UNITED STATES-CHINA ECONOMIC RELATIONS AND CHINA'S ROLE IN THE WORLD ECONOMY

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

FIRST SESSION

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COMMITTEE ON WAYS AND MEANS

BILL THOMAS, California, *Chairman*

Pursuant to clause 2(e)(4) of Rule XI of the Rules of the House, public hearing records of the Committee on Ways and Means are also published in electronic form. **The printed hearing record remains the official version.** Because electronic submissions are used to prepare both printed and electronic versions of the hearing record, the process of converting between various electronic formats may introduce unintentional errors or omissions. Such occurrences are inherent in the current publication process and should diminish as the process is further refined.

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UNITED STATES-CHINA ECONOMIC RELATIONS AND CHINA'S ROLE IN THE WORLD ECONOMY

THURSDAY, APRIL 14, 2005

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

The Committee met, pursuant to notice, at 11:03 a.m., in Room 1100, Longworth House Office Building, Hon. William M. Thomas (Chairman of the Committee) presiding.

[The advisory and revised advisory announcing the hearing follow:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE
April 01, 2005
FC–6

CONTACT: 202–225–1721

Thomas Announces Hearing on United States-China Economic Relations and China's Role in the World Economy

Congressman Bill Thomas (R–CA), Chairman of the Committee on Ways and Means, today announced that the Committee will hold two trade-related hearings in April: **1. United States-China Economic Relations and China's Role in the World Economy, and 2. Implementation of the Dominican Republic-Central America Free Trade Agreement (DR–CAFTA).**

1. UNITED STATES-CHINA ECONOMIC RELATIONS AND CHINA'S ROLE IN THE WORLD ECONOMY

The hearing on United States-China economic relations and China's role in the world economy will take place on Thursday, April 14, 2005, in the main Committee hearing room, 1100 Longworth House Office Building beginning at 10:00 a.m. Oral testimony at this hearing will be from both invited and public witnesses. Any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee or for inclusion in the printed record of the hearing.

BACKGROUND ON CHINA HEARING:

Since the United States and China established diplomatic relations in 1979, China has become an increasingly important trading partner of the United States and a major player in the global economy. Two-way trade between the two countries has increased since that time, growing from $4.8 billion in 1980 to $231.42 billion in 2004. In 2004, China was the United States' third largest trading partner, the second largest supplier of U.S. imports, and the fifth largest buyer of U.S. exports. The U.S. trade deficit with China was $162 billion in 2004. Ten percent of all U.S. trade is with China.

Reflecting its growing role in the world economy, China became a member of the World Trade Organization (WTO) on December 11, 2001, after many years of negotiations on its accession. Since its accession to the WTO, China's integration into the world economy has proceeded rapidly. As a result, Congress, the Administration, and the U.S. private sector have focused on China's compliance with its WTO commitments, its trade balance, the relationship between China's pegged currency and trade with the United States, and other macroeconomic policies.

The goal of this hearing is to discuss China's importance as an economic partner to the United States and the issues surrounding the United States-China economic relationship. In announcing the hearing, Chairman Thomas stated, "China is an important player in the U.S. and global economies. We have been able to resolve many disputes, but we face more challenges to ensure that China integrates itself into the rules-based trading system that governs all WTO members. During this hearing, we will focus on China's important economic role in the world, its progress in meeting its trade commitments, and its macroeconomic policies."

FOCUS OF THE CHINA HEARING:

The hearing will focus on United States-China economic relations and China's role in the world economy, with a narrower focus on the following: (1) China's progress and U.S. response in the implementation of China's WTO accession commitments (including issues relating to China's enforcement of intellectual property rights, use of subsidies, and the use of non-tariff barriers such as standards and import licensing that affect imports); (2) trade relations between the United States and China; (3) China's currency management and other macroeconomic issues; and (4) the relationship between trade with China and the U.S. economy, particularly the manufacturing sector.

DETAILS FOR SUBMISSIONS OF REQUESTS TO BE HEARD AT THE CHINA HEARING:

Requests to be heard at the hearing must be made by telephone to Michael Morrow or Kevin Herms at (202) 225–1721 no later than the close of business Tuesday, April 5, 2005. The telephone request should be followed by a formal written request faxed to Allison Giles, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515, at (202) 225–2610. The staff of the Committee will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Committee staff at (202) 225–1721.

In view of the limited time available to hear witnesses, the Committee may not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing in lieu of a personal appearance. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are required to summarize briefly their written statements in no more than five minutes. **THE FIVE–MINUTE RULE WILL BE STRICTLY ENFORCED. The full written statement of each witness will be included in the printed record, in accordance with House Rules.**

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Committee are required to submit 300 copies, along with an *IBM compatible 3.5-inch diskette in WordPerfect or MS Word format*, of their prepared statement for review by Members prior to the hearing. **Testimony should arrive at the full Committee office, 1102 Longworth House Office Building, no later than close of business on Monday, April 11, 2005.** The 300 copies can be delivered to the Committee staff in one of two ways: (1) Government agency employees can deliver their copies to 1102 Longworth House Office Building in an open and searchable box, but must carry with them their respective government issued identification to show the U.S. Capitol Police, or (2) for non-government officials, the copies must be sent to the new Congressional Courier Acceptance Site at the location of 2nd and D Streets, N.E., **at least 48 hours prior to the hearing date. Please ensure that you have the address of the Committee, 1102 Longworth House Office Building, on your package, and contact the staff of the Committee at (202) 225–1721 of its impending arrival.** *Due to new House mailing procedures, please avoid using mail couriers such as the U.S. Postal Service, UPS, and FedEx.* When a couriered item arrives at this facility, it will be opened, screened, and then delivered to the Committee office, within one of the following two time frames: (1) expected or confirmed deliveries will be delivered in approximately 2 to 3 hours, and (2) unexpected items, or items not approved by the Committee office, will be delivered the morning of the next business day. The U.S. Capitol Police will refuse all non-governmental courier deliveries to all House Office Buildings.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE AT THE CHINA HEARING:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "*109th Congress*" from the menu entitled, "*Hearing Archives*" (*http://waysandmeans.house.gov/Hearings.asp?congress=17*). Select the hearing for which you would like to submit, and click on the link entitled, "*Click here to provide a submission for the record*." Once you have followed the online instructions, completing all informational forms and clicking "submit" on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You ***MUST REPLY*** to the email and ***ATTACH*** your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business Thursday, April 28, 2005. **Finally**, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. Those filing written statements who wish to have their statements distributed to the press and interested public at the hearing can follow the same procedure listed above for those who are testifying and making an oral presentation. For questions, or if you encounter technical problems, please call (202) 225–1721.

2. IMPLEMENTATION OF THE DOMINICAN REPUBLIC–CENTRAL AMERICA FREE TRADE AGREEMENT

The hearing on implementation of the DR–CAFTA will take place on Thursday, April 21, 2005, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m. Oral testimony at this hearing will be from both invited and public witnesses. Invited witnesses will include Ambassador Peter F. Allgeier, Acting United States Trade Representative. Any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND ON DR–CAFTA HEARING:

On October 1, 2002, the President formally notified Congress that he would pursue a Free Trade Agreement (FTA) with Central America. Negotiations began in January 2003. Following nine rounds of negotiations, agreement was reached with El Salvador, Guatemala, Honduras, and Nicaragua on December 17, 2003, and with Costa Rica on January 25, 2004. Negotiations to include the Dominican Republic in CAFTA began in January 2004 and concluded on March 15, 2004. On May 28, 2004, Ambassador Robert Zoellick and ministers of five Central American countries signed the CAFTA. On August 5, 2004, Ambassador Zoellick, the Dominican Republic's Secretary for Industry and Commerce Sonia Guzman, and representatives of five Central American nations signed the DR–CAFTA.

The DR–CAFTA would immediately eliminate tariffs on more than 80 percent of U.S. exports of consumer and industrial products, phasing out the rest over 10 years, thereby opening DR–CAFTA's markets to U.S. goods, services, and farm products and leveling the playing field for U.S. workers and farmers. Because the Central American countries already enjoy duty free access to the United States for over 75 percent of their exports, the agreement is estimated by the International Trade Commission (ITC) to have minimal effect on imports to the United States. At the same time, U.S. agricultural exports to the Dominican Republic-Central American region are estimated to increase by nearly $900 million under the agreement. The ITC found that manufacturers would also benefit through increased exports, especially in sectors such as fabric and yarn, information technology products, agricultural and construction equipment, paper products, pharmaceuticals and medical and scientific equipment. The agreement includes a negative list for services with very few reservations. All agricultural and industrial products are covered by the agreement. The agreement also contains strong protections for U.S. investors.

The United States and the DR–CAFTA region had two-way trade of $33.4 billion in 2004. The DR–CAFTA countries combined make up the 2nd-largest U.S. market in Latin America, behind only Mexico. The United States exports more than $15 billion annually to the region, making it America's 13th-largest export market worldwide.

In announcing the hearing, Chairman Thomas stated, "I am very pleased not only about the potential commercial opportunities for our countries but also about the stability and development that the DR–CAFTA agreement brings to the region. This agreement will cement many of the democratic, legal, and economic reforms that these countries have struggled with in recent years, and it will do so while providing expansive trade opportunities for U.S. goods and services immediately. I look forward to moving this agreement quickly."

FOCUS OF THE DR–CAFTA HEARING:

The hearing will examine the DR–CAFTA and the benefits that the agreement will bring to American businesses, farmers, workers, consumers, and the U.S. economy.

DETAILS FOR SUBMISSIONS OF REQUESTS TO BE HEARD AT THE DR–CAFTA HEARING:

Requests to be heard at the hearing must be made by telephone to Michael Morrow or Kevin Herms at (202) 225–1721 no later than the close of business Tuesday, April 12, 2005. The telephone request should be followed by a formal written request faxed to Allison Giles, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515, at (202) 225–2610. The staff of the Committee will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Committee staff at (202) 225–1721.

In view of the limited time available to hear witnesses, the Committee may not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing in lieu of a personal appearance. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are required to summarize briefly their written statements in no more than five minutes. **THE FIVE–MINUTE RULE WILL BE STRICTLY ENFORCED. The full written statement of each witness will be included in the printed record, in accordance with House Rules.**

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Committee are required to submit 300 copies, along with an *IBM compatible 3.5-inch diskette in WordPerfect or MS Word format*, of their prepared statement for review by Members prior to the hearing. **Testimony should arrive at the full Committee office, 1102 Longworth House Office Building, no later than close of business on Monday, April 18, 2005.** The 300 copies can be delivered to the Committee staff in one of two ways: (1) Government agency employees can deliver their copies to 1102 Longworth House Office Building in an open and searchable box, but must carry with them their respective government issued identification to show the U.S. Capitol Police, or (2) for non-government officials, the copies must be sent to the new Congressional Courier Acceptance Site at the location of 2nd and D Streets, N.E., **at least 48 hours prior to the hearing date. Please ensure that you have the address of the Committee, 1102 Longworth House Office Building, on your package, and contact the staff of the Committee at (202) 225–1721 of its impending arrival.** *Due to new House mailing procedures, please avoid using mail couriers such as the U.S. Postal Service, UPS, and FedEx.* When a couriered item arrives at this facility, it will be opened, screened, and then delivered to the Committee office, within one of the following two time frames: (1) expected or confirmed deliveries will be delivered in approximately 2 to 3 hours, and (2) unexpected items, or items not approved by the Committee office, will be delivered the morning of the next business day. The U.S. Capitol Police will refuse all non-governmental courier deliveries to all House Office Buildings.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE AT THE DR–CAFTA HEARING:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "*109th Congress*" from the menu entitled, "*Hearing Archives*" (*http://waysandmeans.house.gov/Hearings.asp?congress=17*). Select the hearing for which you would like to submit, and click on the link entitled, "*Click here to provide a submission for the record*." Once you have followed the online instructions, completing all informational forms and clicking "submit" on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You ***MUST REPLY*** to the email and ***ATTACH*** your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business Tuesday, April 26, 2005. **Finally**, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. Those filing written statements who wish to have their statements distributed to the press and interested public at the hearing can follow the same procedure listed above for those who are testifying and making an oral presentation. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS FOR BOTH HEARINGS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://waysandmeans.house.gov*.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

*** * * NOTICE—CHANGE IN TIME * * ***

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE
April 07, 2005
FC–6–Revised

CONTACT: (202) 225–1721

Change in Time for Hearing on United States-China Economic Relations and China's Role in the World Economy

Congressman Bill Thomas (R–CA), Chairman of the Committee on Ways and Means, today announced that the Committee hearing on United States-China Economic Relations and China's Role in the World Economy, previously scheduled for 10:00 a.m. on Thursday, April 14, 2005, in the main Committee hearing room, 1100 Longworth House Office Building, ***will now be held at 11:00 a.m.***

All other details for the hearing remain the same. (See Full Committee Advisory No. FC–6, dated April 1, 2005.)

Chairman THOMAS. Good morning. Since becoming a member of the World Trade Organization in 2001 China's growth and integration into the world economy has moved very quickly. Trade between our two countries increased 50 times in 25 years from 4.8 billion in 1980 to 231.4 billion in 2004. China is now our third largest trading partner, the second largest supplier of U.S. imports and the fifth largest buyer of U.S. exports. China's growth, as you might expect, has led to friction and calls for a diligent compliance monitoring and other causes. For that reason the Committee has held hearings in the past and continues to work with the Administration and directly with Chinese officials. For example, last year Members met with Chinese Vice Premier Wu Yi at the successful conclusion of the U.S.-China Joint Committee for Commerce and Trade. We were concerned then with the discriminatory standard for wireless Internet equipment and a discriminatory VAT on semiconductors. In both cases the Administration brought these matters to a amicable resolution.

We underscored our concern about the rampant counterfeiting of U.S. intellectual property, but despite some progress China, in my opinion, has not resolved this significant problem. Not only has it not resolved it, it hasn't resolved it inside its own government offices. China's practice of pegging its currency to the U.S. dollar is obviously also a focal point of criticism. How China deals with certain macroeconomic issues is also in question, particularly the state of its banking system, the manner in which loans are granted, the artificially low interest rates that create cheap money lead to unsound lending practices. Our witnesses will hopefully keep us focused on those particular items describing what impact they have on our trade and other issues. I do look forward to hearing more about what the Administration is doing to move China to a more flexible exchange rate while not undercutting their very fragile banking system.

Frankly, our biggest concerns are just exactly what do our experts believe are appropriate steps to take and what are not appropriate steps to take, both in the short term, the medium and the long term because it is quite apparent, given the rapid emergence of China on the world scene on trade, as indicated by the impact on our trade numbers, that China is not only here to stay but many people say that China has tomorrow all to itself. I am interested in hearing how our other trading partners are dealing with China's trade and macroeconomic policies, and whether or not short of some of the major confrontations we have seen, unfortunately, between major trading nations in the World Trade Organization, how we might be able to work in a coordinated way to continue to bring China into the world family of responsible trading nations. Now I recognize the gentleman from New York, Mr. Rangel, for any opening comments he wants to make.

[The opening statement of Chairman Thomas follows:]

Opening Statement of The Honorable Bill Thomas, Chairman, and a Representative in Congress from the State of California

Good morning. Since becoming a member of the World Trade Organization (WTO) in 2001, China's growth and integration into the world economy has moved very quickly. Trade between our two countries increased 50 times in 25 years, from $4.8 billion in 1980 to $231.4 billion in 2004. China is now our third largest trading partner, the second largest supplier of U.S. imports, and the fifth largest buyer of U.S. exports.

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Mr. RANGEL. Thank you. First let me thank you, Mr. Chairman, for calling this hearing, and I hope at the end of the day or at the end of the testimony of the Administration, that we have a better understanding of what our trade policy is, specifically what our trade policy is with China. It is clear that the current trade policy has failed. It is also clear that you mention trade in connection with any country or combination of countries, and every problem that the United States has is attributed to trade. I was a little surprised to hear that people are now supporting the Central American Free Trade Agreement (CAFTA) without justifying CAFTA because this would unite us against a failed China policy. I don't think any economists have challenged the fact that the trade deficit with China and the trade deficit generally is very dangerous toward the security, the economic security, but with the issue of Taiwan constantly coming up, there is implications that even from a military point of view China has been able to provide a superior Navy around the Taiwan situation. So, I hope that it will not be difficult for the Administration to admit that we don't have a trade policy, and rather help us to try to develop one. This is so serious, Mr. Chairman, I hope you don't mind if I like to yield to Mr. Cardin who is very concerned about this.

Chairman THOMAS. I would tell the gentleman that the Chair intended to recognize on their own time the Chairman of the Trade Subcommittee and the Ranking Member of the Trade Subcommittee since this is a broad-based full Committee hearing, but that the bulk of the workload, as is always the case, will be carried out in Subcommittee. If that is an appropriate procedure with the Ranking Member, the Chair would recognize the gentleman from Florida, Mr. Shaw, the Chairman of the Trade Subcommittee.

Mr. SHAW. Thank you, Mr. Chairman. Today the Committee, as you already have said, addresses one of the most pressing trade issues facing American businesses and consumers, the impact of global trade with the People's Republic of China. In my 3 months as Chairman of the Trade Subcommittee I have met with many domestic interests, and one common theme exists: there is considerable concern regarding our bilateral trade with China. I look forward to hearing from our witnesses this morning and working with you and our other colleagues on both sides of the aisle to strengthen U.S. trade interests.

In 2001 China successfully joined the World Trade Organization (WTO). Three years later Chinese exports grew by an estimated 35 percent for a total of 593 billion, while its imports grew by 36 percent for a total of 561 billion. These figures are startling. China continues to pose many challenges and opportunities for us. It is undeniable that China will continue to grow and consumer more resources and produce more. Much of this production will be for its own population which is becoming more affluent, but even with remarkable annual growth of over 9 percent, it will take many years for China to catch up with the standards of living in the developed countries. We are now just in a global economy. We are in a global competition, and my interest is in making sure American companies have the ability to compete. Trade statistics show that the United States is one of the top export destinations for Chinese goods but the Europeans are ahead of us on exports to China. I would be interested to learn what they are doing that we are not.

Many United States businesses have told me that one of the reasons for this disparity is that when Chinese buyers are shopping they cannot easily and quickly come to the United States because of the restrictions and delays in obtaining visas. I am told that if a German company wants to obtain a visa for a Chinese buyer, the German Consulate can turn out a visa in 24 hours. By the time the United States visa is issued we have lost the sale. This is a hidden cost to the United States' firms and I hope the witnesses will address that here today. I support the Administration's strategy in engaging the Chinese on a consistent and high level. The Administration has been able to respond appropriately and firmly and has obtained good results such as on the VAT issues. We still have the intractable problem of intellectual property piracy in China and in other countries. More work has to be done to open the Chinese markets to our goods and services. Finally I want to address the issue of the Chinese currency. I join the growing chorus of concern about the manner in which Beijing has pegged its currency to the dollar. I have heard from a number of domestic industries opposing the Chinese policy of pegging the currency to the dollar. I strongly support efforts to pressure China to liberalize its currency. However, we must take care in this approach. We cannot push to a crisis point. The prospect of a devastating financial crisis is a distinct possibility. We all remember the 1997 crisis with a shudder and we must remain consistent with our world trade obligations and avoid retaliation against our companies.

Mr. Chairman, I again applaud you for calling this hearing and look forward to the panels.

Chairman THOMAS. Thank the Chairman. The Chairman would recognize the gentleman from Maryland, the Ranking Member on the Trade Subcommittee.

Mr. CARDIN. Let me thank the Chairman for this time, and also thank the Chairman for holding this hearing on China. I think this is one of the most important hearings that we can hold in regards to our trade agenda. We have this hearing with the backdrop of the most recent reports on the trade deficit this past month, February, being $61 billion. We are on track to exceed last year's record number deficit, which was $617 billion. Clearly, Mr. Chairman, these deficits are unsustainable. We need trade policies that will reduce our deficits, not increase our deficits, and we need to know what steps are being taken by the Administration using our existing trade rights and using our leverage within the WTO to reduce those deficits.

The largest trade deficit that we have is with China. It reached $162 billion in 2004, and in simple terms this means that for every six ships that come into America with product from China, only one leaves with product, five leave empty. If you look at the type of products that are being exported by the United States to China, you see that the leading categories are basically junk or scrap steel or cardboard containers that are used by China to send back product to the United States. That simply is unacceptable. China has been increasing its ownership of U.S. IOUs faster than any other country. The United States now owes China more than $194 billion, and that has to raise concerns. Our trade policies are not working. I believe this Administration must be more aggressive in utilizing the tools that are at their disposal to enforce U.S. trade rights.

Mr. Chairman, it has been pointed out that it has been about 4 years since China's accession into the WTO. We were told that by bringing China into the global rules-based trading system that we would be able to engage China more aggressively. It has not worked. What are the lessons that we learn from the accession of China into the WTO? I know, Mr. Chairman, that we are looking at other major countries for accession into the WTO including Russia. I would hope that the lessons that we learn from China that we can use in our negotiations with Russia. We certainly don't want to see the same circumstance repeated again.

My concern is that the Administration seems to be afraid to use the rules to ensure that U.S. companies and workers get the benefits that they are due under the WTO and the U.S. accession agreement. Let me cite three examples if I might. First in regards to piracy. The piracy rates in China are over 90 percent. I join Leader Pelosi, Mr. Rangel, Mr. Levin and other Members urging this Administration to take action against China in the WTO in regards to piracy. It is estimated to be $2.5 billion. Mr. Chairman, we are not just talking about the entertainment community. We are talking about reverse engineering of manufactured products that we see pirated in China. We need to take action that we are entitled to take under our trade remedies against China.

In that same letter we urged the Administration to take action against China on currency manipulation. Each of us have spoken to that. It is estimated that it may undervalue the China currency by as much as 40 percent, placing the United States' manufacturers, producers and farmers at just an unfair position for access to the China market. We need to take action against China now in regards to the currency manipulation. Last, let me mention the issue of using the safeguard mechanisms that were agreed to as part of the WTO accession agreements, that we should be more aggressive in doing that. Let me just mention textiles. We all know that the global textile quota expired on January the 1st, and we have seen a surge of textile products from China enter the U.S. market. We need to be more aggressive in taking action against China.

In all three of these cases the Administration has failed to take decisive action. We need to be more aggressive. Being aggressive with trade policy can clearly make a difference. I do look forward to listening to the witnesses that are on our panel. I must say, Mr. Chairman, I am disappointed that no one from Treasury is here to testify. I hope that is not an indication that Treasury has no interest in the currency issue in China because I do think we need to develop that capacity within Treasury to be aggressive. I will be asking a question to the Administration witness, and that is: our current polices have not worked; what is your plan? What are you recommending that we do in order to bring about a more favorable trade position between the United States and China? Thank you, Mr. Chairman.

Chairman THOMAS. Thank the gentleman. The Chair would remind Members that one of the first hearings in early February this Committee had was with the Secretary of the Treasury himself, and that perhaps there may be additional deputy secretaries that would be available to us if the Senate would release the hold on the nominees that are currently over in the Senate. It would be helpful if the gentleman could coordinate his concern about the lack of Treasury representatives at this hearing with the lack of the ability of the Senate to move forward with filling those vacancies.

