s economic success is that Chinese leaders, including those sometimes regarded as “conservative,” have been successful in undertaking impressively bold reforms during the last three decades. Xiaobo Hu (Clemson University) emphasized the regime’s non-disruptive transformation from a state-owned economy to a largely privatized one led by a new economic elite.

Participants disagreed about the importance of China’s engagement with the international economy. In Keidel’s account, perhaps the most important economic impact of the outside world is that it has provided technology and models of economic development and regulation that China could implement in the service of rapid growth. Exports to foreign markets, especially U.S. markets, have played a relatively modest role in China’s growth. In Rawski’s analysis, China’s international economic opening has played a far greater, and still-growing, role. China’s participation in international product and capital markets has contributed greatly to improvements in the technology and productivity of Chinese firms. Chinese acquisitions of foreign companies and inbound foreign investment in R&D and other sectors will play an increasing role in bringing management skills and technological sophistication to China’s economy. Overseas markets are becoming more important not just as destinations for PRC exports, but also as sources of the managerial know-how and raw materials needed to run China’s expanding economy.

As to threats to China’s continued economic success, Keidel noted risks that the leadership could make poor policy choices in key areas such as overly rapid privatization of financial institutions, largely due to external pressure to open the sector more fully to foreign ownership; too-hasty liberalization of interest rates, which could limit funds available for infrastructure projects; or insufficient diversification of agriculture away from grain production, primarily for fear of peasant unrest or the consequences of dependence on grain-exporting states.

Participants cited dangers stemming from structural weaknesses in the Chinese party-state. Keidel emphasized the center’s limited ability to control the behavior of local officials, the lack of a clear allocation of authority between central and local governments, and weaknesses in the statistics collection system necessary for economic policymaking. All panelists concurred that corruption was a significant threat to the regime’s legitimacy. Hu added that China faces distinctive challenges in addressing this problem because China’s path to privatization has created a richest stratum of entrepreneurs who are overwhelmingly relatives of senior party and government officials.

China’s leadership faces significant challenges in coping with the consequences of reform and rapid development. Hu suggested that China’s increasingly unequal wealth distribution is a threat, particularly given perceptions that much wealth has come through corruption or connections and because much of China’s inequality comes from an urban-rural gap that has broadened through the expropriation of peasant property rights. Keidel generally shared Hu’s concern about the risks the regime faces if it fails in handling the conflicts that arise from dislocations associated with moving land from agriculture to more productive uses or from older residential to higher value urban uses—especially where inadequate compensation and unclear rules characterize the process. Keidel also noted that despite some improvements, discontent over unpaid wages and the regime’s low tolerance for autonomous union activity still threaten unrest in the state-owned sector.

Keidel and Rawski saw China’s rising wealth gap as less cause for concern, arguing that inequality (as measured by the Gini coefficient) typically increases during the transition to an urban economy and then falls again. The key to poverty alleviation in China is urbanization, they said, which is likely to continue, bringing additional growth to the largest and most affluent coastal cities. Such migration also will help ameliorate the inter-regional income gap.

Another challenge is an aging population in a still relatively poor country. China’s relatively restrictive population policies in recent decades portend a rising ratio of retirees to workers in the next 10-20 years. The 1990s “three-pillar” system of individual savings, employer contributions, and guaranteed pension benefits will be severely inadequate. Workers’ recognition of this is leading to higher savings rates. This undermines policies, adopted under foreign pressure, to increase present consumption. Ultimately, the regime may have to adopt difficult fiscal measures to cover older citizens’ needs.

Rawski described China’s financial system and infrastructure investment as threats to continued economic success. He pointed to former Premier Zhu Rongji’s bleak assessment of progress in financial and investment system reform; current policymakers’ conclusion that the state must sell significant ownership stakes in financial institutions to accelerate reform and protect the economy from the dangers posed by inadequately reformed financial institutions; and signs that low interest rates
and inappropriate selection of investment projects have led to inefficient capital allocation and suboptimal job creation. Keidel concurred that China’s market-based, commercial banking system remains immature, with little ability to allocate credit on the basis of risk, but maintained that other aspects of China’s financial system were sounder than Rawski described.

Environmental challenges are often cited as imperiling China’s continued growth, but Keidel and Rawski held that, while the clean-up cost will be large and progress slow, China’s rapid growth also has produced resources and government revenues adequate to address the problems. Rawski argued that China’s air pollution is no worse than what Britain, the U.S., Japan, or Korea faced at analogous phases in their industrialization. Moreover, the Chinese regime is under intense foreign and domestic pressure to address pollution, which already is declining per unit of GDP.

Water is a more serious problem. High pollution levels and supply shortages, especially in north China, pose major challenges. Solutions will be difficult and costly: increasing environmental protection authorities’ resources and autonomy; raising the price of water, or issuing administrative orders to restrict agricultural uses, which would necessitate resettlement and job-creation for displaced farmers. Less foreseeable factors that might derail China’s economic rise include pandemics, natural disasters, or military conflicts.

Finally, Keidel assessed the implications of China’s economic rise for U.S.-China security relations. He emphasized that, per capita, China will long remain far poorer than the U.S., which limits the resources it can devote to building military capability. Current Chinese military expenditures trail those of the U.S., and a larger portion of them go to personnel expenses. Other factors that cut strongly in the favor of the U.S. include accumulated military hardware, the level of military technology, and basing rights and other foundations for effective force projection. Also, economic development and international integration may affect China’s intentions and interests. (The PRC’s recent move to invest some of its vast foreign exchange reserves in international capital markets is one example of China’s growing stake in being a responsible participant in international systems.) This would reduce the likelihood of Beijing’s using its military capabilities in ways that threaten U.S. interests and provoke responses harmful to China’s interests.

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