Mr. CARDIN. If the Chairman would yield just very quickly, I would be glad to join him in making sure we have someone at treasury that is focused on the currency issue in China, and I would be glad to work with the Chairman in that regard.

Chairman THOMAS. I think you will find we have some formidable witnesses, one in particular, who is perfectly comfortable in testifying on the question of currency in China just because she doesn't currently wear a hat that says "Treasury deputy secretary." Any other Members who wish to make a statement can do so by placing a written statement in the record without objection. The Chair would now like to move to the first panel which consists of one Member, the Honorable Bernie Sanders, a representative from Vermont. Thank you for being with us, Bernie, and any written statement that you have will be made a part of the record, and you can see fit to address us for the time you have in any way you see fit.

STATEMENT OF THE HONORABLE BERNARD SANDERS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VERMONT

Mr. SANDERS. Mr. Chairman, thank you very much, and Ranking Member Rangel and distinguished colleagues for allowing me to participate in what I consider to be an extraordinarily important hearing. I do so as the author of legislation which would repeal permanent normal trade relations with China, and that legislation at this point has the support of 52 Democrats and 18, 18 Republicans, and I think if that bill was brought to the floor of the House, all of you would be very surprised at the number of votes that we would get. Mr. Chairman, as I am sure you know, Albert Einstein once said that, quote, "The definition of insanity is doing the same thing over and over again and expecting different results." If that is true, then certainly there can be only one to describe our current unfettered free trade policy with China and other countries, and that is that it is insane. Mr. Chairman, while I want to say that I disagree very strongly with you and Mr. Shaw's view on trade, I also have to say that I am very, very disappointed in my Democrat colleagues. I think that both political parties are way out of touch with what American workers and the American people are feeling, and I think the American people want fundamental changes in our trade policies, and I hope that both parties will be able to do that.

The simple truth of the matter is, is that our current trade policies have failed. One of the major reasons that the middle class in America is shrinking, poverty is increasing and the gap between the rich and the poor is growing wider is due to our disastrous, unfettered free trade policies. If the United States is to remain a major industrial power, producing real products and creating good-paying jobs, we must repeal permanent normal trade relations with China and develop a new set of trade policies which work for the American middle class and working class, and not just for the chief executive officers of large corporations. Mr. Chairman, in the last 4 years we have lost about 16 percent of our manufacturing jobs. In my own small State of Vermont we have lost 20 percent of manufacturing jobs. From 1989 until 2004 we have lost at least 1.5 million jobs as a result of our trade relationship with China.

Permanent Normal Trade Relations (PNTR) has also had a very negative impact on wage growth. Real wages for the overwhelming majority of American workers are declining and real wages today are lower than they were some 30 years go. Is trade the only reason for that? No. Is it a significant reason for that? Yes, it is. Mr. Chairman, I am especially concerned about an issue that we hear very little discussion about. What about the kids who are graduating high school today? 30 years ago those young people were able to get jobs in manufacturing plants, make decent wages, decent benefits. Today they are working at WalMarts, they are working at McDonald's, and their wages today are precipitously lower than they were 25, 30 years ago. We have got to deal with that issue.

Mr. Chairman, the simple truth of the matter is that I didn't hear one word about that today. The simple truth is that American workers cannot and should not be asked to compete against desperate people in an authoritarian country like China, people who are forced to work for 20 or 30 cents an hour and who go to jail if they try to form an independent union or stand up for political freedom. That is a patently absurd policy which should not be allowed to continue. On behalf of the American people we should not be allowing large multinational corporations to throw American workers out on the street, move their plants to China and other low-wage countries, and then bring their products back into this country tariff free or with almost no tariffs.

Mr. Chairman, year after year we were told by supporters of PNTR about the great markets that would be open to us and all the products we would be able to sell in China. The reality is, however, that in 2004 we experienced a record-breaking $617 billion overall trade deficit. The U.S. trade deficit with China alone was 162 billion, the largest ever bilateral trade deficit with any country, and roughly equal to our total trade deficit only 6 years ago. We are moving in exactly the wrong direction in trade with China. According to the National Association of Manufacturers, not great friends of mine, if we continue our current policy our trade deficit with China will more than double to over 330 billion in 2008. Incredibly, the trade deficit with China has increased by 29 percent over the last year alone, and almost 50 percent since the passage of PNTR. How can this policy be a success when our trade deficit is soaring year after year?

Mr. Chairman, in industry after industry corporate America is shipping our manufacturing plants, our good-paying jobs to China and other low-wage countries. Anyone who went Christmas shopping this year knows that more and more products on the shelves are made in China: toys, bicycles, computers, televisions, shoes and sneakers, all kinds of clothing, telephones, furniture, auto parts, even artificial Christmas decorations. Mr. Chairman, you may remember those little flags that the leadership gave us to wave, the little American flags when we were commemorating the tragedy of 9/11. Those little American flags were made in China. As bad as that is, we should be very aware that PNTR with China is not only leading to the destruction of traditional manufacturing and blue collar jobs, it is beginning to lead to the destruction of our whole information technology white collar job sector. Not only is China rapidly becoming the manufacturing center of the world, it is quickly becoming the information technology hub as well. According to a recent study done by Gartner, 30 percent of our information technology jobs are in danger of being outsourced overseas during the next decade.

Andy Grove, the founder of Intel, predicted last year that the United States will lose the bulk of its information technology jobs to China and India over the next decade. John Chambers, the chief executive officer of Cisco, was typical of many high-tech leaders when he said, and I quote, "China will become the IT center of the world. . . . What we're trying to do is outline an entire strategy of becoming a Chinese company," end of quote. Mr. Chairman, the simple question is, if we are losing our blue collar jobs in traditional manufacturing, if we are losing our white collar jobs for our college kids, where are the jobs going to be for our children and our grandchildren? The Bureau of Labor Statistics already tells us, as they project jobs into the future, that the majority of the fastest-growing jobs in America are going to be low wage jobs with on-the-job training. So, Mr. Chairman, I think we cannot accept when people like Jeff Immelt of General Electric say, and I quote, "When I am talking to GE managers, I talk China, China, China, China. You need to be there." Thomas Donahue, the chief executive officer of the U.S. Chamber of Commerce urges, he urges American companies to send jobs abroad. Bill Gates, the wealthiest man in America, tells us that Communist authoritarian China has created, "a brandnew form of capitalism, and as a consumer it's the best thing that ever happened." Mr. Chairman, the time is long overdue to understand we have made a big mistake. It will be a disaster for our country if we continue these trade policies. It is time to rethink them, and I would urge you and Members of this Committee to join me in demanding a repeal of PNTR with China and the negotiating of a new trade policy which is fair to American workers. Mr. Chairman, thank you very much.

[The prepared statement of Mr. Sanders follows:]

Statement of The Honorable Bernard Sanders, a Representative in Congress from the State of Vermont

Chairman Thomas, Ranking Member Rangel, and my fellow colleagues, as the author of legislation to repeal Permanent Normal Trade Relations with China which has the support of 52 Democrats and 18 Republicans, thank you for giving me the opportunity to testify today.

Mr. Chairman, as I'm sure you know, Albert Einstein once said that "The definition of insanity is doing the same thing over and over again and expecting different results".

If that is true, then certainly there can be only one way to describe our current unfettered free trade policy: insane.

The simple truth of the matter is that our current trade policy has failed. One of the major reasons why the middle class is shrinking, poverty is increasing, the gap between the rich and poor is growing wider is due to our disastrous unfettered free trade policy.

But, I think it is safe to say that if I was a CEO who was making 500 times what the average worker earns, and tens of millions of dollars in total compensation each and every year, I would tell you that our trade policy has been a success. It has enabled me to throw American workers out on the street, hire workers in China for 20 cents an hour with no benefits to make my products, and ship those goods back into the United States tariff free, or for virtually tariff free. And, that's why corporate America spent more than $113 million to persuade Congress to grant PNTR to China despite Harris polling showing 79% opposition from the U.S. public. And, that's why corporate America still supports PNTR today.

But, for the middle class, Normal Trade Relations with China has been a different story. From 1989 until 2004, we have lost at least 1.5 million jobs as a result of our trade relationship with China. PNTR has also had a very negative impact on wage growth. Real wages for the overwhelming majority of U.S. workers are now lower than they were two years ago. And, according to Richard B. Freeman, a Harvard economist, who was quoted in a recent New York Times article said that millions of skilled Chinese, Indian and other Asian workers entering the global labor market will increasingly pull down American wages. **"Globalization is going to make it harder for American workers to have the wage increases and the benefits that we might have expected," he said.**

Mr. Chairman, in 2004, we experienced a record breaking $617 billion trade deficit. The U.S. trade deficit with China alone was $162 billion, the largest-ever bilateral trade deficit with any country and roughly equal to our total trade deficit only six years ago. In 1990, our trade deficit with China was only $11.5 billion. Incredibly, the trade deficit with China has increased by 29 percent over the last year alone and almost 50 percent since the passage of PNTR. Very few experts in this area doubt that the trade deficit will continue to escalate in the years ahead, and in fact, we are headed towards a $700 billion plus trade deficit this year.

According to the very conservative National Association of Manufacturers, if we continue our current policy, our trade deficit with China will more than double to over $330 billion in 2008.

In industry after industry corporate America is shipping our manufacturing plants, our good paying jobs, to China where desperate people are forced to work for wages as low as 20 cents an hour. Anyone who went Christmas shopping this year knows that more and more products on the shelves are made in China: toys, bicycles, computers, televisions, shoes and sneakers, all kinds of clothing and hats, telephones, furniture, auto parts and even artificial Christmas decorations. Ironically, the little American flags that members of Congress wave around are often made in China, as over 100 million of them have been made there since 2001.

In the last 4 years the United States has lost 2.7 million manufacturing jobs, over 16 percent of our entire manufacturing sector. In my small state of Vermont we have lost 20 percent of our manufacturing sector during that period. PNTR with China, and our disastrous trade policies in general, are one of the key reasons for that.

As bad as that is, we should be very aware that PNTR with China is not only leading to the destruction of traditional manufacturing and blue collar jobs. It is leading to the loss of millions of high-tech, information technology jobs as well. Not only is China rapidly becoming the manufacturing center of the world, it is quickly becoming the information technology hub as well. These are the jobs, we have been told for years, that our children would be inheriting and are being educated for.

According to a recent study by Gartner, 30% of our information technology jobs are in danger of being outsourced overseas during the next decade.

Andy Grove, the founder of Intel, predicted last year that the United States will lose the bulk of its information technology jobs to China and India over the next decade. John Chambers, the CEO of Cisco, was typical of many high-tech leaders when he said: "China will become the IT center of the world. . . . What we're trying to do is outline an entire strategy of becoming a Chinese company."

Mr. Chairman, if our manufacturing sector continues to collapse, and we lose the bulk of our IT jobs to China and India in the next decade, what jobs will be there for our kids? Good question. Let's get an answer from the Bureau of Labor Statistics "Jobs of the Future". According to this report 7 out of the top ten industries that will experience the most job growth are low wage, low skill, low benefit jobs: nursing aides, orderlies and attendants; waiters and waitresses; janitors and cleaners; cashiers; food preparers and fast food servers; customer service representatives; and retail salespersons.

What jobs does the BLS study tell us will be lost in the next decade? The study says that we will lose 18 percent of our aerospace manufacturing jobs, 12 percent of our computer and electronic production workers, 17 percent of our chemical manufacturing jobs, 20 percent of our steel workers, 31 percent of our textile mill jobs, and 69 percent of our apparel manufacturing jobs.

And, Mr. Chairman, we must also not forget, that at the same time that American companies are throwing workers out on the street and shipping our decent-paying jobs to China, they are receiving hundreds of billions of dollars in corporate welfare and tax breaks, and our actually bragging about shipping our jobs overseas.

Jeff Immelt of General Electric says: "When I am talking to GE managers, I talk China, China, China, China, China. You need to be there. . . . I am a nut on China. Outsourcing from China is going to grow to $5 billion."

Thomas Donahue, the CEO of the U.S. Chamber of Commerce "urges" American companies to send jobs overseas.

Bill Gates, the wealthiest man in America tells us that Communist authoritarian China has created, "a brand new form of capitalism, and as a consumer it's the best thing that ever happened."

Mr. Chairman in that context, what we have to understand is that our trade policy has failed during Administration after Administration, Congress after Congress, controlled by Republicans and Democrats. I would respectfully assert that we have got to rethink our trade policy and that is why I hope you will join me in supporting my legislation to repeal PNTR with China.

Chairman THOMAS. The Chair thanks the gentleman from Vermont. Any Member wish to inquire?

Mr. RANGEL. Yes, briefly.

Chairman THOMAS. Gentleman from New York.

Mr. RANGEL. What do you think the implication would be if we killed the bill that we have with China as it relates to the World Trade Organization?

Mr. SANDERS. I think obviously if the U.S. Congress repealed PNTR it would have a profound impact on the whole discussion of international trade and our relationship within the WTO. Mr. Rangel, my view is that trade is a good thing, a positive thing. My view is that our current trade policies are a disaster for the American worker and that we have got to renegotiate our trade agreements all across the board. I am concerned about poor people throughout the world, and I want to see their standard of living grow, but we don't have to destroy the American middle class to improve the lots of poor people around the world. So, clearly it would be profound, but I am suggesting that the time is long overdue for this Congress to take a profound step and stop the decline of the middle class.

Mr. RANGEL. Thank you.

Chairman THOMAS. Any additional inquiries? The gentleman from Florida.

Mr. SHAW. Just briefly, Mr. Chairman. Mr. Sanders, we also have concern about our trade relations with China and that is why we are having that hearing today. So, we are hopeful to learn from this. However, I think that cutting off trade, our normal trade relations with China, concerned about several things. One is what effect would that have on the $35 billion exports that we have to China? Are any of those jobs in Vermont?

Second, would it result in a partial collapse of the Chinese economy, and what effect would that have on our economy and the world economy? What effect would that have on unemployment and global unemployment? I share your concern that we have to level out our imbalance which is really growing out of control and something we need to be very concerned about, but I think that to use a meat ax on a problem that should be negotiated would be a terrible mistake. I think we need to negotiate. We need to get concessions from the Chinese, and I think they will be forthcoming because the Chinese economy is very dependent upon the United States, and I think that they certainly want to do what they can to avoid our country taking a radical step, as I consider would be of passage of the bill that you are supporting.

Mr. SANDERS. Mr. Shaw, I would respond this way. you are correct in saying that we have $35 billion in export to China and that is a lot of money. As you know, we have five times as much in terms of import, and that gap between exports and imports is growing wider. So, the question, it is a fair question, what impact the loss—and it is not a question of loss—what impact it would have on our exports, but you also got to consider what is happening to our economy as a result of our disastrous trade deficit with China today, and not only in jobs, but an issue that we don't discuss enough, wages. With an explosion of technology and worker productivity, Mr. Shaw, why aren't wages going up in the United States? Why are they declining? Don't you think that that has something to do with American workers being forced to compete against people who make 30 cents an hour? You suggest that what I am proposing is a meat ax, and in some way you are correct, but the reason that I brought forth that legislation is I want to catch your attention and the attention of the American people. The current trade policies are failing, and nibbling around the edges is not going to do it. I am not against trade with China. I think there is a lot to be said for trade with China. It has got to be done in a way that benefits us, not just large corporations.

Mr. SHAW. Thank you, Mr. Chairman.

Chairman THOMAS. Any additional Member? The gentlewoman from Connecticut.

Mrs. JOHNSON OF CONNECTICUT. Thank you. You know, Mr. Sanders, I agree with you that this is a serious matter that we have to address. I was part of a bipartisan group that worked on altering America's trade policy during the '80s to address the impact of the entry of Japan into the world market, and there are things that we can do and we must respond more rapidly in 2005 than we had to respond in the '80s. I think it is important to diagnose the issue correctly, and while we have a lot more goods coming from China, we don't have a lot more imports coming from all of Asia. There is a routing issue here where goods are going from other Asian countries to China and then to America, so it does—we just need to be accurate about how we respond, about how we understand the problem so we can be accurate in how we respond.

The other thing that I want to point out as we consider a proposal as radical as yours is that we have done mighty little, and particularly given the pace of change and the environment we live in, to help make our companies more competitive. There are lots of fronts on which we could be moving ahead in a bipartisan fashion to address rising health care costs, to address the unlevel playing field in international tax policy, to address energy costs, to address legal costs. Most of those initiatives get bogged down here in Congress and take four or five years to attend to.

So, Congress has to begin thinking about domestic policy in the context of the pace of change of a global environment, and that is every bit as important. Our savings is the lowest it has ever been at. So, you know all those problems. They are as much a part of solving this as improved trade policy, and I say to myself and I would say to you, make no mistake about that.

Mr. SANDERS. If I may briefly respond, Mrs. Johnson. I certainly agree with your assertion that we have to deal with domestic issues as well as we look at the overall trade situation. We probably do not agree—I think we need a national health care plan to put us on a level playing field, and you probably disagree. More importantly, I think—and an issue I haven't heard discussed, and Mrs. Johnson, you as a Member of the Committee have to address it—talking about making our companies more competitive. You know and I know that virtually every major corporation in America today is investing huge sums, tens and tens of billions of dollars in China, and I have to tell you, I do not believe that there is anything that you can do to make America competitive with China in terms of wages, which to my view is the major issue. How are we going to compete with a country that pays workers 30 cents an hour and puts them in jail when they form a union? You tell me how we are going to do that.

Mrs. JOHNSON OF CONNECTICUT. Mr. Sanders, we certainly disagree on that. We have competed with countries that are paying very low wages for decades, and we can do it, but it requires a far more comprehensive analysis of both the problem and our response to it, which is what this hearing is initiating. It also means that domestically we don't have the luxury of the same old debates that we have debated here in this House for the last 20 years I have been here, and the ability to change the nature of those debates is not impressive to me. So, thank you.

Mr. SANDERS. Mrs. Johnson, with all due respect, I don't think you have addressed that issue. Can the American worker, should the American worker be forced to compete against somebody who makes 30 cents an hour who goes to jail if they want to form an independent union? I don't think any American worker or any company can compete under those circumstances. That is why they are going to China.

Mrs. JOHNSON OF CONNECTICUT. We certainly want a level playing field, no question about it.

Mr. CARDIN. Mr. Chairman?

Chairman THOMAS. The gentleman from Maryland.

Mr. CARDIN. Thank you, Mr. Chairman. Mr. Chairman, those of us who support what Mr. Sanders is pointing out about the need for a dramatic change in our trade policy but disagree with the approach that he would take in the repeal of the PNTR—which as Mr. Rangel points out, the repeal of PNTR with China would basically blow up the WTO—I think you have a responsibility to suggest what would take its place. You have acknowledged that trade is important, that we need to be engaged in international trade, and if we don't use the WTO, what do we have? I think it is incumbent upon those who believe that the WTO needs to be basically repealed to give us what mechanism would be used.

I do want to point out that I am in complete agreement with the point that you made. We need a dramatic change in trade policy in this country, but I think it starts with enforcing our trade rules that were hard negotiated, particularly the WTO accession agreement. That gives us certain rights and we haven't exercised those rights. We have rights under the WTO and we haven't brought cases to them. Look, the currency manipulation hasn't been tested. We think it is a no-brainer as far as violating the principles of WTO. So, I guess the point that I would bring out is that we agree with the frustration that you have expressed and that we just can't do patchwork change in our trade policy, that we must enforce our trade rights and we must negotiate with our trading partners much more effective trade agreements to recognize the differences among our countries. To suggest that we pull out of international trade without having another mechanism in place, to me would be counterproductive.

Mr. SANDERS. Mr. Cardin, I agree with much of what you said, but you still did not address that question. Should an American worker I Maryland or Vermont be forced to compete against somebody who makes 30 cents an hour and goes to jail if he or she stands up for her——

Mr. CARDIN. Of course not.

Mr. SANDERS. Well, that is what the——

Mr. CARDIN. We should be in our trade agreements enforcing international labor standards that make it clear. One of the things that our party, the Democratic Party has stood for is moving forward in international labor standards and trade agreements because of the points that you bring out. We agree with that point. The point is, how do you move forward on those issues? We do have certain rights, and some of the issues that you are referring to violate WTO standards, and we haven't brought the cases against these countries.

Mr. SANDERS. Wait a second. If we agree with those positions, then why did we enter PNTR? It is no secret that workers in China go to jail when they stand up for their rights, that they are working for horrendous wages, that there is a huge amount, millions of workers prepared to work there for nothing, almost nothing. We entered into that agreement understanding that.

Mr. CARDIN. There were certain provisions in the PNTR that Mr. Levin negotiated, that was negotiated in good faith that are in those bills that provide for the monitoring, provide for the actions to be taken, and this Administration has not taken those actions.

Mr. SANDERS. Nor have past Administrations.

Mr. CARDIN. PNTR wasn't there—it wasn't implemented until this Administration.

Mr. SANDERS. You are right, just NAFTA, right.

Mr. CARDIN. Just look at our timing, I hope a Democratic Administration will have the opportunity to do that 1 day.

Chairman THOMAS. Any additional Member inquiries? The gentleman from California, Mr. Becerra.

Mr. BECERRA. Thank you, Mr. Chairman. Mr. Sanders, thank you very much for your testimony. One question to you. Any comment on those who are saying that we must pass the Dominican Republic Central American Free Trade Agreement that was negotiated by this Administration with those countries recently, and that may be before us this year or next year for congressional approval? Any comment about those who say that we must have this Central American deal; otherwise the situation will get even worse with regard to China and the difficulties for the Central American Dominican Republic?

Mr. SANDERS. Mr. Becerra, I think that the NAFTA policy has failed, China has failed, and I do not, cannot understand why anybody would want to expand a policy which is failing the American people. So, I think CAFTA would be another disastrous trade policy and I would hope we do not pass it.

Chairman THOMAS. The gentleman relinquish his time? The gentleman from California relinquish his time?

Mr. BECERRA. Yes, Mr. Chairman.

Chairman THOMAS. Thank you. Thank you, Bernie. The Chair would have some concern that if the response to every possible trade agreement is that we shouldn't have one. That then clearly draws a fundamental difference between many Members of—I think all Members of this panel and the gentleman's position. However, I do want to focus on the comments that the gentleman from Vermont made about the mission of dealing with China.

The Chair believes we are probably going to have a hearing on Japan as well, but when you examine Japan and its lack of natural resource but its ability to focus and become a power in the world, when you take a look at China's assets at the beginning of the process and how rapidly they have moved, there is just no question that we are going to have to engage China both in terms of a narrow trading partner, but as a phenomenon in world trade that everyone needs to focus on. The Chair appreciates the gentleman from Vermont's fundamental presentation in front of the Committee that we have to deal with it. How we deal with it is obviously going to be a matter of disagreement, but there is no question that the China issue is absolutely in the forefront, not just of the United States and its trade, but frankly, the world. I want to thank the gentleman.

Mr. SANDERS. Mr. Chairman, I want to thank you very much for this opportunity. Again, my view is not that we should not have trade. Of course we should have trade. It should be a trade policy that works for the American worker. Thank you again very much.

Chairman THOMAS. Thank you very much. The Chair is looking at a series of votes, and would very much like to at least begin the next panel, and then we will have to recess because there is currently on the floor a motion to adjourn. We are going to have then an additional 5 to 10 minutes of debate, and then we will go to a series of votes. The Chair is not inclined to go over and vote on the motion to adjourn, and the Chair intends to continue to run the Committee until we have votes on the previous question and on the rule.

With that, the Chair would ask if Dr. Kristin Forbes, who is a member of the President's Council of Economic Advisers; and Charles W. Freeman, III, the Assistant U.S. Trade Representative on China Affairs, would please come forward to the dais. The third member of the panel, Dr. Douglas Holtz-Eakin, our Director of the Congressional Budget Office, will join us at some time during the hearing. He is currently engaged in other activities, will be here as soon as possible. First of all thank you, and any written testimony you may have will be made a part of the record and you may address in any way you see fit for the time you have, and I will begin with Dr. Forbes and then move to Mr. Freeman. Dr. Forbes.

STATEMENT OF KRISTIN J. FORBES, PHD, MEMBER, PRESIDENT'S COUNCIL OF ECONOMIC ADVISERS

Ms. FORBES. Mr. Chairman, Ranking Member and Members of the Committee, thank you for inviting me to testify. I will briefly summarize my longer written testimony which focuses on China's economic development and how China's growth has affected global trading patterns in the U.S. economy. I will also discuss how the Administration has followed a multi-pronged strategy to ensure that the United States continues to benefit from China's economic emergence. China's recent economic performance has been impressive. Since 1980 China's annual rate of real GDP growth averaged over 9 percent. That is among the most rapid sustained periods of growth observed anywhere in the world at any time. China's rapid economic growth has generated a dramatic improvement in the lives of Chinese citizens. The World Bank reports that China's economic growth has been the single most important factor countering global poverty since the 1980s.

Despite these important accomplishments, China continues to face significant structural economic challenges: a weak banking system, environmental degradation, a rapidly aging population and inefficient state-owned enterprises. China also faces a number of immediate challenges related to its rapid growth and overheating economy including bottlenecks, shortages and a potential housing price bubble in select cities. The government has relied largely on administrative controls instead of more market-based mechanisms to try to slow growth, creating additional economic distortions that will lower productivity and growth in the future. Therefore, as we discuss economic engagement with China, it is important to keep in mind the substantial challenges that China faces. As China's economy has developed China has played a more important role in global trade flows. China's demand for imports has boosted export growth in many economies, especially Asian neighbors and commodity exporters. Although China's exports have increased drastically, if you will look at the chart there, this has raised concerns about other countries' abilities to compete with these exports. This export growth is not unprecedented. The graph right there replicates Figure 4 in the testimony. As you can see on the graph, several Asian economies such as Japan and Korea have actually experienced even more rapid export growth during their periods of rapid economic development than recently experienced by China.

As China has grown, U.S. exports to China have increased dramatically so that China is currently the fifth largest export market for the U.S. U.S. exports to China have increased by nearly 115 percent since 2000, as shown on the graph. This is the fastest rate of increase to any country in the world over this period. This increase in U.S. exports to China is particularly noteworthy considering that U.S. exports to the rest of the world were fairly stable between 2000 and 2004, as shown in the graph also. Even if growth in China moderates, China can continue to be an important source of U.S. export growth in the coming years. Although U.S. imports from and exports to China have both been increasing rapidly, the U.S. had a trade deficit with China equal to about 1.4 percent of U.S. GDP in 2004. Although trade with China is often blamed for the recent increase in the trade deficit, this is not entirely accurate for three reasons.

First, as shown in the figure, the U.S. trade deficit, excluding China, the full bar, has also risen sharply. Trade with China accounted for roughly a quarter of the increase in the U.S. trade deficit since 1997. That is only slightly more than the contributions to the increase in the U.S. trade deficit from NAFTA and from Europe. In fact, China's contribution to the overall U.S. trade deficit today is currently less in percentage terms than it contributed in 1997.

Second, increased imports from China largely reflect decreased imports of the same goods from other countries instead of a net increase in the U.S. trade deficit. Many of the products that the U.S. currently imports from China were previously imported from other countries, not produced in the United States. As shown on the next graph, although the share of U.S. imports coming from China (the red part of the bar) has increased since 1990, the share of imports coming from the other countries in the Pacific rim (which is the rest of the bar) has actually fallen by even more than the increased share of imports coming from China. Therefore, the share of total imports coming into the U.S. from the Pacific Rim, including China, has actually fallen. Much of China's recent increase in the U.S. import share (the red part of the graph) has largely come at the expense of Japan (the yellow part of the graph).

Third, it is important to keep in mind that we should be focusing on the multilateral trade balance instead of the bilateral balance between any two countries to understand the corresponding factors that are causing the large U.S. trade deficit. A multilateral trade deficit reflects a shortage of national saving relative to national investment. Therefore, if the U.S. trade deficit could suddenly be reduced, this would need to occur with a corresponding adjustment in other variables, such as an increase in the U.S. trade deficit with other countries, an increase in U.S. national saving or a decline in U.S. national investment.

The Administration has been pursuing an active and multipronged agenda to ensure that the U.S. continues to benefit from China's growth and increased trade flows. Individual sectors of the U.S. economy have faced increased competitive pressure due to China's increased role in global trade. Adjusting to these changes can be difficult, not only for individual companies but also for their families and their communities. Therefore, the Administration has taken a number of steps to help individuals adjust to these changes and to ensure that U.S. workers have adequate skills in order to succeed in new job opportunities, adopt new technologies and benefit from increased trade. Several Administration programs and new proposals to achieve these goals include the recent expansion of trade adjustment assistance, the President's Jobs for the 21st

Century Initiative, a pilot program for Personal Reemployment Accounts, and a proposal for opportunity zones that will help workers in poor communities and communities that have lost jobs in sectors such as manufacturing and textiles. As a strong signal of commitment to all of these programs, the President has proposed over $21 billion for worker training and employment programs in the 2006 budget. In addition to taking steps to help U.S. workers adjust to increased global trade flows, the Administration has also actively engaged to ensure that China continues to open its market to U.S. imports and fully implements its commitments to the WTO. The Administration is also encouraging China to reduce barriers to capital flows, develop more sophisticated capital markets and adopt a more flexible exchange rate regime. The Administration believes that now is the appropriate time for China to move to a more flexible exchange rate regime. It is in China's best interest to adopt a more flexible currency now while economic growth is strong. A more flexible currency would provide China with greater independence in monetary policy, a step that could be very useful today to help reduce the current risk of overheating.

The Chinese authorities have clearly stated their intent to move to a more flexible exchange rate regime. Although they have not specified a date for this adjustment, China has taken a number of steps over the past year to develop the infrastructure and tools to successfully adopt more exchange rate flexibility. For example, China is developing foreign exchange trading including hedging instruments and internal controls on foreign exchange exposure. Last month China announced steps to allow foreign banks to trade and quote prices in eight currency pairs. This provides a platform that can now be used to trade a more flexible yuan. The Administration, led by the Treasury Department, has also been actively involved in assisting the Chinese authorities in resolving concerns in areas they see as obstacles to exchange rate flexibility. For example, the U.S. Treasury has established a technical cooperation working group that had three sessions with China in 2004 to focus on these issues. Additional sessions are already planned for 2005. I have participated in a Joint Economic Committee meeting last fall, chaired by Secretary Snow, to discuss financial and exchange rate issues with senior Chinese officials. The U.S. Administration has recently built on these bilateral engagements by continuing to work through multilateral channels.

For example, the International Monetary Fund has repeatedly called for China to adopt a more flexible exchange rate regime including more recently in its World Economic Outlook, which was just released as part of this weekend's Bank/Fund meetings. A final key pillar of the Administration's strategy to ensure that the U.S. benefits from China's rapid growth and increased trade flows is to strengthen the U.S. economy and ensure that the U.S. is an attractive location for companies to do business. To achieve these goals the Administration will continue to restrain spending, strengthen institutions for future generations and support pro-growth policies. The Administration will continue to enforce our trade agreements and lower barriers to trade through multilateral and bilateral trade agreements to ensure that U.S. companies can successfully compete in foreign markets.

GDP growth in the U.S. in the last 2 years was higher than in any other member of the G–7 group of developed economies. This trend is expected to continue in 2005, as shown on the graph. The IMF just released new predictions that growth in the U.S. will be 3.6 percent in 2005. That is stronger than in every other member of the G–7, and double the expected growth rates in Germany, Japan and Italy. Therefore, to conclude, as we discuss different proposals to shape the future of the U.S. and its relationship with China, we must be careful not to threaten this success with short-term fixes that could damage our long-term competitiveness. Instead, as the U.S. Administration pursues an active and multi-pronged agenda to ensure that the U.S. benefits from rapid growth and development in China, we must remember that any steps taken to smooth this adjustment should also ensure the U.S. continues to be a competitive and dynamic economy. The Administration is committed to continuing and building on these efforts.

Thank you.

[The prepared statement of Ms. Forbes follows:]

Statement of Kristin J. Forbes, Ph.D., Member, President's Council of Economic Advisers

Mr. Chairman and Members of the Committee, thank you for inviting me to testify on the subject of China's economy and the impact of China's development on global trade and the U.S. economy. I will begin by discussing China's recent economic performance—highlighting not only its successes, but also its ongoing challenges. Then I will discuss how China's growth and development are affecting global trading patterns. Next I will provide a more specific evaluation of how China's development is impacting the U.S. economy, focusing on U.S. trade patterns, the U.S. trade deficit, and U.S. employment. Finally, I will close by describing steps the Administration has taken and will continue to take to help the United States adapt to and benefit from China's economic development.

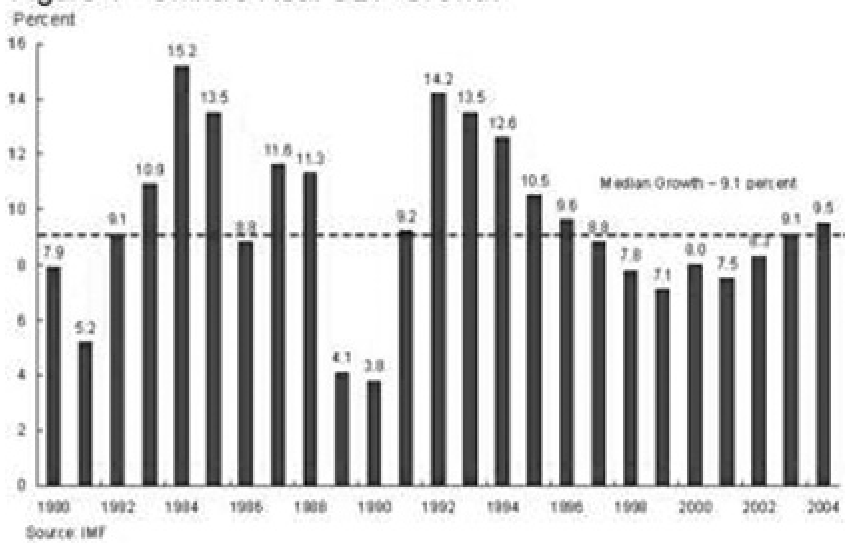
A key theme throughout my comments is that China's rapid economic growth and its emergence as an important force in the global economy and global trading system presents a valuable opportunity for the United States. China (along with the United States) has recently been a key engine of global growth and China has been among the fastest growing market for U.S. exports. Adjusting to China's economic emergence, however, also presents challenges. The U.S. Administration is pursuing an active and multi-pronged agenda to ensure that the United States is able to benefit from these changes and to help facilitate the adjustment process. Although this process will be difficult at times, any steps taken to facilitate adjustment should also be aimed at supporting, if not improving, the competitiveness and dynamism of the U.S. economy.

China's Economic Performance

Although China's recent economic performance has been impressive and received substantial attention, the country still faces imposing challenges, such as resolving longer-term structural problems and addressing shorter-term risks related to overheating. In 2004, China's growth rate in real GDP was 9.5% (according to official Chinese government statistics).[1] This was among the fastest rates of economic growth anywhere in the world—although several countries rebounding from sharp recessions (such as Venezuela and Uruguay) experienced higher growth rates in 2004. Even more important than strong GDP growth in any given year, however, is a country's ability to maintain strong growth over an extended period of time. According to this criterion, China's economic performance is even more remarkable. Since 1980 China's annual rate of real GDP growth averaged over 9%—among the most rapid, sustained periods of growth observed anywhere in the world at any time. [Figure 1.]

[1] Chinese government statistics are imprecise and subject to error. Private sector estimates indicate that real GDP growth in China was likely higher than the official government estimates in 2004.

Figure 1 - China's Real GDP Growth



This sustained rate of strong GDP growth has raised China's total annual output from about $300 billion in 1980 to more than $1.6 trillion today. At the end of 2004 China was the world's seventh largest economy when total output is measured using current exchange rates, ranking just behind Italy and ahead of Canada. Using purchasing-power parity exchange rates (which adjust for price differences for the same goods across countries), China was the world's second largest economy—ranked only behind the United States.

China's rapid economic growth has generated a dramatic improvement in the lives of Chinese citizens. Faster economic growth is the only way to substantially and permanently raise peoples' standards of living and provide resources to reduce poverty. In 1980, China's per capita income was approximately $220—less than that of countries such as Chad, India, Ghana, and Nigeria. Today China's per capita income has increased nearly five-fold to more than $1,000—so that the average citizen in China is more than three times as wealthy as the average person in Chad, Ghana and Nigeria, and closer to average income level in countries such as the Philippines.

China's social indicators have also improved significantly. Since the 1970's, average life expectancy in China has risen from 65 to 72 and adult illiteracy has fallen by half. From 1980 to 2000, infant mortality fell by nearly 20%. But perhaps the most noteworthy, and most uplifting, has been how China's growth has reduced global poverty. The World Bank reports that China's economic growth has been the single most important factor in countering global poverty since the 1980's. Since 1980, over 220 million Chinese citizens have been lifted above the global poverty line. Nearly 75% of the reduction in poverty throughout the developing world has taken place in China. During the same period, China's rate of rural poverty declined by 89%. During just the 1990's, the number of people consuming the equivalent of less than $1 per day declined from 368 million to 265 million.[2]

Despite these important and impressive accomplishments, China continues to face significant economic challenges. The banking system is still dominated by the government, causing an inefficient allocation of credit and impeding the growth of domestic capital markets. The banking system is believed to be insolvent if assessed according to western accounting standards, and the value of bank loans that are likely to never be fully repaid may be as large as 40% of GDP. China's rapid growth and heavy reliance on coal to satisfy its energy requirements have caused severe environmental damage. China's population is aging rapidly, with the ratio of working-age people to retirees falling from about six today to two in 2040. This will impose significant fiscal costs on the government, especially as many citizens have no

[2] World Bank Country Assistance Strategy for China. February 2003. Speech by World Bank Vice President for Asia and the Pacific. October 17, 2004.

formal pension or health care coverage. State-owned enterprises consume a large share of public resources, contribute to banks' non-performing loans, and constrain the credit available to fund private-sector development. At the same time that the Chinese government is attempting to restructure its inefficient state-owned enterprises—often resulting in substantial layoffs—the government is concerned about creating jobs rapidly enough too absorb over 200 million new labor market entrants over the next decade.

In addition to each of these longer-term structural challenges, China also faces a number of immediate challenges related to its rapid growth and overheating economy. After experiencing real GDP growth of 9.3% in 2003, the Chinese government took a number of steps to attempt to rein in growth. Most of these steps were in the form of administrative controls and central government directives. For example, the government expanded price controls, placed restrictions on investment in certain sectors, and rationed bank credit for certain projects. The central bank of China raised interest rates (albeit only by 27 basis points) in October of 2004 and relaxed controls on certain interest rates so that banks could charge more for loans. Despite these attempts to slow growth, real GDP growth accelerated to 9.5% in 2004—well above the government target of about 7%.

This potentially unsustainable rate of growth presents a number of risks. Bottlenecks and shortages have already occurred in a number of sectors—including energy and transportation. Inflation could also pick up quickly. Although inflation fell slightly to 2.8% (y/y) in 2004 from 3.2% (y/y) in 2003, this was a sharp pickup from deflation in 2002. Moreover, recent data suggest that inflation increased again in 2005—reaching 3.9% (y/y) in February. One price increase of particular concern is the sharp rise in housing prices in major cities, which some analysts have interpreted as evidence that Chinese cities are experiencing a housing bubble. Average residential housing prices in the city center of Shanghai jumped 28% in 2004.[3] Although the government has recently taken steps to rein in housing prices—such as raising down-payment requirements, increasing mortgage costs, and raising the tax rate on short-term capital gains for real estate in Shanghai—it is unclear if these steps will be effective.

Moreover, by relying mainly on administrative controls instead of more market-oriented mechanisms to try to slow growth throughout the economy, China is creating additional economic distortions that will lower productivity and growth in the future. These concerns are supported by recent data on fixed investment. Investment in fixed assets (such as factories, equipment, property and infrastructure) has been increasing rapidly—growing by almost 26% in 2004—so that fixed investment in 2004 reached 51 percent of GDP according to official Chinese statistics. This is very high and well above rates observed elsewhere. For example, the investment-to-GDP level in India and the United States averaged about 23% and 18%, respectively, over the decade through 2002. The average ratio for lower-middle income countries (which includes China) was 26%. The level and growth of fixed investment in China suggest that resources are not being used efficiently and therefore it will be increasingly difficult to sustain high growth rates.

If the Chinese economy is overheating and "bubbles" have formed in some sectors, such as housing, any adjustment could be sharp and severe. In the past twenty-five years, China experienced three episodes of overheating—in 1982, 1987, and 1992. In the first two of these episodes, a sharp increase in inflation was immediately followed by a rapid slowdown in growth. Although a slowdown in China could reduce global commodity prices, thereby benefiting net commodity importers, a sharp fall in Chinese growth could have serious repercussions for countries that have relied heavily on exports to China to support growth. This risk is greatest for many Asian economies and countries that are commodity exporters.

Therefore, as we discuss U.S. economic engagement with China, it is important to keep in mind the substantial challenges China currently faces in maintaining its high rate of economic growth and how China's strong economic growth has benefited the global economy. Although China has had remarkable success in raising its per capita income level, it is still a relatively poor country (especially when compared to many of its Asian neighbors). Although China's rapid growth has lifted hundreds of millions of people out of poverty, there are still hundreds of millions of people in China living in abject poverty. The World Bank estimates that over 200 million Chinese (about 15% of the population) remain below the international poverty threshold of $1 per day. Moreover, since the United States and China are expected to be key drivers of global economic growth in 2005, any policies that cause a sharp economic slowdown in China could undermine global economic growth. It is in the interest of the United States and entire global economy that China reduces its risk

[3] Source: *Economist,* "Property in China", March 23, 2005.

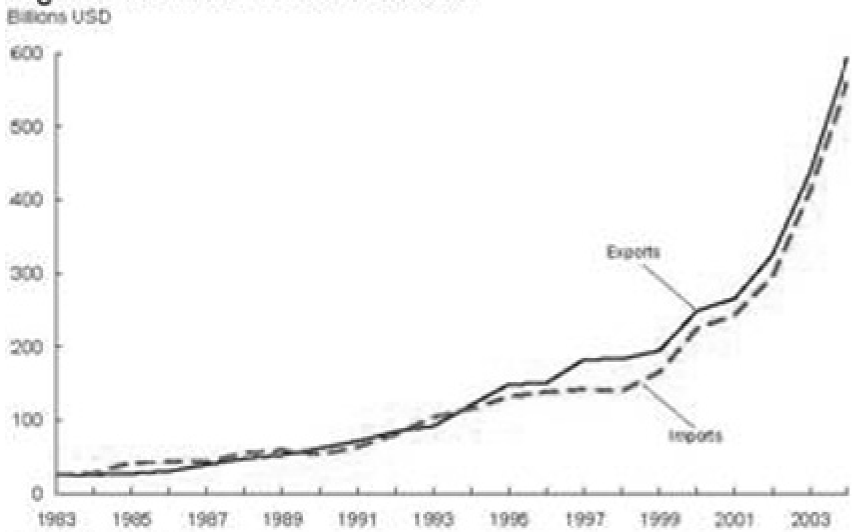
of overheating, avoids a sharp economic slowdown, addresses its significant structural challenges, and continues to be a robust engine of global growth.

China and Global Trading Patterns

As China's economy has grown and developed, China has played a more important role in global trade flows. My colleague from USTR will provide a more detailed discussion of China's trading relationships, so I will only comment briefly on this topic. I will focus on the broader implications of China's emergence as an important participant in global trade.

China's emergence as a major participant in world trade is fairly recent. Total imports to and exports from China were modest throughout the 1980's. [Figure 2.] Imports and exports grew more rapidly in the mid-1990's, partially in anticipation of China's entry into the WTO. China's trade flows have increased even more dramatically since 2000. As a result, the level of Chinese goods' imports and exports has more than tripled over the past five years.

Figure 2: China's Trade in Goods

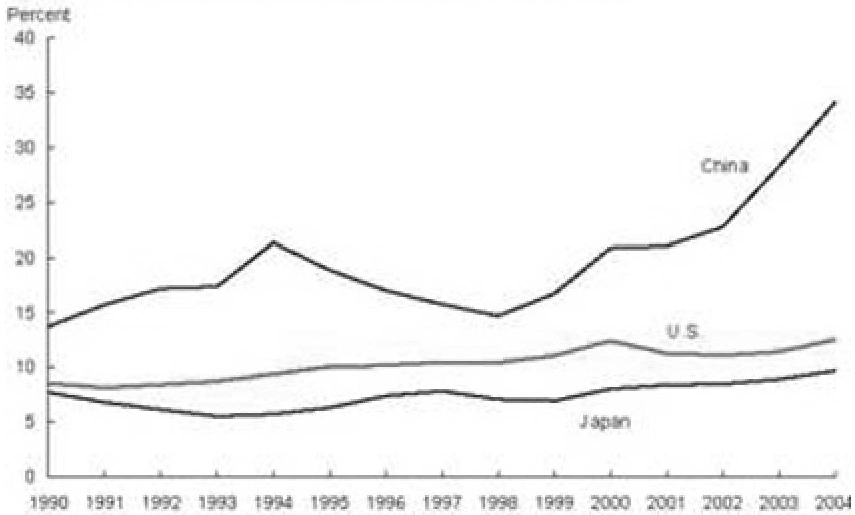


Source: Haver Analytics.

Focusing first on China's imports, China's increased demand for foreign manufactured goods and raw materials has been dramatic. In fact, China is now the world's largest importer of both iron and steel, and the world's third largest importer of manufactured goods. China now purchases about one-third of global soybean imports and one-quarter of global cotton imports. China's imports of both manufactured goods and raw materials have more than doubled over the past seven years. China's demand for imports is particularly striking when measured relative to GDP per capita. Data from the International Monetary Fund indicate that at the end of 2003 China imported $363 worth of goods per dollar of per capita income—far higher than the comparable $34 for the United States, $20 for Germany, $13 for the United Kingdom and $11 for Japan. This increased Chinese demand for imports has boosted exports and growth in many economies, especially Asian neighbors and commodity exporters.

Some U.S. business owners are surprised to see this rapid growth in China's imports, since many companies have faced challenges penetrating the domestic Chinese market. It is true that there are hurdles to doing business in China—such as the weak protection of intellectual property rights and difficulty complying with Chinese regulations that are often not transparent. Even with these challenges, however, China has made progress opening up relatively quickly in a short period of time. [Figure 3.] According to the most common economic measure of openness (the share of imports in GDP), China's imports of goods are roughly 34% of GDP, well above the 13% share for the United States and 10% share for Japan.

Figure 3: Goods Imports as a Percent of GDP



Source: Haver Analytics.

Turning next from China's imports to its exports, although China's exports have increased rapidly, this growth is not unprecedented. Several Asian economies actually experienced even more rapid export growth during their period of rapid economic development than China. For example, Japan, South Korea, and the newly-industrialized economies of Asia (Hong Kong, Singapore and Taiwan), had even faster export growth over an extended period of time than recently experienced by China. [Figure 4.]

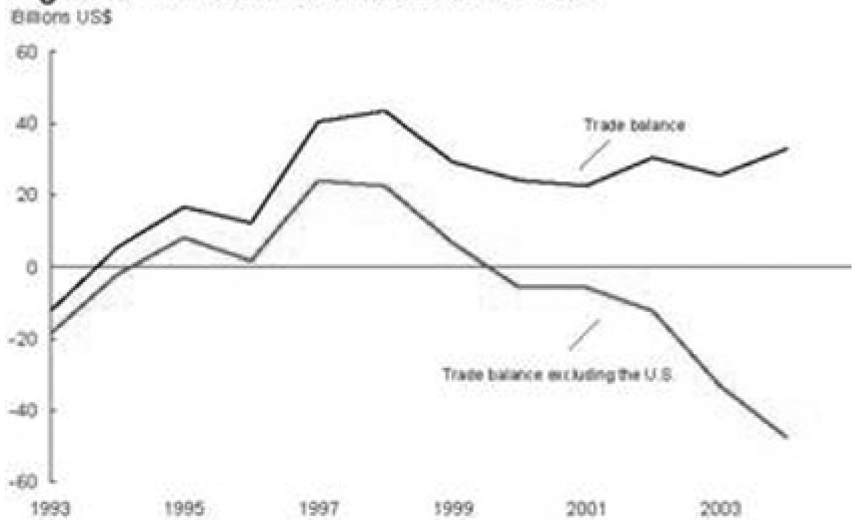
Figure 4: Exports of Selected Economies

(Index, beginning of period = 1, log scale)

Source: IMF, *Direction of Trade Statistics*. Annual exports in U.S. dollars. Newly industrialized economies include Hong Kong SAR, Korea and Singapore.

This combination of rapid growth in both Chinese imports and exports has generated a moderate trade surplus for China over most of the last 15 years. The trade balance has recently increased slightly, from 1.8% of GDP in 2003 to 2.0% of GDP in 2004. (China's current account surplus increased from 3.2% to 4.2% of GDP over the same period.) Much of this trade surplus, however, results from trade with the United States (discussed in more detail below). China has actually had trade deficits or very modest surpluses with many other economies and regions of the world. For instance, in 2004 China had a trade deficit equivalent to 1.4% of GDP with Japan, 2.3% of GDP with Korea, and 3.5% of GDP with Taiwan. China's trade deficits with most countries are so large that China has sustained a trade deficit with the world excluding the United States for several years, and in 2004 China's trade deficit with the world excluding the United States was 2.9% of GDP. [Figure 5.]

Figure 5: China's Trade Balance in Goods



Source: Haver Analytics.

Another important aspect of China's growing trade integration with the global economy is the role of foreign direct investment. Although China still maintains controls on many types of capital flows, China is fairly open to most types of foreign direct investment (FDI). Net FDI in China totaled $64 billion in 2004, making China the world's second largest FDI recipient in that year (after the United States). On a cumulative basis, the United States is the second largest foreign investor in China after Hong Kong, with $48 billion invested through 2004.

High levels of foreign investment in China are closely related to China's trade flows because many of "China's exports" to other countries are actually goods produced by multinational companies in China or Chinese companies that are partially owned by foreigners. In fact, a large fraction of the recent surge in Chinese exports has come from Chinese subsidiaries of global multinational corporations. The share of Chinese exports produced by foreign firms rose from 1% in 1985 to 55% in 2003.[4]

Trade between China and the United States

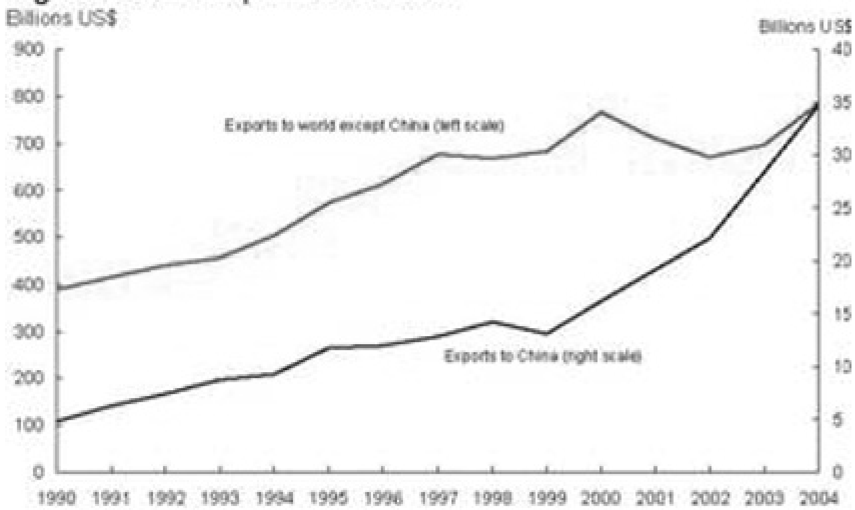
China's rapid growth in its trade flows, foreign investment and overall economy has been apparent not only in the global economy, but also in the world's largest economy—the United States. U.S. purchases of Chinese goods have nearly doubled since 2000, so that the United States is currently China's most important export market. In 2002, China was the 2nd largest source of U.S. imports (behind only Canada).

U.S. exports to China have also increased dramatically so that China is currently the 5th largest export market for the United States. Between 2003 and 2004, U.S. exports to China increased by 22%. This was among the largest increases in U.S. exports to any country in the world. Even more impressive, U.S. exports to China have increased by nearly 115% since 2000. The United States has not increased ex-

[4] Source: Nicholas Lardy, "China: The Great New Economic Challenge," in C. Fred Bergsten (2004) *The United States and the World Economy: Foreign Economic Policy for the Next Decade.*

ports by a comparable amount to any other country in the world over this period. This increase in exports to China is particularly noteworthy considering that U.S. exports to the rest of the world were fairly stable between 2000 and 2004. [Figure 6.] Moreover, even if growth in China moderates, China's large population of over 1.3 billion individuals combined with its expected growth rate higher than in most other large economies suggest that China will continue to be an important driver of U.S. export growth in the coming years.

Figure 6: U.S. Exports of Goods

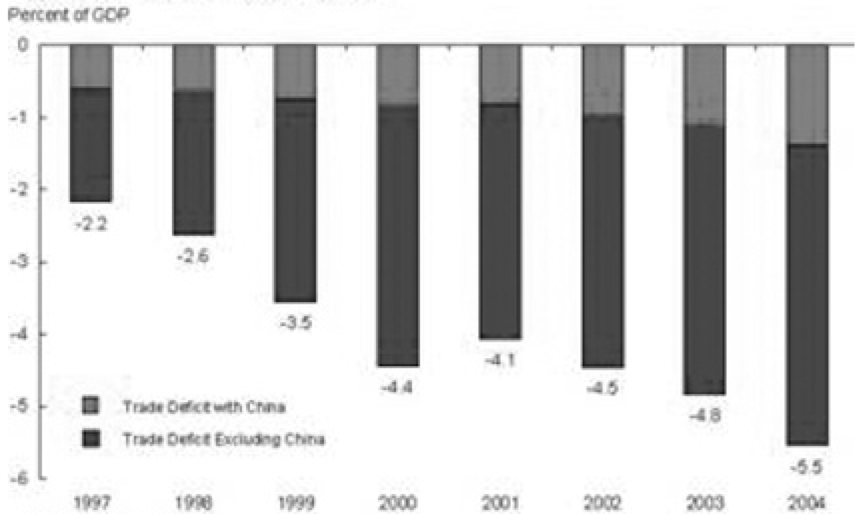


Source: Haver Analytics.

Although U.S. imports from and exports to China have both been increasing rapidly, trade between the U.S. and China is imbalanced. In 2004 the United States reported a trade deficit with China in goods of $162 billion, which is equal to 1.4% of U.S. GDP. This is about 25% of the total U.S. trade deficit of 5.5% of GDP in 2004. Since the U.S. trade deficit with China has increased over the same period that the overall U.S. trade deficit has increased, trade with China is often blamed for the recent increase in the U.S. trade deficit. This is not entirely accurate, however, for three reasons.

First, the U.S. trade deficit excluding China has also risen sharply. In fact, even if the U.S. trade deficit with China was not included, the U.S. trade deficit would still have increased sharply from 1.6% of GDP in 1997 to 4.2% at the end of 2004. [Figure 7.] Trade with China accounted for roughly 24% of the increase in the U.S. trade deficit since 1997—only slightly more than the contributions from U.S. trade with the Euro area (20%) and NAFTA (18%). In fact, China's current contribution to the overall U.S. trade deficit is slightly less than its contribution in 1997, when the U.S. trade deficit with China was 1.5% of GDP.

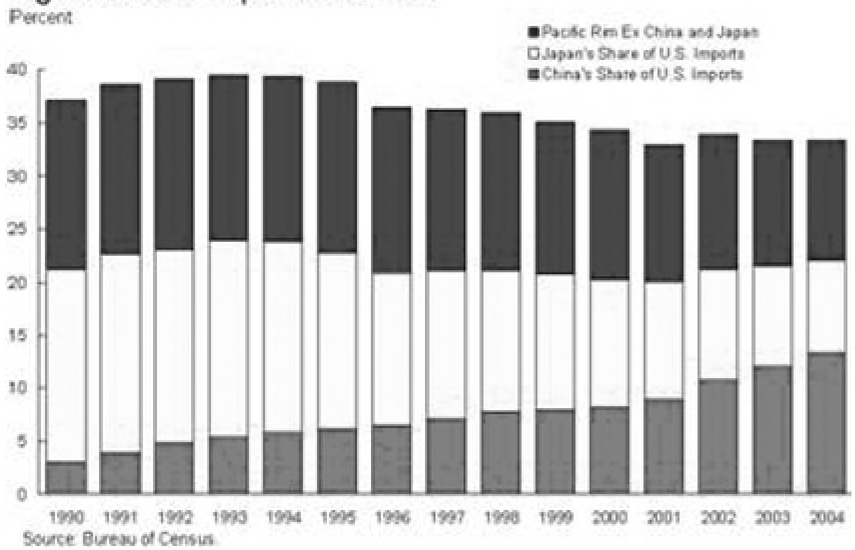
Figure 7 - U.S. Trade Deficit



Source: Haver Analytics.

Second, increased imports from China largely reflect decreased imports of the same goods from other countries, instead of a net increase in the U.S. trade deficit. In other words, many of the products that the United States currently imports from China were previously imported from other countries, not produced domestically in the United States. For example, although the share of U.S. goods' imports coming from China has increased since 1990, the share of imports coming from other countries in the Pacific Rim has fallen by even more—so that the total share of U.S. imports coming from the Pacific Rim (including China) has actually fallen. [Figure 8.] In fact, much of China's recent increase in U.S. import share has come largely at the expense of Japan. Japan's share of U.S. goods imports fell from 12.0% in 2000 to 8.8% in 2004. Over the same time period, China's share of U.S. goods imports increased from 8.2% to 13.3%. Therefore, the share of U.S. imports coming from both China and Japan has only increased slightly, from 20.2% in 2000 to 22.1% in 2004.

Figure 8: U.S. Imports of Goods



This pattern of increased U.S. imports from China largely replacing imports from other Asian countries is apparent not only in bilateral trade patterns, but also in many of the individual sectors in which U.S. imports from China have recently surged. For example, the share of U.S. footwear imports from China increased from 9% in 1989 to 69% in 2003, while the share of U.S footwear imports from other Asian countries (Japan, Hong Kong, Taiwan, and South Korea) fell from 51% to 1% over the same period. South Korea's share of the U.S. footwear import market fell from 27% in 1990 to 0.3% by 2004, while Taiwan's share fell from 16% to 0.4%.

Third and finally, although China is competitive with some low-end U.S. manufacturing products, U.S. trade with China is largely complementary. U.S. imports from China are over 60% consumer goods and 27% capital goods. U.S. exports to China are largely capital goods (46%), industrial supplies (35%), and food (11%). U.S. consumers and U.S. companies that purchase Chinese goods benefit from less expensive Chinese products. Many U.S. retailers that specialize in consumer goods have been able to open more stores and hire more workers due to their ability to sell lower priced goods imported from China. These trends have been particularly beneficial for many low—and middle-income Americans that spend a higher share of their incomes on consumer goods that are more likely to be imported from China.

For all of these reasons, focusing just on the bilateral trade deficit with China is problematic. In fact, the bilateral trade balance between any two countries is generally not considered meaningful in an economic sense. Instead, it is more important to focus on multilateral trade balances, and the corresponding domestic factors causing any multilateral imbalances. A multilateral trade deficit reflects a shortage of national savings relative to national investment. Therefore, any reduction in the U.S. trade deficit would need to be balanced by a reduction in the difference between U.S. national savings and investment. If the U.S trade deficit with China was suddenly reduced, it would need to occur with a corresponding adjustment in other variables—such as an increase in the U.S. trade deficit with other countries, an increase in U.S. national savings, or a decline in U.S. national investment. An increase in U.S. national savings or a decline in U.S. national investment would likely correspond to slower growth in the United States.

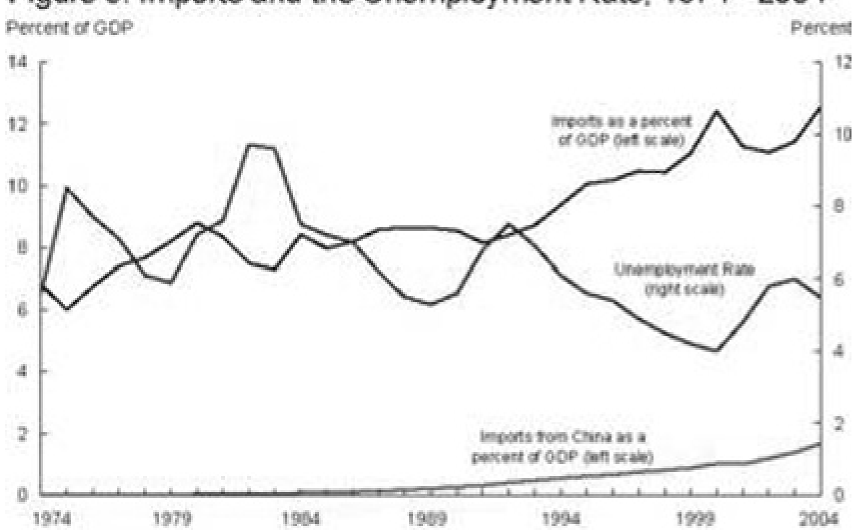
In addition to the relationship between trade with China and the U.S. trade deficit, a closely related issue that has received substantial attention is the impact of China's economic growth and increased trade flows on U.S. employment—especially manufacturing employment. Trade with any country does play a role in shifting U.S. employment towards industries in which the United States has a comparative advantage (mostly services and high-skilled, high-tech manufactured products). Increased trade with China, however, has not caused a large share of aggregate U.S. job losses, even in the manufacturing sector as a whole.

Increased trade with China is a relatively recent phenomenon, while manufacturing employment has been declining as a share of total U.S. employment for decades. This long-term downward trend in manufacturing employment primarily reflects relative gains in manufacturing productivity that have not been offset sufficiently by increased purchases of manufactured goods. In fact, although U.S. manufacturing employment has fallen roughly 20% since 1970, rapid productivity growth has allowed manufacturing production to more than double over the same period.

More recently, the most severe job losses in U.S. manufacturing were mainly concentrated in industries where imports from China are small. Five industries that have contributed significantly to manufacturing job losses since 1997 are: computer and electronic equipment (15.4% of all manufacturing job losses from 1997 to 2004), transportation equipment (8.5%), machinery (11.4%), fabricated metal products (6.4%), and apparel (13.4%). With the exception of apparel, these are export-intensive industries for the United States. Therefore, a more important factor driving job losses in these sectors (with the exception of apparel) was slower export growth to most of the world (excluding China) instead of increased competition from China.

Moreover, employment in the United States has recovered over the past two years, at the same time that imports from China have continued to increase. In fact, over a longer time period, there is no apparent relationship between imports from China, or even total imports, and U.S. unemployment. [Figure 9.]Even though imports as a percentage of GDP (from China as well as the world) have increased since the 1970's, this has not led to any significant increase in the U.S. unemployment rate. Over the past decade the U.S. economy has experienced historically low unemployment, even though imports grew significantly. Roughly 3 million jobs were created in the United States since May 2003, 33,000 jobs were added in manufacturing since February 2004, and the unemployment rate fell to 5.2% in March—below the average of the past three decades. All of these improvements in the U.S. labor market occurred as imports from China surged. Moreover, as trade between the United States and China continues to increase, analysts expect strong job growth to continue in the United States. Blue Chip consensus forecasts predict that approximately 2.2 million jobs will be added to the U.S. economy in 2005 and 2006.

Figure 9: Imports and the Unemployment Rate, 1974 - 2004



Source: Haver Analytics.

Administration Engagement to Ensure the United States Benefits from China's Economic Development

The Administration has been pursuing an active and multi-pronged agenda to ensure that the United States continues to benefit from China's economic growth and increased trade flows. It will be important to continue and strengthen these efforts. Even if trade with China has had a relatively small impact on aggregate U.S. employment and the recent increase in the U.S. trade deficit, individual sectors of the U.S. economy can be harmed by China's rapid economic growth and increased role in global trade. Although some companies and their corresponding workers benefit from increased exports to China, other companies and workers face greater competition from increased imports from China. Although many U.S. consumers benefit from cheaper sneakers, toys and sporting goods from China, other Americans could become unemployed due to this greater competition. These difficult adjustments affect not only individual companies and workers, but also their families and communities. Therefore, the Administration has taken a number of steps to help individuals adjust to these changes and to ensure that U.S. workers have adequate skills in order to succeed in new job opportunities. After discussing these specific steps, I will then describe a number of additional components of the Administration's strategy (including on exchange rate policy and maintaining U.S. competitiveness) to ensure that the United States continues to benefit from China's economic development.

The Administration has taken a number of important steps to ensure that U.S. workers have adequate skills in order to adapt to and benefit from increased trade with China (as well as trade with all other U.S. trading partners). Several programs focus on ensuring that workers receive training so that they can adopt new technologies to succeed in the global economy. For example, the Trade Adjustment Assistance (TAA) program was recently expanded to cover more workers and provide more income support, training, relocation and job search allowances. A health coverage tax credit was also added. The President's "Jobs for the 21st Century" initiative supports students and workers by improving high school education and strengthening post-secondary education and job training. This initiative includes funding to increase job training at community colleges. In addition, to help workers find better, higher-paying jobs, the President has proposed doubling the number of people trained through our principal job-training grant programs that are authorized under the Workforce Investment Act.

To further increase individual choice for workers, Innovation Training Accounts, as proposed by the President in his Job Training Reform proposal, build upon the success of Individual Training Accounts that are authorized under the Workforce Investment Act. Innovation Training Accounts allow individuals to access a broad range of public and private training resources through a single, self-managed account. They would also authorize longer-term training opportunities by acknowledging that many skills needed for today's jobs require more than just short-term attention and exposure.

Another important new step for helping Americans succeed is Personal Reemployment Accounts (PRAs). PRAs will provide certain individuals who lose their job with money that they can use in a manner they think will best help them obtain a new job—such as for training, transportation, child care, or relocation. Workers who find new jobs quickly and retain those jobs for six months will receive a reemployment bonus. The Department of Labor currently is administering a PRA demonstration that includes seven states.

Also, to help workers in poor communities and communities that have lost manufacturing, textile and other jobs, the President has proposed the creation of opportunity zones. These zones will include special tax relief and other incentives to attract new business and to improve housing, job training, and high-tech infrastructure in order to assist these communities. Although none of these proposals can fully remove the difficulty and suffering for workers and their families when they become unemployed, they should help ease the transition and help provide workers with new skills to find employment. As a strong signal of commitment to all of these programs, the President has proposed over $21 billion for worker training and employment programs in the 2006 budget, including more than $7 billion in Pell Grants to be used at two-year post-secondary schools, where many people train for work.

In addition to taking steps to help U.S. workers adjust to increased global trade flows, the Administration is also taking a number of steps to ensure that the U.S. continues to benefit from increased trade with China. The Administration is actively engaged in a number of dialogues and meetings to ensure that China continues to open its market to U.S. exports and fully implements its commitments made to the World Trade Organization. China must continue to open its markets to U.S. services, agriculture and industrial products, as well as to effectively enforce intellectual property laws. My colleague from the USTR will discuss the Administration's vigorous efforts in these areas in more detail.

The Administration is also actively engaged with China to reduce barriers to capital flows, develop more open and sophisticated capital markets, and adopt a more flexible exchange rate regime. The Administration has stated in private bilateral meetings as well as in multilateral forums (such as the G–7, IMF, and APEC), that the international trading system works best with free trade, the free flow of capital, and currency values set in open and competitive markets. In particular, the Administration believes that now is the appropriate time for China to adopt a more flexible exchange rate regime. It is in China's best interest to adopt a more flexible currency now while economic growth is strong. A more flexible currency would provide China with greater independence in monetary policy—a step that would help reduce the current risk of overheating.

The Chinese authorities, on a number of occasions, have clearly stated their intent to move to a more flexible exchange rate regime. Although they have not specified a date for this adjustment, China has recently taken a number of steps to build the necessary infrastructure and gain experience useful to successfully adopt more exchange rate flexibility. For example, China has recently taken important steps to develop foreign-exchange trading, including the development of hedging instruments and internal controls on foreign-exchange exposure. In March 2005 China announced that seven international banks would join two domestic ones as market makers for foreign-exchange trading. These banks will be able to trade and quote prices in eight currency-pairs—providing a platform that can then be used to trade a more flexible yuan. China is also making solid progress in restructuring its state-owned banks by reducing non-performing loans and improving lending standards and corporate governance.

The Administration, led by the U.S. Treasury Department, has also been actively assisting the Chinese authorities in resolving concerns in areas they see as obstacles to exchange rate flexibility. For example, the U.S. Treasury has established a Technical Cooperation Working Group that had three sessions with China in 2004 to focus on issues such as supervising banks' management of exchange rate risk and regulating foreign currency derivatives' markets. Additional sessions are already planned for 2005. In September 2004, Secretary Snow hosted a high-level meeting of the Joint Economic Committee (JEC), which included Federal Reserve Chairman Greenspan and 40 Chinese delegates. The JEC discussed a range of economic and financial issues and agreed to a joint public statement including China's commitment to exchange rate flexibility. The U.S. Treasury Department also designated a special representative, Ambassador Paul Speltz, to continue frequent dialogue with the Chinese government on these issues and encourage them to accelerate movement toward a flexible exchange rate regime.

The U.S. Administration has also recently built on these bilateral engagements by continuing to work through multilateral channels to encourage China to move to more exchange rate flexibility. In February of 2005, G–7 Finance Ministers and Central Bank Governors met again with their Chinese counterparts. They reaffirmed their support for flexible exchange rates and emphasized that more flexibility "is desirable for major countries that lack such flexibility to promote smooth and widespread adjustments in the international financial system." In the last two months key Ministers in Japan, Korea, and Britain have spoken publicly on the need for a flexible currency regime in China. The International Monetary Fund has repeatedly called for China to adopt a more flexible exchange rate regime, including most recently in its World Economic Outlook just released as part of the Bank-Fund Spring meetings. President Haruhiko Kuroda, in his first press conference as the new head of the Asian Development Bank, also urged China to adopt more exchange rate flexibility.

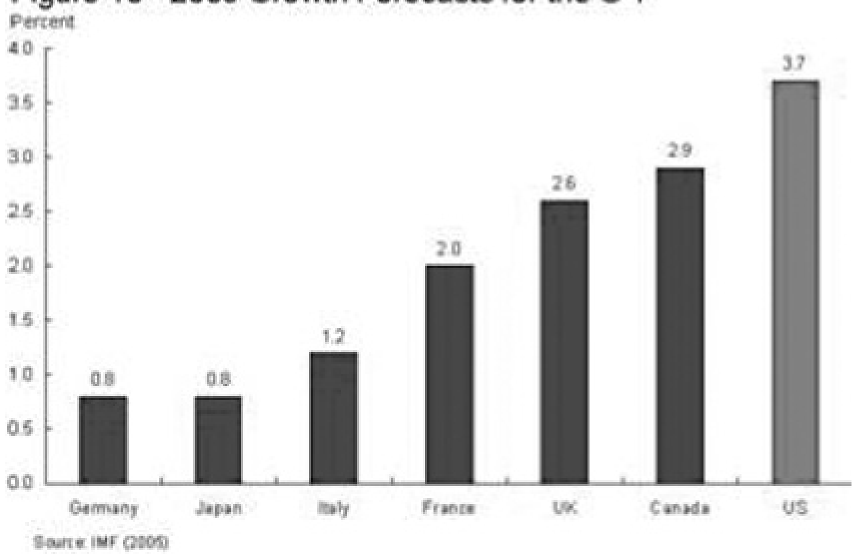
A final key pillar of the Administration's strategy to ensure that the United States benefits from China's rapid economic growth and increased trade flows is to strengthen the U.S. economy and make certain that the United States is an attractive and competitive location for companies to do business. In an effort to attain these goals, the Administration will continue to restrain spending and strengthen institutions such as social security for future generations. The Administration will continue to enforce our trade agreements and lower barriers to trade through multilateral and bilateral trade agreements, in order to ensure that U.S. companies can successfully compete in foreign markets. The Administration will also continue to support pro-growth policies, such as: making tax relief permanent; reducing the burden of lawsuits by supporting additional tort reform; passing a comprehensive national energy policy in order to increase energy efficiency and ensure an affordable and predictable energy supply; making health care costs more affordable through proposals such as Association Health Plans, tax-free Health Savings Accounts and health information technology; and streamlining regulations to ensure that they are reasonable and affordable.

Final Thoughts

China's rapid economic growth and development has lifted hundreds of millions of people out of poverty and helped spur global exports and global growth. China's emergence as a significant participant in the global economy and global trade, however, also presents challenges as countries, including the United States, adjust to these developments. The U.S. Administration is pursuing an active and multi-pronged agenda to ensure that the United States is able to benefit from these changes. Since China is one of the fastest growing export markets in the world, part of this agenda will continue to be to ensure that U.S. companies have access to this large market and the opportunity to compete. Although adjusting to China's increased economic role will not be easy, it is important to remember that any steps taken to smooth this adjustment should also be aimed at ensuring the United States continues to be a competitive and dynamic economy.

Average GDP growth in the United States in 2003 and 2004 was higher than in any other member of the G–7 group of developed economies. This trend is expected to continue in 2005—with the IMF forecast predicting that growth in the U.S. will be 3.7% in 2005—not only stronger than in every other member of the G–7—but more than double the expected growth rates in Germany, Italy, and Japan. [Figure 10.]

Figure 10 - 2005 Growth Forecasts for the G-7



Therefore, as we discuss different proposals to shape the future, we must be careful not to threaten this success with short-term fixes that could damage our long-term competitiveness. Instead, it is important to focus on ways to help strengthen the U.S. economy as the global economy evolves, and ensure that we continue to improve the competitiveness of companies operating in the United States. The Administration is committed to continuing and building on these efforts.

Chairman THOMAS. Mr. Freeman.

STATEMENT OF CHARLES W. FREEMAN, III, ASSISTANT U.S. TRADE REPRESENTATIVE OF CHINA AFFAIRS, OFFICE OF THE U.S. TRADE REPRESENTATIVE

Mr. FREEMAN. Thank you, Chairman Thomas and Members of the Committee. I do appreciate the opportunity to testify today on issues surrounding U.S.-China trade. I have submitted prepared testimony but would like to summarize that and offer a few thoughts on the key issues affecting bilateral U.S.-China trade. Obviously with concerns raised by Congressman Sanders and others about our trade deficit with China and the other issues that are inherent in this complex a relationship as that which we have with China, a number of very positive economic considerations to that relationship can be overlooked. This is especially true as we review the years since China joined the WTO on December 11, 2001.

We should not forget in approving China's accession to WTO, the United States did not make any specific new concessions to China other than to agree to accord China the same treatment it accords the other 146 members of the WTO. In contrast, China committed to make dramatic changes to its trade regime and to open its market significantly to U.S. manufactured goods, agricultural commodities and services. As a result, and as discussed by my colleague from CEA, U.S. exports to China have increased dramatically to $35 billion in 2004, close to double the total for 2001. From 2001 to 2004 U.S. exports to China increased eight times faster than U.S. exports to the rest of the world. As a result, China rose from our ninth largest export market in 2001 to become our fifth largest export market in 2004. China is more welcoming of imports than some of our other trading partners in the region, especially given this stage in its development. China is certainly a major exporting power. It is the world's third biggest now, but it is also the third biggest importing economy.

Our focus at USTR, therefore, is ensuring that U.S. exporters of manufactured goods, agricultural commodities and services have unimpeded access to China's market and that Chinese trade practices do not otherwise unfairly disadvantage U.S. producers. The emphasis in this work has been to focus on resolving problems in a way that delivers results as expeditiously as possible for America. With that in mind the Administration has had a comprehensive engagement with China that has over the course of the past few years resulted in solutions to trade concerns that have enabled billions of dollars of goods and services to reach China's markets. In late 2003 President Bush and Chinese Premier Wen Jiaboa constructed a problem-solving dialogs that resulted in the resolution of 7 potential WTO cases against China in 2004 and paved the way for a resolution of the first ever and only WTO case filed against China by any WTO member on China's tax treatment of imported semiconductors.

We clearly continue to have our work cut out for us and there are a number of critical trade issues with China that we will face over the months and years to come. Intellectual property rights infringement is obviously at the top of our priority list with respect to China. We have initiated a comprehensive strategic effort to deal with the problem of IPR infringing exports from China. We are reviewing the consistency of China's IPR regime with WTO requirements and we are working to improve the capacity for IPR enforcement in China. Later this month the Administration will complete an out of cycle review of China's IPR regime under Special 301 of the Trade Act 1974, and we look forward to working with Congress and industry to address the results of that review. With the end of the textile quota system on January 1st of this year we clearly face a dramatic shift in textile and apparel trade patterns that has already been of profound benefit to China. The scale of China's textile production and the fact that China was not a member of the

WTO when the agreement on textiles and clothing was established in 1995 is one of the main reasons we negotiated the special textile safeguard as part of China's WTO accession agreement during the previous Administration.

As you know we exercised that safeguard a number of times in 2003, and recently, following the rise of textile imports earlier this year, the Administration self-initiated safeguard investigations in to imports of three categories of apparel from China. In addition to these issues and apart from issues with which other agencies, including Department of the Treasury and Labor, are seized, the Administration is working hard across the board to encourage greater market access for our agriculture producers, intellectual property rights holders, service providers and manufacturers. We have an ongoing dialog with our Chinese counterparts to improve access for U.S. agriculture into China which is already a very significant market for our farmers, to reduce barriers to trade in services in which enjoy a healthy surplus with China, ensure the ability of our exporters to distribute goods easily in China, do away with industrial and tax policies, standards and other measures that encourage Chinese enterprises to develop at the expense of our exporters, and ultimately and finally, improve China's regulatory transparency.

We are making good headway, but continuing on this path requires constant vigilance and the attention of Congress and senior officials across the range of departments. Your continued leadership and support on these issues and constant encouragement of both the Administration and the Chinese government to make sure that this is a trade relationship that works for American interests is critical. We look forward to continuing our production relationship with your offices, and I look forward to your questions. Thank you.

[The prepared statement of Mr. Freeman follows:]

Statement of Charles W. Freeman III, Assistant U.S. Trade Representative of China Affairs, Office of the U.S. Trade Representative

Introduction

Chairman Thomas, Congressmen Rangel and Members of the Ways and Means Committee, I appreciate the opportunity to testify today on issues surrounding the U.S.-China trade relationship and, in particular, the Administration's efforts in ensuring that China fulfills the commitments that it made upon joining the World Trade Organization (WTO). This is a subject of considerable importance and a matter of great priority for the Administration and the Office of the U.S. Trade Representative (USTR), in our capacity as the lead agency with responsibility for U.S. trade policy.

Clearly, China's economic emergence presents both challenges and opportunities for U.S. manufacturers, farmers, service providers and workers. While there is much positive to say about our success in penetrating the Chinese market, there is understandable concern that certain Chinese trade practices have frustrated efforts to further open the market, or have in other ways contributed to our large and growing trade deficit with China.

There are several areas where we have problems with China's trade practices, and this Administration is working vigorously to address those, using the most effective tools at our disposal, including our trade remedy laws.

Let me first put in context the concerns about our trade relationship with China:

- When China joined the WTO in December 2001, the United States did not make any specific new concessions to China, other than to agree to accord China the same treatment it accords the other 146 members of the WTO. In contrast, China committed to make dramatic changes to its trade regime and to open its market significantly to U.S. manufactured goods and services.

- U.S. exports to China have increased dramatically since China joined the WTO in 2001. U.S. exports to China totaled $35 billion in 2004, close to double the total for 2001. In fact, from 2001 to 2004, U.S. exports to China increased nearly eight times faster than U.S. exports to the rest of the world. As a result, China rose from our ninth largest export market in 2001 to our fifth largest export market in 2004.
- In the past four years, the Administration has taken aggressive action to help facilitate this export growth, using a variety of diplomatic, legal and other tools to bring real results in our trade relationship. In 2004, we used high-level dialogue and trade diplomacy to resolve seven potential WTO disputes with China, and we were the first (and still only) WTO member to file a dispute settlement case against China at the WTO.
- In part as a result of these efforts, the American Chamber of Commerce opined in September 2004 that, "[w]ith the exception of intellectual property rights, we believe China is substantially in compliance with its WTO deadlines and specific obligations." That is an optimistic opinion in some respects, but it does reflect the significant progress China and the United States have made in the years since China's WTO accession.
- Our trade deficit with China is driven by many factors, including the strong growth of our economy and our expanding ability to buy and consume large amounts of imports.
- A large portion of the recent increase in our trade deficit with China represents a shift in trading patterns, particularly in Asia, and has come at the expense of other countries. That is, much of the import growth from China is displacing imports from other countries rather than U.S. production.
- With respect to our trade remedy laws, the United States was the first WTO member to invoke the China-specific textile safeguard to address market disruption caused by a surge in Chinese imports, and has just self-initiated investigations to consider limits on additional categories. We have also continued to apply our anti-dumping laws with respect to unfairly traded imports from China and make use of special non-market economy methodologies in assessing dumping margins.

With this background, let me give some more detail about China's implementation of its WTO commitments and the Administration's efforts to ensure an open and level playing field for our manufacturers, service suppliers, farmers and workers.

China's WTO Compliance

In its accession agreement to the WTO, China agreed to extensive, far-reaching and often complex commitments to change its trade regime, at all levels of government. China committed to implement a set of sweeping reforms that required it to lower trade barriers in virtually every sector of the economy, to provide national treatment and improved market access to goods and services imported from the United States and other WTO members, and to protect intellectual property rights (IPR). China also agreed to special rules regarding subsidies and the operation of state-owned enterprises, in light of the state's large role in China's economy. In accepting China as a fellow WTO member, the United States also secured a number of significant concessions from China that protect U.S. interests during China's WTO implementation stage. Implementation should be substantially completed—if China fully adheres to the agreed schedule—by December 11, 2007.

To date, while China's efforts to fulfill its WTO commitments are impressive, they are far from complete. At times, China's efforts have been unsatisfactory, and the Administration has responded with appropriate steps in such cases. The first year of China's WTO membership (2002) saw significant progress, as China took steps to repeal, revise or enact more than one thousand laws, regulations and other measures to bring its trading system into compliance with WTO standards. In 2003, however, China's WTO implementation efforts lost momentum, and we identified numerous specific WTO-related problems.

In response, the Administration stepped up its efforts to engage China's senior leaders. In December 2003, President Bush and China's Premier, Wen Jiabao, committed to upgrade the level of economic interaction and to undertake an intensive program of bilateral interaction with a view to resolving problems in the U.S.-China trade relationship. Premier Wen also committed to facilitate the increase of U.S. exports to China. This new approach was exemplified by the highly constructive Joint Commission on Commerce and Trade (JCCT) meeting in April 2004, with Vice Premier Wu Yi chairing the Chinese side and Secretary of Commerce Evans and United States Trade Representative Zoellick chairing the U.S. side. At that meeting, which followed a series of frank exchanges covering a wide range of issues in late 2003 and early 2004, the two sides achieved the resolution of no fewer than seven potential disputes over China's WTO compliance. Those successes ranged across the economic spectrum, from wireless standards to biotechnology to trading rights and distribution services.

At the same time, when our discussions with China were not successful, we did not hesitate to use the full range of tools made available to us as a result of China's WTO accession. The United States filed, and was able to successfully resolve, the first-ever dispute settlement case brought against China at the WTO. In that case, the United States, with support from four other WTO members, challenged discriminatory value-added tax policies that favored Chinese-produced semiconductors over imported semiconductors. In July 2004, about three months after the United States had initiated the case, China agreed to end its discriminatory policies, allowing U.S. manufacturers to preserve and expand their $2 billion export business to China.

Our trade relationship with China is large and growing, so it is not surprising that despite successes in a number of areas, some problems still remain and new ones have emerged. Of key concern, for example, is that China's implementation of its WTO commitments has lagged in areas in which the United States has a competitive advantage, particularly where innovation or technology plays a key role. At present, we are pressing China in the following priority areas:

- The Administration places the highest priority on improving the protection of intellectual property rights (IPR) in China. Counterfeiting and piracy in China are at record levels and are hurting a wide range of U.S. businesses. While China has recently taken a number of steps at the national level to address this situation, such as lowering the value thresholds that trigger criminal investigations and prosecutions, so far these steps have not translated into actual reduced infringement at the provincial and municipal levels. The Administration is currently conducting a China-specific out-of-cycle review under the Special 301 provisions of U.S. trade law and will take appropriate action at the conclusion of that review to ensure that China develops and implements an effective system for IPR enforcement, as required by the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights.
- Supplementing these bilateral IPR efforts, the Administration has taken comprehensive action to block trade around the world in counterfeit and pirated goods through the Strategy Targeting Organized Piracy (STOP!), a U.S. government-wide initiative begun in October 2004 to empower U.S. businesses to secure and enforce their intellectual property rights in overseas markets, to stop fakes at U.S. borders, to expose international counterfeiters and pirates, to keep global supply chains free of infringing goods, to dismantle criminal enterprises that steal U.S. intellectual property and to reach out to like-minded U.S. trading partners in order to build an international coalition to stop counterfeiting and piracy worldwide.
- While China has implemented its commitment to allow companies and individuals to import goods into China directly without having to use a middleman, our companies are not faring as well when it comes to selling those same products at the wholesale and retail level in China. China did issue regulations calling for timely implementation of its WTO commitment to open up wholesaling and retailing to foreign companies by December 2004. However, U.S. and other foreign companies have encountered impediments to actually providing these services because of ambiguities in the application of these regulations, as well as related licensing procedures. The Administration has been pressing the Chinese authorities to clarify these procedures so that our companies can take advantage of the rights that they have in the wholesaling and retailing areas. Meanwhile, one segment of the distribution services sector—direct selling—is causing particular concern. Not only has China failed to implement timely regulations, but China is also considering restrictions that would make it difficult or impossible for U.S. direct selling companies to operate in China. The Administration has made clear its serious concerns in this area.
- Since acceding to the WTO, China has periodically resorted to policies that limit market access by non-Chinese origin goods and that aim to extract technology and intellectual property from foreign rights-holders. The objective of these policies seems to be to support the development of Chinese industries that are higher up the economic value chain than the industries that make up China's current labor-intensive base, or simply to protect less-competitive domestic industries. Of particular concern is China's recent proposal to implement restrictive government procurement policies for software, which will not only hurt U.S. interests but also undermine China's efforts to develop its software industry. The United States and China made important progress toward resolving conflicts over a number of these industrial policies in 2004 (for instance, China's pro-

posed use of a unique, mandatory Chinese standards for wireless encryption), but more work needs to be done, and the advent of new or similar policies in the future will require continued vigilance.

- While the United States enjoys a substantial surplus in trade in services with China, and the market for U.S. service providers in China is increasingly promising, problems remain in a number of important service sectors. Through an opaque regulatory process, overly burdensome licensing and operating requirements, and other means, Chinese regulatory authorities continue to frustrate efforts of U.S. providers of insurance, express delivery, telecommunications and other services to achieve their full market potential in China.
- With U.S. agricultural exports totaling $5.5 billion in 2004, China has become one of the fastest growing overseas markets for U.S. farmers. Despite this growth, however, China's regulation of the agricultural sector is beset by uncertainty. Capricious practices by Chinese customs and quarantine officials can delay or halt shipments of agricultural products into China, while sanitary and phytosanitary standards with questionable scientific bases and a generally opaque regulatory regime frequently bedevil traders in agricultural commodities. While the Administration was able to make substantial headway on a number of key issues in agricultural trade in 2004, particularly in the area of biotechnology approvals and the removal of problematic sanitary and phytosanitary measures that had been curtailing trade, maintaining and improving China's adherence to WTO rules in the area of agriculture will require continued high-level attention in the months and years to come. Currently, one of our top priorities in this area is for China to re-open its market to U.S. beef based on internationally accepted scientific standards for human and animal health.
- While China's Ministry of Commerce has made laudable moves toward adopting WTO transparency norms, other ministries and agencies have lagged behind. As a result, China's regulatory regimes continue to suffer from opacity, frustrating efforts of foreign—and domestic—businesses to achieve the potential benefits of China's WTO accession. The Administration remains committed to seeking improvements in this area.

U.S. Enforcement of Trade Remedy Laws

The rapid expansion of trade between the United States and China since China's WTO accession has inevitably led in some cases to competition between our domestically produced goods and Chinese imports. When our industries face injurious trade with China, the Administration is fully committed to enforcing U.S. trade remedy laws and to exercising the important rights that the United States negotiated under China's WTO accession agreement.

One important U.S. right is the ability to continue to apply special methodologies to China under the antidumping laws. The Administration has applied those special methodologies in numerous cases. Since China's entry into the WTO, the Department of Commerce has imposed 22 antidumping orders on imports from China, representing one-third of total U.S. antidumping orders issued during that time period.

As part of the WTO accession agreement, the United States negotiated—and China agreed to—two separate China-specific safeguard mechanisms that allow WTO members to address market disruption caused by increasing economic integration with China. One of these mechanisms, the product-specific safeguard, was codified as Section 421 of the Trade Act of 1974, and is available until December 11, 2013. Since the implementation of Section 421, five petitions have been brought requesting import relief. In two cases, the International Trade Commission found that our domestic producers' market had not been disrupted by imports from China. In three other cases, while the ITC found market disruption, the President determined that the adverse impact on the U.S. economy of employing a safeguard was clearly greater than the benefits from providing import relief. While to date no import relief has been granted under Section 421, the President, in his most recent determinations, reiterated his commitment to using this safeguard mechanism when the circumstances of a particular case warrant.

The second safeguard mechanism agreed to by China as part of its WTO accession package, available until December 31, 2008, allows WTO members under certain circumstances to invoke a 7.5 percent cap on annual growth in imports of a given textile category for up to one year (6 percent for wool products). In 2003 and 2004, when most categories of textiles and apparel products were still subject to quotas, the Committee for Implementation of Textile Agreements (CITA) found for petitioners in four investigations under this safeguard mechanism and imposed 7.5 percent caps on imports of Chinese socks, knit fabric, brassieres, and robes and dressing gowns.

On January 1, 2005, the structure of global trade rules that had governed the textiles sector for several decades changed, as all WTO members lifted remaining quotas on textile and clothing imports in accordance with an agreement negotiated more than 10 years ago. While the Administration has confidence in the ability of our textile industry to compete under these new circumstances, many countries, including the United States, face new competitive challenges as a result of the lifting of the quotas.

In late 2004, the Administration agreed to consider 12 petitions from industry alleging a "threat" of market disruption due to anticipated surges in Chinese imports following the lifting of quotas at the beginning of this year. However, in a lawsuit initiated by one group of textile importers, the U.S. Court of International Trade enjoined the United States from further consideration of these threat-based requests. The Administration has appealed that injunction and is awaiting a decision. In the interim, the Department of Commerce implemented a new system to monitor imports of textiles and apparel products in order to provide the Administration and the public timely access to preliminary data regarding the impact of imports on the U.S. market. Using that data, earlier this month, CITA self-initiated safeguard investigations of cotton knit shirts and blouses, cotton trousers and cotton and man-made fiber underwear from China, all of which have been imported in substantially increased quantities in the first three months of this year. A short time later, U.S. industry filed seven petitions, covering 14 other product categories. We are in the process of considering those now.

Broader U.S.-China Economic and Trade Cooperation

As China's integration into the world economy deepens, it becomes increasingly important for the United States and China to work together to promote our mutual interests. The United States and China have discussed various ways in which we can cooperate on international economic and trade issues, particularly given our largely complimentary economies.

Of particular importance at this time are the WTO's Doha Development Agenda negotiations. We have had frank discussions with China on the progress of those negotiations and will continue to engage China in an effort to promote our common areas of interest. In the coming year, China will become a focal point in the negotiations, as Hong Kong will be hosting the WTO's Sixth Ministerial Conference in December, when WTO members intend to set the stage for conclusion of the negotiations in 2006.

Conclusion

Mr. Chairman and members of the Committee, thank you for providing me with the opportunity to testify. I look forward to your questions.

Chairman THOMAS. Thank you very much. I enjoyed reading the testimony that you submitted. I want to congratulate you, Dr. Forbes. You got in almost every one of the graphs that you had in your written statement in your verbal presentation. It is useful and valuable information. I don't know whether the rules permit me to say this, but C–SPAN is taping this and they will show it at a later date, and so far I don't know if we are going to retain the audience that began at the beginning because they probably want to submit at least one unit and perhaps three units of graduate credit for the way in which we discuss this issue. I could ask you a series of questions dealing with the ongoing difficulty notwithstanding the fact our ability to export agricultural products to China, but if not a systematic, certainly an enduring non-tariff trade barrier problem with sanitary and phytosanitary concerns. It just seems as though you can never get on top of it, and China is not the only one that has that problem.

What I am trying to do is cut through a lot of these particulars, especially in response to what people are reading about in the headlines in terms of the enormous trade imbalance, and notwithstanding the factual evidence of comparing the rapid growth of the beginning of the trade imbalance with China and parallel it with Korea and Japan, that is to assume that that means it is okay because it has some historical relevance, and most people would say that they do not agree with that. So, one of the things that I would like you to do, if possible in the brief response time, is to take a step back from the very narrow particulars that you have presented quite adequately, and give us two or three fundamental "don't do them," and hopefully two or three fundamental "dos."

Now, we have some difficulty in dealing with that because there is just a myriad of areas that we can examine in terms of China, but one of the areas that I think, I hope is in your response is what we can do to deal with the dual-ability of the government of China to peg its currency which creates a windfall and a distortion, but also to control the interest rate which allows for an inordinate stimulant within the country which magnifies the factor of the currency pegging, and that where in your opinion can we get the Chinese to move on at least some front. My personal belief is the interest rates are far easier and ought to be opened up as much as possible so that you can get a real indication of growth, and that the currency would be a bit more unstabling in the Chinese economy, and perhaps that would occur later. Two or three "dos" and two or three "don't's" please.

Ms. FORBES. Okay. It is hard to limit myself to two or three but I will try.

Chairman THOMAS. That is why I structured it that way.

Ms. FORBES. Yes. What not to do, I will start with that. One policy I would highly recommend not to do is to put a large tariff on all imports from China. That would not only hurt the U.S. economy, for example, that would raise import prices in the U.S., it would raise consumer prices in the U.S. so all of your people in your district who like to shop at WalMart and stores like that would suddenly see prices rise. This could feed inflationary pressure in the U.S. It could raise the cost of doing business in the U.S. for companies that import inputs from China.

Chairman THOMAS. That is one.

Ms. FORBES. Second, what I would not do is up the rhetoric so much against China that it becomes hard for them to work with us in a collaborative engagement.

Chairman THOMAS. Okay.

Ms. FORBES. That was then a lead-in to what I would do. I would support continued constructive engagement and collaboration between the U.S. and China through a whole host of dialogs which we have established in the Administration. This has yielded real results. We have much more work to do, but by working together I think we have accomplished much, much more than bringing every single dispute to a multilateral trading mechanism.

Chairman THOMAS. I will agree with that, but you need to emphasize the wins, and frankly you need one or two big ones in a short timeframe, as I hope you have noticed the change in the climate. Thank you. Mr. Freeman?

Mr. FREEMAN. I think one of the dos from our standpoint is to make sure that we are focusing on some of the real issues in our trade relationship. Yes, the currency issue is fundamental, but there are multiple different issues that really affect the trade relationship and really are a priority, and a key one is obviously intellectual property rights, and we really need leadership, not just from the Administration, but also from the Congress to make sure that China understands that it needs to muster the political will to address the problem. There is a lot that we can do, the Administration currently can do, to try to work to limit the impact of imported counterfeiting into this country from China, and also to try to develop the capacity within China to take care of some of the legal capacity in China to deal with IPR. Really it is about making sure that the Chinese government understands that this is something that requires them to exercise dramatic political will to address the situation domestically.

Chairman THOMAS. You would think that for starters the government of China itself would not utilize counterfeit software within the government. That would seem to be a reasonable first step. It is those kinds of counterpoints that come back to you that in the Chair's opinion completely demolishes your argument that you are going to be working together and see progress moving forward. That kind of an inability to respond specifically to the fact that at least the Chinese government ought not to use it itself. Rather than worry about exporting counterfeits to the U.S. or controlling counterfeits within its own country, which are difficult in many other countries as well, but at least the government commits to not using it. Those are the kinds of points that if they aren't articulated strongly by our government and not responded to by the Chinese that is going to continue to feed the attitude that you see here and obviously partially expressed by the Chairman. The gentleman from Michigan wish to inquire?

Mr. LEVIN. I am glad I came after you because it is a follow up to what you said. You know I have read your testimony, and I will tell you how it clearly comes across, and that is the policy, the approach of this Administration is basically acquiescence. It is not energetic. Just look at your testimony, Ms. Forbes, on page 8 and 9. You give all the reasons why it is wise to tone down concern about our trade deficit with China. Excluding China the trade deficit has also risen sharply. That does not cut much ice. That increased imports from China largely reflect decreased imports of the same goods from other countries, there has been some displacement, but the figures show the overall imports from Asia have increased.

Then you go on and say: Although China is competitive with some low-end U.S. manufacturing—this is on page 8 and page 9—U.S. trade with China is largely complementary. It is increasingly less complementary. Mr. Freeman, you talk on page 6 about 421. You say: Well, today no import relief has been granted under section 421. The President, in his most recent determinations, reiterated his commitment to using this safeguard when the circumstances of a particular case warrant. That is very lame. Look, we worked on China. There is no question about the need for engagement. We set up tools for the Administration to use. It hasn't used them actively, energetically. We set up, or wanted to be sure there was an annual transitional review mechanism within the WTO. This Administration has allowed the Chinese to make that essentially meaningless. We set up the special safeguard. We worked hard to get that in. There has been this flood of goods. The three cases that were brought, the Administration turned down. So, there is more rhetoric. The President says he will use it. He hasn't, even though the ITC said, "Use it."

The textile safeguard. The Court, as you know, said there could not be use in terms of threat, there had to be actual impact. It was your regulations that essentially excluded threat as a basis for action. You haven't used the 301 process. You were petitioned to use it as to currency. You haven't used it except in one case on anything. If there isn't action on currency, we are going to take action to refile it to get you moving, and if you don't do that, we will have to do something else. You haven't used the dispute settlement mechanism. feebly, compared to the past. On currency manipulation, look almost everybody says to you, do something. Then you say you are making progress. Nothing has happened in terms of the pegging of the currency, zero. You use all kinds of economic theories, all to essentially excuse—oh, not to excuse—to go easy, to shrug your shoulders. I can just tell you it isn't our imagination, it is what we see going on in terms of our relationship, in terms of displacement here that makes people want something more than rhetoric.

Mr. SHAW. [Presiding] The time of the gentleman has expired, but if the panelists would like to—I don't know if that was a question or a lecture, but——

Mr. LEVIN. It wasn't a lecture.

Mr. SHAW. The panel is invited to respond.

Mr. LEVIN. It wasn't a lecture, Mr. Chairman. I object to your use of that term.

Mr. SHAW. If the panel would like to—I was looking for a question, and Mr. Levin, I didn't find one. If the panel would like to respond?

Ms. FORBES. Sure. I will respond briefly on the currency issue, and then Charles will respond on some of the trade issues. First and foremost, we are not shrugging our shoulders and acquiescing. We are very engaged with China on the issue of their exchange rate and strengthening their financial system. We have got——

Mr. LEVIN. Will it be in the report that is supposed to come out tomorrow? It hasn't been in the recent reports.

Ms. FORBES. The Treasury Department is working on the report right now. Release has been delayed until probably the end of the month, and it is too early to know what the——

Mr. LEVIN. Why wasn't it in previous reports?

Ms. FORBES. No, China was not found in previous reports because if you look at the exact written statements in the report, it says for China to be identified according to the standards of the report, it must have a large multilateral current account surplus. Actually, for most of last year it looked like China would have a multilateral trade deficit, not surplus. The bigger picture issue. We are very engaged with China on this issue. We have had extensive dialogs. We have sent a number of people to China to work with them on the exchange rate. We established a technical cooperation working group to help them work through how to move to a flexible exchange rate. It sounds easy to us. It is a very difficult and risky process. It is important for China to develop the tools, trading platforms, hedging mechanisms, and so forth., before they move to a flexible exchange rate. Over the past year they have made progress in taking those technical steps, but we do feel now that we have given them time, they have take the steps, they have prepared themselves, and that now it is time for them to move on their exchange rate regime. That is the message China is hearing very loud and clear from the U.S. government, as well as from the G–7, as well as from leading officials around the world in multilateral institutions.

Mr. LEVIN. Heard that for years.

Mr. FREEMAN. To respond briefly, you are absolutely right, that there is a very complex situation and requires a multi-faceted approach and something that we have obviously worked hard on. We are aware of how much effort that you put into—in person—into the tools that allow us to really make progress, and we do use those tools. The key thing is to try to make progress. What we do is we work very closely with your constituents and others, and your offices, to try to make sure that we are delivering results that actually result in meaningful progress for American businesses, to try to make sure that we are increasing exports in the case of market access issues. With respect to dispute settlement, we have used the WTO process extraordinarily effectively, I believe, to try to bring forward not only China to make sure that they understand what requirements they have to meet, but actually to resolve those cases before you have to go into litigation. We are still the only one that has actually brought a WTO dispute case to Geneva, and we did——

Mr. LEVIN. One case.

Mr. FREEMAN. Well, we still are the only one, and the issue is not whether or not we filed a case, but whether it resolved the issues that underlie the cases, and we have resolved thus far eight in 2004, and continue to work on the range of others. The other part of dispute resolution, as you know, is you have to work closely with the constituents or the industries involved, and they need to be 100 percent behind you going forward. You are trying to deliver results for them. So, when they are not 100 percent for dispute resolution, you need to make sure that you are working to achieve their results in as effective a manner as possible. With respect to the safeguards and others, we have I think utilized the safeguard with respect to textiles fairly assertively according to our Chinese counterparts, and certainly we have been attempting to do that within the boundaries of the WTO accession agreement that was negotiated and resolved back in 1999.

As to 421, you are absolutely right, we have not yet applied import relief in the three cases that we have seen, and the reason is, as you know, you are trying with import relief to benefit domestic industry. If you apply import relief and it is of now benefit to a domestic industry, then you effectively you are rewarding third countries and you are punishing U.S. consumers. In the three cases to date that we have seen, at least in two of them, there was fairly clear evidence that even the petitioner would not have benefited by any relief, that what would have happened is that you would have seen the imports source shift from China to third countries. In the third case, you had a very clear case of a lot of U.S. producers benefiting more from not imposing import relief than some of the petitioning industries. So, you have to ultimately do a balance of interests in that case and try to make sure that you are delivering the most economic benefit through the process that you can and——

Mr. SHAW. Time has expired. The panel has been joined by Dr. Doug Holtz-Eakin, who is the Director of the Congressional Budget Office. So, we will suspend questioning, and look forward to your testimony. As the other witnesses, your full testimony has been made a part of the record and you may proceed as you see fit.

STATEMENT OF DOUGLAS HOLTZ-EAKIN, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. HOLTZ-EAKIN. Mr. Chairman and Members of the Committee, thank you for the chance for the CBO to be here today and I apologize for my late arrival. I was testifying on the other side of the Capitol.

Mr. SHAW. We understand that takes a long time.

Mr. HOLTZ-EAKIN. I am delighted to be here. We have submitted a fairly lengthy statement for the record. Let me take only a few moments of your time to summarize some of the key points. The highlights of that statement are that trade with China is not the source of the U.S. trade imbalance or more generally the U.S. current account deficit, that trade with China is neither the root cause of our losses in U.S. manufacturing employment. Fixing the dollar to yuan exchange rate is not a panacea for China; neither is floating that exchange rate a panacea for the United States. The emergence of China as a significant global trading entity and as a source of growth is an important development, but it has changed the dynamics of specific markets, particularly commodities, textiles and intellectual property.

Let me expand briefly on a few of these points but not all of them. First and of recent interest has been the role of trade with China in declines in U.S. manufacturing employment. Between 2000 and 2004 what we have labeled the import penetration ratio, the fraction of final sales attributed to imports in manufactured goods, has risen from all countries including China, from about 22.6 percent to 24.6 percent, and China is the bulk of that. So, there has been a large increase in manufacturing imports. Taken at face value, this might suggest losses in manufacturing employment of 2 to 3 percent, a small fraction of the overall 17 percent decline that occurred during that period. However, if one goes underneath the headline numbers, there is very little evidence that links higher import penetration directly to the loss of jobs, despite the suspicion that some industries may have been affected. There is little difference between the job losses among those industries that had large increased import penetration and those that did not. Computers and electronic equipment are a great case study in this regard. Imports from China increased by a factor of about 2½ between 2000 and 2004. Using our import penetration ratio, China's ratio rose from a bit above 4 to over 11 percent. So, there is a dramatic increase in the import penetration of goods from China. Employment in this industry declined equally dramatically, by about 430,000 jobs or 27 percent.

However, the penetration ratio for overall imports of those goods was essentially unchanged. So, the large increase in the Chinese import penetration was offset by decreased imports elsewhere, and the upshot has been that imports from China have substituted for imports from other partners. Whereas, generally much of the drop in employment is not attributed to imports, but to a decline after the boom in the late 1990s in the computer industry. For that reason, moving the exchange rate as a solution to these kinds of problems strikes us as not especially a high-return strategy. The impact of floating the exchange rate is far from obvious. It would depend greatly on how much of a change in the exchange rate got transferred into net terms of trade and effective prices, and the degree to which China relaxed its capital controls in the process.

On the former, China is to a great extent a location for final assembly, and only about 20 to 30 percent of the total value of an import from China might represent value added in China. Changing the yuan exchange rate might make Chinese finished goods more expensive, but it would make the cost of much of their inputs cheaper than that impact on overall price competitiveness is far less than the overall change in the exchange rate. For example, to the extent that one did have something like a 27-percent increase in the nominal yuan xchange rate, this might yield as little as 8-percent increase in the effective price to a U.S. purchaser, and to the extent that the Chinese manufacturer was willing to accept the lower profit margin, it would be a smaller imcrease yet. So, the impacts are not as clear as the simple exchange rate change might suggest. Finally, let me say a few words about the particular markets in commodities, especially energy, textiles and intellectual property.

With respect to energy, it is the case that sustained growth in China has placed upward pressure on world energy prices. These higher prices are not in and of themselves a threat to U.S. economic growth, but do place us more susceptible to price risks for any supply shock. On textiles, this in the near term looks like a case study of the difficulties facing the competitiveness of international trade. There may remain internationally competitive U.S. firms in the textile industry, but it is sensible to anticipate that the industry will shrink. Managing that transition cost, especially for the displaced workers, is central to reaping the benefits of lower apparel prices and greater exports of U.S. cotton.

Finally, on intellectual property, it is important to enforce the proper rights of the creators of intellectual property, U.S. manufacturers and creative artists. However, this takes place in two important international contexts, one which is the difficulties of enforcing digital property rights everywhere, and in China the difficulty in moving toward greater reliance on private property rights for all products, not just intellectual property. I apologize for being late. I apologize for talking extremely fast, and I look forward to your questions.

[The prepared statement of Mr. Holtz-Eakin follows:]

Statement of Douglas Holtz-Eakin, Ph.D., Director, Congressional Budget Office

Mr. Chairman and Members of the Committee, thank you for inviting the Congressional Budget Office (CBO) to testify on economic relationships between the United States and China and on China's role in the world economy. Today, I will review some of the basic facts of U.S. trade with China; the impact of China's exchange rate policy on the U.S. current-account deficit; the impact of trade with China on manufacturing jobs in the United States; and recent developments in the markets for petroleum and other commodities, products based on intellectual property, and textiles and apparel.

Economic Linkages Between the United States and China

The United States' current-account balance includes net investment income and net unilateral transfers, as well as the balance of trade in goods and services; thus, it is an overall summary of the United States' transactions with the rest of the world. The current-account balance—in deficit by some $666 billion in 2004—also reflects the difference between saving and investment in the United States. Those activities are driven by market forces that incorporate a complex mix of factors in the U.S. and foreign economies—such as business cycles, demographic trends, monetary and fiscal policies, political stability, opportunities for profits, taxation, and the regulatory environment.

One important component of the current-account deficit is the U.S. trade deficit in goods, which was over $700 billion in 2004.[1] Of that, the deficit for trade in goods with China accounted for about $176 billion.[2] Having increased rapidly in recent years, it now is the single largest bilateral deficit (see Table 1). Nevertheless, because the United States' trade deficit with the rest of the world has risen about as fast, the deficit with China has generally remained between 20 percent and 25 percent of the total (see Figure 1).

Table 1. The 10 Largest U.S. Trade Deficits in Goods in 2004

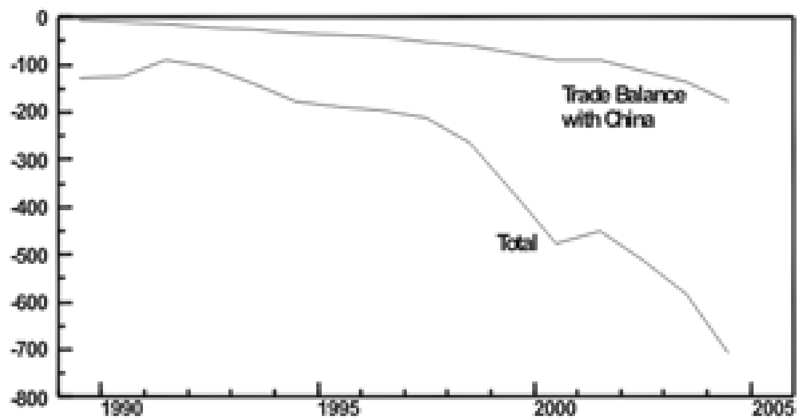
	U.S. Trade Deficit in Goods in Billions of Dollars	U.S. Trade Deficit in Goods with Each Country as a Percentage of Total
China	**175.8**	**24.8**
European Union	118.3	16.7
Japan	78.9	11.1
Canada	72.1	10.2
Mexico	47.0	6.6
South Korea	21.5	3.0
Venezuela	21.5	3.0
Malaysia	18.2	2.6
Saudi Arabia	17.3	2.4
Nigeria	15.6	2.2
Memorandum: All Countries	708.9	100.0

Source: Congressional Budget Office based on data from the Bureau of the Census
Note: Numbers are based on free-alongside-ship values of total exports and customs-insurance-freight values of general imports.

[1] Figures for trade in goods are based on data from the Bureau of the Census, which differ from the measurements used by the Bureau of Economic Analysis for the current-account balance.
[2] No data exist on trade in services with China.

Figure 1. The United States' Trade Balance in Goods with China and with the World, 1989 to 2004

(Billions of dollars)



Source: Congressional Budget Office based on data from the Bureau of the Census.
Note: Trade balances are calculated using free-alongside-ship values of total exports and customs-insurance-freight values of general imports.

Much popular attention has been focused on the role of the dollar/yuan exchange rate in determining the volume of trade flows. However, China's exchange rate policy has only a modest influence on the overall trade deficit and, in turn, on the current-account deficit. Any influence probably stems as much from the role of China's central bank in increasing liquidity in the United States as from maintaining the price competitiveness of Chinese goods and services.

China has fixed the exchange value of the yuan at about 8.3 yuan per dollar since 1995. China pegs the value of the yuan to the dollar through the use of exchange controls in conjunction with its official buying and selling of dollars. If exporters' earnings and inflows of foreign capital result in more dollars received than are needed to purchase imports, China requires that the dollars be turned in to the central bank in exchange for yuan at the fixed rate. If a shortage of dollars develops, those accumulated dollars (referred to as foreign exchange reserves) can be provided to importers in exchange for yuan at the prescribed rate. Over the past few years, China's fixed exchange rate policy has yielded its central bank a large and rising volume of assets. From 2000 to 2004, those foreign exchange reserves rose at an average annual rate approaching 40 percent, reaching $610 billion—most of it in U.S. dollar assets.

Although the Chinese government's purchases of U.S. dollar assets have prevented the yuan from appreciating against the dollar and contributed to lower interest rates in the United States (encouraging U.S. spending), China's currency policy is not primarily responsible for the large U.S. current-account deficit. The steady rise in the U.S. current-account deficit has resulted from many developments, including stronger economic growth in the United States than in other industrial countries, faster productivity growth in the United States since 1995, and strong international demand for U.S. assets from countries besides China; for example, the Japanese government purchased more U.S. dollar assets than the Chinese government did over the 2000–2004 period.

There is concern that a large sale of U.S. Treasury securities by the Chinese could cause a significant increase in the Treasury yield and a sharp fall in the dollar. Such fears appear to be exaggerated. The combined holdings of China and Hong Kong represented only slightly more than 5 percent of outstanding U.S. Treasury securities at the end of 2004.[3] Therefore, even a large sale by China would be a modest fraction of the highly liquid market for Treasury securities worldwide.[4] Only

[3] At that time, China owned $195 billion and Hong Kong, $53 billion in such securities.
[4] China owns other dollar-denominated assets as well. If they were included, CBO's conclusions would probably not change significantly.

if such a sale triggered a broader shift against dollar—denominated assets could it spur a noticeable rise in U.S. interest rates. At the same time, any broad fall in the dollar relative to other currencies would help improve the U.S. trade balance, lowering the foreign-currency price of U.S. exports and raising the price that U.S. businesses and consumers pay for imports.

The future of China's exchange rate policy is unclear. In contrast to the recent past, China may not wish to continue to fix its currency at 8.3 yuan per dollar. A growing stock of dollar assets exposes China's central bank to large capital losses if the yuan does eventually appreciate. The longer the fixed-exchange-rate regime, the larger the accumulated dollar assets, and the bigger the potential capital loss.[5] Moreover, as the Chinese become wealthier and import more from the rest of the world, the benefits of freeing the yuan to appreciate and commanding greater purchasing power would also grow. Ultimately, those arguments for allowing the yuan to float may outweigh two factors that up to now appear to have played a more dominant role: China's desire for rapid, export-led growth to employ its large population moving from farms, and concerns about the maturity of the Chinese financial system.

The implications of ultimately allowing the yuan to float will depend on whether or not China retains capital controls. Without capital controls, to the extent that Chinese citizens and businesses wanted to diversify their portfolios and reduce their exposure to potential problems in the Chinese banking system, they would probably remove some of their funds from Chinese banks, leading to an outflow of funds to other countries. China's commercial banks have been struggling to resolve a large amount of nonperforming loans—that is, loans not being repaid or repaid on time—and rebuild their capital bases. Any outflow, if sufficiently severe, could cause financial stress if capital controls were removed prematurely.

If China Allows the Yuan to Float and Retains Capital Controls

If China retains capital controls and the dollar/yuan exchange rate is determined solely by the supply of and demand for dollars from trade flows, then the yuan will probably appreciate against the dollar and the bilateral deficit in the U.S. goods trade with China will diminish.[6] The resulting dollar/yuan exchange rate, reflecting a constrained capital market, would be higher than a market rate that reflected the supply and demand of dollars from both trade flows and from unconstrained capital flows.

Although the yuan would appreciate in that scenario, the overall U.S. current—account deficit would probably diminish by less than the bilateral trade deficit with China would. As exchange rates shifted, the pattern of trade would change, most likely resulting in imports to the United States from other, now more competitive countries. Viewed from another perspective, the cessation of purchases of dollar assets by the Chinese government would reduce one external source of capital for the United States. However, more capital might come from other countries, thereby diminishing the improvement in the U.S. current-account deficit.

Regardless of the extent to which any appreciation of the yuan affected U.S. economic growth and employment overall, it would directly affect consumers and some producers in the United States by increasing the prices paid for imports and reducing the prices paid for exports.

If China Allows the Yuan to Float and Lifts Capital Controls

The Chinese government has indicated its willingness to allow the yuan to float and its intent to become more integrated with the international financial market. Private bond-rating agencies report that the government has made significant, though not yet sufficient, progress in improving the soundness of the Chinese banking system—a necessary condition for removing capital controls.[7] Moreover, China recently made arrangements with seven international commercial banks to help two

[5] At the end of 2004, China's foreign exchange reserves amounted to about 38 percent of its gross domestic product.

[6] At the current exchange rate, there is an excess supply of dollars (from exports to the United States) relative to the demand for dollars (from imports to China from the United States). Left unchecked, that would exert downward pressure on the price of dollars in terms of yuan. The yuan would have to appreciate substantially against the dollar to induce those exports to fall and those imports to rise until the demand for dollars equaled the supply.

[7] Standard & Poor's reports that the Chinese government recently injected $45 billion into two major state-owned commercial banks, although that rating agency still considers capitalization to be weak and the level of assets that are impaired to be high. Fitch Ratings suggests that the rules for the capital required of Chinese banks have come up to Basel I standards.

domestic banks gain the necessary expertise for foreign exchange trading. Those steps suggest a greater preparedness for open trade in both goods and capital.

If China allows the yuan to float and simultaneously lifts capital controls, the impact on the value of the yuan is less clear than when capital controls remain. If a sufficiently large outflow of private funds occurred, occasioned by the liberalization of capital controls, the yuan might depreciate. (A potential factor in this regard is that a portion of the buildup of China's reserves may reflect an inflow of funds by speculators in anticipation of gains from a revaluation. If the currency was allowed to float and reach its market value, such one-sided speculative activity would cease, thereby ending that source of upward pressure on the yuan.)

In the absence of large outflows of private capital from China, a move by the Chinese government to float the yuan would reduce the demand for U.S. dollar assets. That decline in demand would tend to lower the exchange value of the dollar.

Ultimately, however, trade is not affected by the nominal exchange rate alone, but by the relative prices of exports and imports. The effect of a change in the dollar/yuan exchange rate on the bilateral trade balance will depend on the extent to which Chinese and U.S. exporters pass through that change to their export prices.

The Effect of a Stronger Yuan

If the yuan appreciated relative to the dollar, it would directly increase the U.S. price of imports from China. However, those increases would probably be much less than the appreciation of the yuan itself. One reason is that a large share of the price of Chinese exports reflects the cost of imported materials, and an appreciation of the yuan would reduce the yuan prices of many of those inputs. Only the value added in China would be made more expensive in dollar terms by the yuan's appreciation. One group of analysts has estimated that, on average, only 20 percent to 30 percent of the value of exported Chinese goods represents value added in China.[8] If so, a 20 percent appreciation of the yuan would increase the final dollar price of the exports by only 4 percent to 6 percent (20 percent appreciation times 20 percent to 30 percent value added), even if the extra cost were passed through completely.

Moreover, Chinese firms and their workers may also absorb part of any increase in the yuan's exchange value. Exporters tend to try to prevent the appreciation of their currencies from eroding their price competitiveness (and thus market shares) in the international market by accepting a cut in their profit margins. The opportunity for such cost cutting is presumably limited to the value added in China, unless Chinese exporters can find even cheaper sources of their imported inputs.

The ultimate impact of any resulting price increase on the volume of U.S. imports from China depends on how competitive China is compared with other countries. If the countries that previously assembled the products that China now assembles remain close competitors of China, then a price increase of plausible magnitude might be enough to induce a substantial shift in production from China back to those other countries. In effect, the process by which U.S. imports from China grew over time would to some extent be reversed. Imports from China would decline (or grow more slowly), but imports from the other countries would rise. The United States' overall trade deficit would decline only slightly.

U.S.-Chinese Bilateral Trade in Goods

While the dollar value of U.S. exports of goods to China has more than doubled since 2000, the value of U.S. imports of goods from China has increased even more—creating a widening bilateral trade deficit in goods for the United States that now is the largest one it has with any of its trading partners. Part of that growth in the imports of goods, however, has displaced imports from other countries rather than U.S. domestic production.

As described, the primary force driving the increase in imports of goods from China is that manufacturers have shifted the final assembly of many of their products from other Asian countries (and perhaps a few non-Asian countries) to China. Much of the value of Chinese exports thus consists of parts made elsewhere in Asia. Consequently, the United States' bilateral trade deficit with China reflects the net

[8] See the statement of Lawrence J. Lau, "Is China Playing by the Rules? Free Trade, Fair Trade, and WTO Compliance," before the Congressional-Executive Commission on China (September 24, 2003); and Xikang Chen and others, "The Estimation of Domestic Value-Added and Employment Induced by Exports: An Application to Chinese Exports to the United States" (presentation to the Institute of Systems Science, Academy of Mathematics and Systems Science, Chinese Academy of Sciences, Beijing, June 18, 2001). See also Xikang Chen and others, "The Estimation of Domestic Value-Added and Employment Induced by Exports" (revised December 2001), as cited in the statement of Stephen S. Roach before the Commission on U.S.-China Economic and Security Review, September 25, 2003.

balance of trade in goods with many Asian countries that is channeled primarily through China.

With the growth of U.S. exports to and U.S. imports from China, China has become one of the United States' most important trading partners. Last year, the largest category of U.S. exports of goods to China was semiconductors and other electronic components, while the largest category of imports of goods was computer equipment.

U.S. Exports of Goods to China

U.S. exports to China have grown rapidly but remain only a small percentage of total U.S. exports. That rapid growth has raised China from the 10th largest U.S. export market in 1997 to the fifth largest in 2004. In fact, between 2000 and 2004, exports to China accounted for half of the increase in total U.S. exports (see Table 2).

Table 2. The 10 Largest Markets for U.S. Exports of Goods

(Billions of dollars)

	U.S. Exportsof Goods in 2000	U.S. Exportsof Goods in 2004	Change, 2000 to 2004
Canada	176.4	187.7	11.3
European Union	167.9	172.6	4.6
Mexico	111.7	110.8	−0.9
Japan	65.3	54.4	
China	16.3	34.7	18.5
South Korea	27.9	z	−1.6
Taiwan	24.4	21.7	−2.6
Singapore	17.8	19.6	1.8
Hong Kong	14.6	15.8	1.2
Australia	12.5	14.3	1.8
Memorandum: All Countries	780.4	816.5	36.1
China's Share of Total (Percent)	2.1	4.2	51.2

Source: Congressional Budget Office based on data from the Bureau of the Census.
Note: Numbers given are free-alongside-ship values of total exports.

Some of the largest categories of exports by value in 2004 were semiconductors and other electronic components, waste and scrap, soybeans, aerospace products and parts, and various electronic equipment (such as navigational and medical instruments) (see Table 3). The identity of the 10 largest categories has changed very little since 2002, although the ranking within the top 10 has changed slightly. An exception is cotton exports—ranked seventh in 2004 after growing tenfold in value between 2002 and 2004—which supplied raw materials for China's rapidly growing textile and apparel industries.

Table 3. The 10 Largest Categories of U.S. Exports of Goods to China in 2004

Product Category [a]	In Billions of Dollars	As a Percentage of Total
Semiconductors and Other Electronic Components	3.6	10.3
Waste and Scrap	2.5	7.2

Table 3. The 10 Largest Categories of U.S. Exports of Goods to China in 2004—Continued

Product Category [a]	In Billions of Dollars	As a Percentage of Total
Soybeans	2.3	6.7
Aerospace Products and Parts	2.1	6.1
Navigational, Measuring, Electromedical, and Control Instruments	1.7	5.0
Other Basic Organic Chemicals	1.6	4.6
Cotton	1.4	4.1
Resin and Synthetic Rubbers	1.4	4.0
Computer Equipment	1.4	3.9
Other General-Purpose Machinery	1.1	3.2
Memorandum: All Product Categories	34.7	100

Source: Congressional Budget Office based on data from the Bureau of the Census.
Note: Numbers are free-alongside-ship values of total exports.
[a] Product categories correspond to five-digit codes of the North American Industrial Classification System.

U.S. Imports of Goods from China

In the past four years, U.S. imports from China roughly doubled (see Table 4). With that rapid growth, China has moved from being the fifth largest supplier of U.S. imports in 1997 to the third largest in 2004, when it accounted for almost 14 percent of U.S. imports.

Table 4. The 10 Largest Suppliers of U.S. Imports of Goods

(Billions of dollars)

	U.S. Imports of Goodsin 2000	U.S. Importsof Goods in 2004	Change, 2000 to 2004
European Union	233.9	290.0	57.0
Canada	232.7	259.8	27.1
China	107.6	210.5	102.9
Mexico	137.5	157.8	20.4
Japan	150.6	133.3	−17.3
South Korea	41.7	47.8	6.1
Taiwan	42.3	36.2	−6.0
Malaysia	26.4	29.1	2.7
Venezuela	19.6	26.3	6.7
Brazil	14.6	22.7	8.1
Memorandum: All Countries	1,258.2	1,525.5	267.3
China's Share of Total (Percent)	8.6	13.8	38.5

Source: Congressional Budget Office based on data from the Bureau of the Census.
Note: Numbers are customs-insurance-freight values of general imports.

Some of the largest categories (in terms of value) of U.S. imports from China are various kinds of electronic equipment (for example, computers and audio and video equipment), toys, footwear, and semiconductors (see Table 5). The identity of the 10 largest categories of imports from China has changed very little in the past two years.

Table 5. The 10 Largest Categories of U.S. Imports of Goods from China in 2004

Product Category [a]	In Billions of Dollars	As a Percentage of Total
Computer Equipment	30.3	14.4
Audio and Video Equipment	13.0	6.2
Dolls, Toys, and Games	13.0	6.2
Footwear	11.8	5.6
Semiconductors and Other Electronic Components	10.4	4.9
Household and Institutional Furniture	9.6	4.6
Women's and Girls' Apparel	6.8	3.2
Radio and Television Broadcasting and Wireless Communications Equipment	6.2	2.9
Other Manufactured Commodities	6.2	2.9
Commercial and Service-Industry Machinery	5.1	2.4
Memorandum: All Product Categories	210.5	100

Source: Congressional Budget Office based on data from the Bureau of the Census.
Note: Numbers are customs-insurance-freight values of general imports.
[a] Product categories correspond to five-digit codes of the North American Industrial Classification System.

Not all of the U.S. imports from China represent lost U.S. production. A significant share of imports from China appears to replace imports from other countries. For example, the U.S. International Trade Commission (ITC), observed in testimony before this Committee that China's rising share of U.S. imports of both electrical and nonelectrical machinery from 1990 through 2002 coincided with a fall in Japan's import share in those same goods.[9] In analyzing changes in total imports to the United States from 2000 to 2002, the ITC found that China's increase in imports to the United States was largely offset by declines in imports to the United States by Japan, Taiwan, Singapore, Korea, and other Asian nations. Movement of the final assembly of manufactured goods from those other Asian countries to take advantage of lower labor costs facilitated China's apparent displacement of other Asian nations' imports in the U.S. market.

The Possible Effects of Imports from China on Employment in Particular U.S. Industries

Manufacturing employment in the United States declined by about 3 million jobs (or about 17 percent) between early 2000 and early 2004 and remains close to its recent low point. The bulk of the decline reflects the recession and the subsequent slow recovery in the demand for manufactured goods, as well as continued rapid growth in productivity within U.S. manufacturing and a long-term decline in the manufacturing sector as a share of total employment.[10] A decline in employment in any particular sector, such as manufacturing, does not necessarily mean lower employment in the economy as a whole; employment in many sectors has, in fact, ex-

[9] Statement of Robert A. Rogowsky, Director of Operations, U.S. International Trade Commission, before the House Committee on Ways and Means (October 30, 2003), p. 10.
[10] Congressional Budget Office, What Accounts for the Decline in Manufacturing Employment? (February 18, 2004).

panded over the past two years. Nevertheless, job losses are likely to be costly for individual workers who need to find new jobs.

From 2000 to 2004, the overall import-penetration ratio for manufactured goods from all countries, including China, rose from 22.6 percent to 24.6 percent.[11] Other things being equal, that increase might have been expected to directly reduce manufacturing employment in the short run by between 2 percent and 3 percent—a small fraction of the 17 percent decline that actually occurred. Surprisingly, however, little evidence links higher import penetration directly to the loss of jobs. There is little difference between the job losses among industries that experienced particularly large increases in import penetration in that period and those where increases were smaller. (The general increase in imports of goods can be tied to an increase in the foreign exchange value of the dollar in the late 1990s, which reduced the price competitiveness of U.S. goods in world markets. The dollar has since fallen against a number of currencies of the major industrialized nations, leading to expectations of greater U.S. exports to those nations and a slowing of imports.)

Nevertheless, some industries probably were affected more by imports, including those from China, than the manufacturing sector as a whole was. Above-average declines in employment occurred in several industries with particularly large increases in the share of domestic demand accounted for by Chinese imports, including those for textile mill products, apparel, leather and allied products, computer and electronic products, and electrical equipment and appliances. By contrast, in furniture and fixtures, where the import-penetration ratio for Chinese goods also rose (from 5.9 percent to 12.9 percent), job losses were slightly below average.

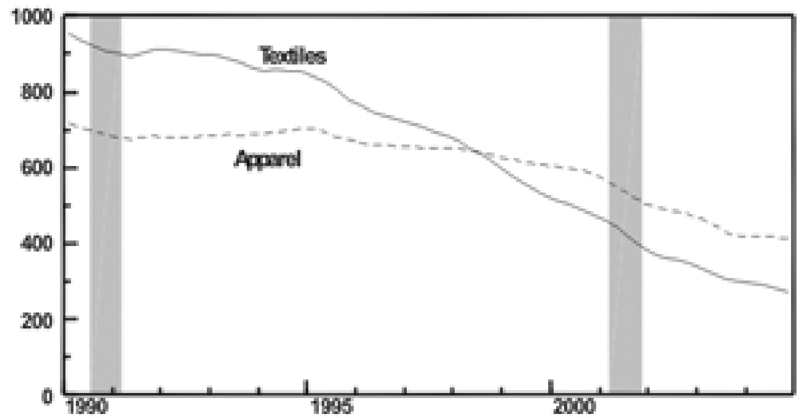
Two interesting cases are the computer and electronics industry and the apparel industry. Imports of computers and electronic equipment from China increased by a factor of about 2½ between 2000 and 2004, and the import-penetration ratio for such goods from China rose from 4.3 percent to 11.1 percent. Meanwhile, employment in that industry declined by about 430,000 jobs (27 percent) between early 2001 and mid-2003 and has been roughly constant since then. However, the penetration ratio for imports from all countries was virtually unchanged, suggesting that imports from China were largely replacing imports from other sources. And much of the earlier drop in employment can be traced to the large boom in the late 1990s and the subsequent decline in businesses' investment in computers and telecommunications equipment, rather than to increases in imports.

Imports of apparel from China have also risen significantly in the past several years, from $8.7 billion in 2000 to $9.8 billion in 2002 and $13.9 billion in 2004. That rise was accompanied by a decline in employment of nearly 200,000 jobs (37 percent) between the second quarter of 2000 and the second quarter of 2003 and an additional 50,000 jobs (16 percent) by the first quarter of 2005. Employment in the closely related sectors for textiles and fabrics and textile mill products also experienced above-average employment declines both during the recession and since 2003. But those declines appear to represent a continuation of a long-standing trend: employment in the apparel sector had already fallen by 400,000 jobs, or by more than 40 percent, between 1992 and 2000 (see Figure 2).

[11] Statement of Robert A. Rogowsky, Director of Operations, U.S. International Trade Commission, before the House Committee on Ways and Means (October 30, 2003), p. 10.

Figure 2. Employment in the U.S. Apparel and Textiles Industries, 1990 to 2004

(Thousands of workers)



Sources: Congressional Budget Office; Department of Labor, Bureau of Labor Statistics.

Any simple correlation of declines in employment with increased imports from China could be misleading, however. Such calculations do not account for the extent to which imports from China displaced imports from other countries. They also do not account for the contributions of demand changes to job gains or losses in particular industries.

Recent Developments in the Markets for Petroleum, Intellectual Property, and Textiles and Apparel

Currently, attention is focused on China's growing role as a consumer of petroleum and other commodities and of intellectual property, including both creative products and technologies. In the markets for textiles and apparel, debate has intensified about China's increased share of world exports and U.S. imports—particularly since protections against those goods were dropped at the beginning of the year as part of China's entry into the World Trade Organization (WTO).

Petroleum and Other Commodity Markets

Increased demand for a broad range of important raw materials that trade in world markets is a global phenomenon. Fast economic growth in China is a contributor. The commodities for which growth in China's imports appears to be greatest are crude oil and petroleum products (including petrochemicals), iron and raw steel, other metals (including copper, aluminum, and magnesium), wood and paper pulp, and fibers (including cotton, wool, and synthetics).

The fixed business investment that is accompanying China's rapid urbanization partly accounts for the nation's rising demand for basic commodities. To support the construction of buildings and roads, China has become the world's largest consumer of steel and cement. To help support the electrification of the country, China also has become the world's largest consumer of copper. However, much of the new demand for raw materials also supports new domestic consumer demand. Developments in consumer markets provide some indication of the fundamental nature of the changes under way in China and of reasons why the demand for resources will continue to grow.

Significant changes in China's transportation sector have shifted the country from being a net exporter of crude oil as recently as 1992 to being the second largest importer last year (after the United States). From 1998 to 2004, China accounted for more than 25 percent of the total increase in world demand for oil. (In contrast, the United States accounted for only 17 percent of the global increase in petroleum use over that period.) Currently, China's oil consumption is over 6.5 million barrels a day, or about 8 percent of world use. Coincident with the global increase in demand for oil, which accelerated in 2004, world oil prices have doubled in the past year (from $28 a barrel in January 2004 to about $55 today) and have more than tripled since January 2002 (when the price was only $17).

With more people in China owning and using automobiles, the upward trend in oil demand and prices probably will continue. At the end of 2004, China's stock of motor vehicles for civilian use stood at 27.4 million vehicles, up from 16.1 million in 2000. New vehicle sales in China were about 4.3 million in 2004 (including 2.3 million passenger cars), and they are expected to surpass sales in Japan by 2008. Extensive road construction that increases the total length of the country's highway system by about 30,000 miles each year (including over 2,500 miles of new expressways and several important new inter-regional arteries) supports the growing demand for automobiles and crude oil. In addition, China is investing in new petroleum refineries to help with the transition from a product mix dominated by industrial raw materials and kerosene to one dominated by gasoline and diesel fuel.

To support China's efforts to raise its share of the world oil market, the central government in recent years has ordered the consolidation of a long list of small companies involved in oil production, importation, transport, processing, and distribution into a few large vertically integrated firms with the goal that they compete with the other major oil companies of the world. Those new firms have been directed to help secure China's access to oil assets abroad through a range of joint ventures and long-term contracts. (The most important of those new world players are the Chinese National Petroleum Corporation, or CNPC, and the China Petroleum and Chemical Corporation, or Sinopec.)

The U.S. and world markets already are adjusting to higher prices on both the supply and demand sides, developing new sources of crude oil and new substitutes for it, as well as more-energy-efficient technologies. In this country, oil and gas drilling has increased by a total of about 50 percent over the past two years (in terms of both the number of active rigs and feet drilled). The economic prospects of oil fields in remote regions worldwide have improved. Backstop technologies such as tar sands and gas-to-liquids conversion are more profitable, too. On the demand side, high oil prices give businesses and consumers an incentive to switch to vehicles that are more fuel-efficient or to otherwise change their driving habits. That process may be under way already, with demand for large SUVs (sport utility vehicles) having dropped sharply since the end of 2004 and new hybrid vehicles coming to the market.

Following the major oil price increases of the 1970s, consumers and businesses in the United States made many advances that resulted in a large decline in the amount of energy needed to produce a dollar of output. Comparably large improvements in energy efficiency in the United States may be difficult in the future, but opportunities still exist. And there is great potential in China and other fast-developing regions of the world to make large improvements.

In the near term, however, all of those responses may not help to ease price pressures. For example, new drilling has not yet slowed the decline in domestic production, and changing preferences for new cars will not significantly affect total gasoline demand for years to come. However, new sources of energy and major changes in energy consumption are likely to occur soonest if investors and consumers expect oil prices to remain high, and those changes will help to curb further price increases.

The increase in the price of oil could slow the momentum of global growth because consumers who have to pay higher prices for gasoline have less to spend on purchases of other goods and services from domestic producers. The resulting slowing of spending could have reverberating effects in the short run, slowing both production of nonoil goods and services and, possibly, capital investment outside the oil sector. The International Monetary Fund, in its recent *World Economic Outlook*, forecast that global growth would slow by about 0.7 percentage points to 0.8 percentage points in the 2005–2006 period compared with that in 2004, in part because of the rise in petroleum prices.

Although the impact on U.S. growth is not very large at current prices, it could be more significant if prices rise substantially higher than they currently are. That possibility cannot be ruled out: oil prices are highly variable, and forecasts of those prices notoriously unreliable. At the end of 2003, for example, few people expected prices to rise much above $30 per barrel.

Intellectual Property Markets

Infringement of intellectual property in China is a pressing concern for U.S. holders of patents, copyrights, and trademarks. For example, although estimates of the market value of infringing (or "pirated") products are subject to numerous qualifications, the International Intellectual Property Alliances (IIPA) calculates that sales lost to pirated movies, music, software, and books in China totaled $2.5 billion in

2004. Economic losses to U.S. copyright owners from pirated works in China have remained at or above 90 percent since 2000. Reflecting those concerns, the United States Trade Representative negotiated specific commitments from China during a meeting of the Joint Commission on Commerce and Trade on April 7, 2004, and has scheduled a special review of China's progress in fulfilling those commitments for early 2005.

However, greater enforcement of the rights of U.S. intellectual property owners in China faces several near-term obstacles. First, the estimated $2.5 billion in lost sales of copyrighted works from piracy in China is a relatively small amount when compared with the $34.7 billion in exports.[12] As a result, efforts by the United States to protect its intellectual property could, in the event of retaliatory measures by China, be damaging to U.S. trade more broadly. Second, the digitization of creative works has made engaging in piracy easier—through unauthorized redistribution over the Internet and illicit manufacturing of CD–ROM (facilitated by sharp declines in the cost of CD-stamping equipment). As a result, copyright infringement is a challenge not just for China, but for other countries with similarly lagging institutions for intellectual property enforcement.[13] For example, the IIPA places Russia second behind China in copyright infringement, with estimated losses to U.S. copyright owners of $1.7 billion in 2004.

For the longer term, China has recently committed to strengthening its intellectual property laws and enforcement and, as its regulatory regime improves and the amount of intellectual property originating domestically increases, China should have increasing ability and incentive to protect U.S. intellectual property. China now successfully competes with U.S. and other producers on world markets for high-tech goods. As the importance to China of having its own patents respected abroad increases, so too should its efforts to enforce the intellectual property rights of foreigners in its own markets.[14]

Textile and Apparel Markets

After trade protections eased in 2001 with China's entry into the World Trade Organization, the value of Chinese exports of textiles and apparel to the United States increased by 49 percent between 2002 and 2004, from about $12.2 billion to over $18.2 billion.[15] Preliminary data for the first three months of 2005 indicate another large increase in China's exports of textiles and apparel to the United States as a consequence of lifting the remaining trade protections at the beginning of this year. Those developments in bilateral trade in textiles and apparel between the United States and China are part of a larger and longer-running increase in the share of U.S. textile and apparel consumption accounted for by imports (see Figure 3).

[12] The estimate of $2.5 billion in sales lost to copyright infringement in China does not take into account the impact of patent and trademark violations.

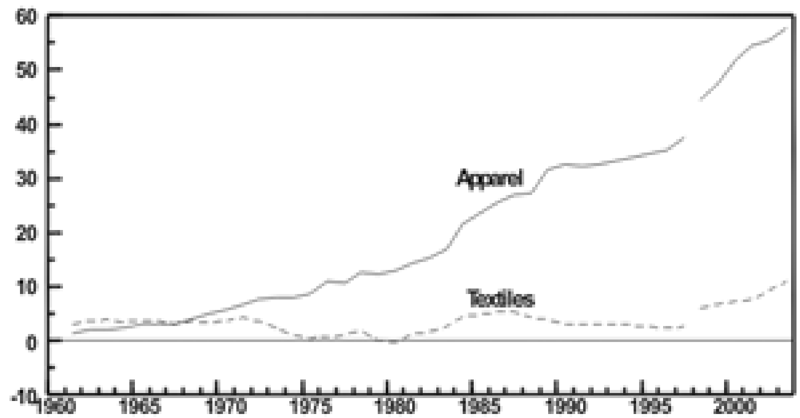
[13] Congressional Budget Office, Copyright Issues in Digital Media (August 2004).

[14] See Hal R. Varian, "Copying and Copyrighting," mimeo (March 29, 2005), available at www.sims. berkeley.edu/~hal/Papers/2004/copying-and-copyright.pdf.

[15] U.S. Census Bureau, Foreign Trade Division.

Figure 3. U.S. Net Imports in Textiles and Apparel, 1961 to 2003

(Percentage of U.S. market)



Source: Congressional Budget Office based on data about trade and industry shipments from the Department of Commerce, Bureau of the Census and Bureau of Economic Analysis.

Notes: Net imports equals imports minus exports. The U.S. market is equal to apparent consumption, which is domestic industry shipments plus imports minus exports. Exports are measured as the free-alongside-ship values of domestic exports. Imports are measured as the landed-duty-paid value of imports for consumption.

The breaks between 1997 and 1998 are a consequence of the change from the Standard Industrial Classification system to the North American Industrial Classification System.

An assessment released by the International Trade Commission (ITC) in early 2004 points out that in 2002, the average cost per operator-hour in the textile industry (for spinning and weaving, specifically) in China's coastal region was $0.69. Costs for major East Asian producers—South Korea, Taiwan, and Hong Kong—were 8 to 10 times higher. Wages were lower in other South Asian countries, but productivity was also lower, granting Chinese producers a unit-cost advantage. In comparison to sources of U.S. imports in the Western Hemisphere—including Mexico, Guatemala, and El Salvador—China had a smaller but still substantial advantage. In summarizing its outlook for the U.S. textile and apparel markets, the ITC concluded that China "would become the 'supplier of choice' for many U.S. importers . . . because of its ability to produce almost any type of textile and apparel article at any quality level at competitive prices."[16]

Over the next several months, the Committee for the Implementation of Textile Agreements, an interagency group including one representative each from the Office of the Special Trade Representative and the Departments of Commerce, State, the Treasury, and Labor may conclude that the safeguards included in the agreement to accept China into the WTO ought to be put in place to constrain the growth of specific Chinese textile and apparel products imported to the United States. Yet, after the resulting pause in the growth of Chinese imports, the cost advantage enjoyed by Chinese producers will probably allow Chinese imports to displace both the imports of other nations and domestic production in the U.S. market.

Regardless of whether safeguards that slow the growth of Chinese imports are activated, further contraction of the U.S. textile and apparel industries is likely. Policies currently in effect that provide assistance, including cash grants, training support, and tax credits for health insurance and wage insurance, may ease the continuing transition of workers and communities out of textile manufacturing and into other economic activities.[17] Current policy also recognizes, however, the ultimate benefits of allowing markets to function and the location of production to be determined by cost. In the future, the scenario of a shifting cost advantage, economic dis-

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[16] U.S. International Trade Commission, Textiles and Apparel: Assessment of the Competitiveness of Certain Foreign Suppliers to the U.S. Market (January 2004), pp. E3

[17] In fiscal year 2004, almost 30 percent of the cases certified for trade adjustment assistance were in the textile and apparel industry.

location, and overall economic gain, which is occurring in textile and apparel markets, is likely to play out in a number of markets as the world economy adapts to the addition of the labor forces of China, India, and other South Asian countries.

Mr. SHAW. Thank you.

Mr. McCrery?

Mr. MCCRERY. Thank you, Mr. Chairman.

Dr. Holtz-Eakin, your testimony seems to downplay the impact of trade with China on our economy in general and on our manufacturing base in this country. Is that a fair summary of your statement?

Mr. HOLTZ-EAKIN. I think it is fair to say that we believe the overall impact is smaller than simple measures such as the fraction of imported goods that come from China, that the economics are more subtle than that, and often the overall impacts are less than the statistics might indicate.

Mr. MCCRERY. Can you review for us the general health of the manufacturing sector in this country? Compare it to years past, for example?

Mr. HOLTZ-EAKIN. Health in any industry is a multidimensional item. Measured by employment, health in the manufacturing industry would appear to be declining. However, measured by the productivity of an industry, the manufacturing sector is extraordinarily robust. Those are mirror images of one another. Manufacturing has largely maintained its share in the value of U.S. output by increases in productivity which do in fact free up resources for use elsewhere in the economy, and we have seen a steady transition of that type. The third measure would be measures such as profitability and return on investment. There we have experienced a real shift over the past several years. This past recession was largely a recession characterized by declines in business investment the hurt manufacturers directly. It was characterized by slow global growth and that hurts exports of manufactured goods directly. We have seen reversals on both fronts to some extent in the past several years. So, I would say the report card is short of straight A's, but one which would not indicate failing grades either.

Mr. MCCRERY. What about as a share of our GDP, manufacturing activity?

Mr. HOLTZ-EAKIN. Share of value added? I don't have the number off the top of my head but it has been relatively steady over a period in which, employment has declined.

Mr. MCCRERY. Do you have any numbers on the top of your head about exports from the manufacturing sector?

Mr. HOLTZ-EAKIN. We have those. They are available, and if I could grab my cheat sheets I would get them for you, but certainly the manufacturers are central exporters for the United States, the dominant form of exports at the moment. I think most observers would anticipate that exports of services will increase going forward. Services are a source of American comparative advantage, but at the moment manufacturers are the heart of the export industry.

Mr. MCCRERY. Would you recommend any measures that the Administration might take in its negotiations or talks with China vis-a-vis the trade issues or currency issues?

Mr. HOLTZ-EAKIN. As you know, I am statutorily barred from making policy recommendations, so I will dance carefully around that question and try to say what good economists think would be sensible for any Administration. I think most economists would agree that it would be unwise to choose any array of policies which was specifically discriminatory against China, such as an across-the-board tariff or quota on a particular country. It would be better to bring any trading partner into the broad set of trade agreements and the legal environment that characterizes all trading parties so it was a level playing field. I think some of the hot button issues in China have to do with protection of intellectual property. It is important to make the playing field level there as with other trading partners. Those are fruitful steps to make sure that future trade is one which is beneficial to all, and that is the goal.

Mr. MCCRERY. Just to be clear to people who may be watching today's hearing, you are not a member of the Administration, are you?

Mr. HOLTZ-EAKIN. No. I work for the Congress and different in that way.

Mr. MCCRERY. You are the head of the Congressional Budget Office and you were appointed in a bipartisan fashion, isn't that right?

Mr. HOLTZ-EAKIN. I am a joint appointment of the Speaker of the House and the President pro tempore of the Senate for a 4-year term.

Mr. MCCRERY. It has been. Thank you.

Mr. SHAW. Mr. Rangel?

Mr. RANGEL. The President and Speaker of the House are both Republicans, but we always have enjoyed your good attempts to be bipartisan, and it is appreciated around here. So, as far as you are concerned we don't have a major problem with this deficit with China?

Mr. HOLTZ-EAKIN. I believe that our efforts should be focused on the overall balance of the current account, not on any particular source.

Mr. RANGEL. I think that some people believe that if we support and pass CAFTA that that might in some way protect our hemispheres against the explosion of exports of Chinese textiles. Have you explored whether or not CAFTA would hurt or help with this large deficit we have with China?

Mr. HOLTZ-EAKIN. We have not done any specific work on CAFTA, although we would certainly be willing to work with you on that if you would like.

Mr. RANGEL. So, as far as United States having a policy in dealing with China from a policy point of view you don't see any need for a change?

Mr. HOLTZ-EAKIN. I won't overstate my awareness of the details of industry-specific negotiations, the regulatory environment, product standards, protection for intellectual property. Those are all important items. To the extent that we are happy with the state of play, then that is a judgment that you can make. If not, then those are areas where certainly further work would be useful. My comments in my written testimony are focused largely on the broad aggregates and the notion that somehow you could easily subtract the deficit with China and have the total come down. That is highly unlikely.

Mr. RANGEL. As it relates to a manufacturing base where you found a decline in employment, have you found that many of the things that we have been able to do well, that we have foreign countries doing it and that our base of having exports to be able to compete with our imports seems to be dramatically decreasing in terms of things that we do well? Are you satisfied with our manufacturing base as it relates to the future of America, not just the deficit, the type of things that we are importing that we used to export? Is that within the CBO jurisdiction? Did you look at that?

Mr. HOLTZ-EAKIN. What we have tried to understand better were the links between the patterns of international trade and any specific declines in employment and industries, and——

Mr. RANGEL. Leave employment alone. I am just talking about from a national security point of view certain countries should be independent in terms of what they are able to manufacture. There has been some concern among many Americans that foreigners are doing this and we are becoming more and more dependent on their abilities as we find it cheaper to import than to export, manufacture ourselves.

Mr. HOLTZ-EAKIN. Simply, we haven't explored the national security dimensions of this problem. We have only looked at the economics. There is no particular economic entity that is entirely self-reliant, so the question is the degree to which it is more efficient to bring things in from the outside as opposed to do everything yourself. That is not a security issue. That is an economic pursuit of advantage.

Mr. RANGEL. If indeed China is becoming a second largest creditor of the United States and has built up a navy that may be considered by some as superior to ours, and we are talking about them promising to invade Taiwan and make it a part of China. All the other stuff doesn't mean anything if national security is not included in the study, if we can't defend ourselves against communists, then the deficit doesn't really mean that much. Did you take a little look at that or should it be requested? How do we handle that?

Mr. HOLTZ-EAKIN. If you would be interested in our views on the broader array beyond the trade linkages, certainly we can talk about that. We didn't look at it for purposes of this hearing.

Mr. RANGEL. I yield the balance of my time.

Mr. SHAW. Mr. Camp.

Mr. CAMP. Thank you, Mr. Chairman. I appreciate that. I actually would like to associate myself with Mr. Levin's remarks. I think that there is the perception and reality that we haven't done enough with regard to China, particularly on the currency issue. I want to just take a little bit of a different tack with regard to auto manufacturers and particularly auto parts manufacturers especially in Michigan. We continue to lose market share to tens of millions of dollars each year to Chinese counterfeit auto parts and components, and we are losing jobs because of the counterfeit parts that are being sold far below market price. Mr. Freeman, what do you think is the appropriate remedy to stop this type of practice that has continued for far too long?

Mr. FREEMAN. It is a multi-part answer to your question. The first answer is that we need to work more closely with our manufacturers to make sure that they are seeking and achieving their rights within China. There is an existing legal regime which a number of U.S. companies are increasingly taking advantage of and increasing receiving results through, but we don't think that the existing legal regime in China is adequate to deliver the results that our industries really need to make sure that their rights are secured. So, we need to make sure that we continue to work with our Chinese counterparts, not only to ensure that they have the structural requirements to deal with the problem, but that also they have the legislative requirements, that they change the legal regime to actually put in place better laws than they have on the books. Finally, we need to make sure—well, second, I guess, we need to make sure that we are working very actively with our Customs Department and Customs Departments of like-minded WTO members to ensure that at a minimum we limit the problem of counterfeits to China so that we are not seeing, as we currently are, a variety of counterfeits, auto parts and others, being sent into third markets. These, as you probably are aware, in many cases are not simply counterfeit but present significant health and safety risks to the people that, the unwitting consumers that get a handle on them. So, that is a critical issue.

Finally, we really need to make sure that we have our legal ducks in a row with respect to WTO, and we need to make sure that we continue to work with industry to develop the kind of data on Chinese counterfeiting and piracy to make sure that we can proceed with the most appropriate WTO strategy. As you may be aware, we initiated at the beginning of this year an out-of-cycle review under Special 301, which sought data from our industry. We did receive a variety of submissions from both individual companies and trade associations representing thousands of other companies, to try to give us the kind of background that we need to understand whether or not what we have is an actionable WTO case. So, we will come out with that report at the end of the month, and look forward to working with Congress to make sure that we are approaching WTO remedies as appropriate and——

Mr. CAMP. The estimate is 210,000 jobs since 1995 to counterfeit parts worldwide, not just China, $12 billion a year to the industry alone. The time for reports is over. We would like to see some action on this area. Then if you move into the agricultural area, for example, with regard to apples. We have a similar situation where there has been no action, and the flood of cheap imports of apple concentrate and fresh apples that are really undercutting the livelihood of Americans. So, I guess I would just echo the comments of some of my colleagues that not enough is being done, and I think that we are going to need to see some action as soon as possible. Thank you, Mr. Chairman.

Mr. SHAW. Mr. Cardin.

Mr. CARDIN. Thank you, Mr. Chairman.

Mr. SHAW. Immediately after your questions, we will recess.

Mr. CARDIN. Let me just underscore the point on the intellectual property rights and piracy. Since the WTO session, we have been moving in the wrong direction. It used to be more entertainment type products. Now, we're seeing manufactured products. I think Mr. Levin and Mr. Camp's point that we have to aggressively enforce the laws on piracy, and as Mr. Rangel pointed out, part of that is with the government itself in the use of its product.

I just really want to make I guess one major point on the currency issue. If I listen to your testimony, I would think that perhaps the U.S. dollar will be getting stronger, because the economy is going so well. So, maybe our trade strategy should be to lock at 78 cents the exchange rate between the dollar and the euro, because, therefore, as the dollar goes up in value, we will get a discounted price internationally on our exported products. Now, I don't think anyone of the three of you would recommend that policy for this country, and, in fact, it would be WTO illegal. Yet we sit back and let the Chinese currency be fixed and not float. We know that it provides a discount for their products in our market. How much it is we can argue. For some industries, it is different. It could be as high as 40 percent.

Now, in the 1990s, the Chinese officials indicated they were considering making the currency fully convertible by 2000. Now, it is 2005. The Vice Governor of the People's Bank of China recently said that, well, that China has had 8,000 years of history. One year, 3 years, 5 years or 10 years for our Chinese that is just a twinkling of the eye. My point is that we can sit back and 10 years from now, we are going to be the same position. I understand the complexity, Dr. Forbes, you recognize about allowing it to float. They certainly could devalue. We know that. They could change their exchange rate. They could some things now to show that they are serious about an accurate value of their currency for international trade, and I just want to express the frustration we are finding by many of the Members of Congress. We need action. We need action. It is not—those who have lost their jobs because of unfair trade practices, whether it is piracy or the wrong exchange rates, they are not sitting back saying gee, nothing is wrong with this. So, we need action, and, Mr. Chairman, I thank you for the courtesy of allowing me to raise these issues before we have to go into recess.

Chairman THOMAS. When the Committee returns, if anyone on the panel wishes to reply to Mr. Cardin's questions, we have two and a half minutes left on his time. We now have to go into recess for two votes that are on the floor, and we will reconvene immediately following those votes.

[Recess.]

Chairman THOMAS. [Presiding.] Okay, if our guests would take their seats and the panelists return. As you see, there is another vote that has been called, but we do have time for Mr. English to inquire. Mr. English?

Mr. ENGLISH. I want to thank you, Mr. Chairman, for the opportunity. First of all, Dr. Forbes, in your testimony, you point to the truism that if a trade deficit is suddenly reduced, that is to say that the reduction would clearly need to be replaced by an increased deficit with other nations and an increase of national savings or a decrease in national investment, certainly—is Dr. Forbes here? In that case, I wonder, Mr. Freeman, in your testimony you mentioned USTR's strong willingness to use the most effective tools at your disposal, including our trade remedy laws to address China's illegal trade practices. I recognize that this Administration has utilized some of the tools made available to Congress while denying to invoke others. What is frustrating to many of us in Northwestern Pennsylvania is that after a unanimous ruling by the ITC in the section 421 case was rejected by the Administration. I was wondering what are some of the economic factors that the Administration examined in making—what would you examine in making the decision to accept a 421 Petition?

Mr. FREEMAN. Well, the first and foremost is to make sure that any import relief that was provided through 421 actually benefited the producers in question. In the case of at least of the cases of 421 investigations that would be looked at. It was pretty clear that there was no likely benefit to the producers, and what would is simply that there would either be a direct shift in imports from a third-party country or there was at least one case in which the importer would simply refuse to do business with the petitioner in question. I think the key factor really is to make sure that import relief is effective. It is difficult I know to look at these and recognize that there is producer that is out there that is hurting that you want to benefit. The key is to find ways to do that. In these cases, 421 would not have resulted in that result. The ITC, of course, in looking at whether or not there is market disruption in the case of a 421, doesn't look at the economic impact. They simply look at ceteris paribus. If the market conditions stayed the same, what relief would benefit the producer in question, the petitioner in question? In the cases that we looked at, the market conditions would not have stayed the same, and, therefore, there would not have been a benefit or a perceived benefit.

Mr. ENGLISH. May I gently suggest I am not sure the petitioners shared your view that they would not in any way benefit. Dr. Forbes, since you are back, given that you have testified with regard to the bad effect, potential effects, when a trade deficit is suddenly reduced, I wonder if you would comment on the possible consequences to the United States if we continue to run a trade deficit which is now clearly tipping over 6 percent of GDP. I cannot think of a single example in history of a country that has successfully managed to continue to grow and remain healthy while running a trade deficit in the range of six percent of GDP. Are you aware of any examples that I may be unaware of?

Ms. FORBES. I apologize for missing your question earlier. Actually, when you look at trade deficits—trade deficits are very difficult to understand. There is a whole host of factors that cause trade deficits. So, when you talk about reducing a current account deficit, you do need to look at why it is being reduced. Some reasons why current account deficits are reduced are actually signs of weakness.

Mr. ENGLISH. I recognize that. I would also, though, go to the specific point—that a trade deficit is. Can you think of any examples of a country which has successfully run a trade deficit over time in the range of 6 percent of GDP?

Ms. FORBES. I don't know any off the top of my head, but I do know some similar examples. Right now, Australia has a trade deficit comparable to ours, and Australia is growing very strongly. Greece has a trade deficit larger than ours. Australia has run a large trade deficit greater than——

Mr. ENGLISH. Larger than 6 percent of GDP?

Ms. FORBES. Well, greater than 3 percent of GDP for over 20 years, every year, except for one——

Mr. ENGLISH. This is 6 percent, not 3 percent. Would you say there is a quantitative difference?

Ms. FORBES. Yes. Obviously, 6 percent is greater than 3 percent.

[The information follows:]

May 3, 2005
Representative Phil English
1410 Longworth HOB
Washington, DC 20515

Dear Representative English:

In my testimony before the House Committee on Ways and Means on April 14, you asked if I was aware of "a single example in history of a country that has successfully managed to continue to grow and remain healthy while running a trade deficit in the range of 6 percent of GDP." I was not able to answer your question at the time, but have since been able to review the data. There are actually several examples of countries that have run current account deficits around 6 percent of GDP (or higher) and been able to grow and remain healthy. A few examples are below, with all supporting data from the International Monetary Fund.

1. Greece had a current account deficit of 6 percent of GDP or greater from 2000 through 2003 and managed to grow over this period by more than or close to 4 percent annually.
2. Iceland had a current account deficit of 6.9 percent of GDP in 1998, 7.0 percent in 1999, and 10.1 percent in 2000. Iceland grew at a rate of 5.5 percent in 1998, 4.2 percent in 1999 and 5.7 percent in 2000. In addition, Iceland is projected to run a current account deficit of 10.1 percent of GDP this year while growing by 5.7 percent.
3. New Zealand had a current account deficit of 5.9 percent of GDP in 1996 and grew at a rate of 4 percent that year. In 1999, New Zealand had a current account deficit of 6.2 percent of GDP and grew by 4.3 percent. In 2004, New Zealand had a current account deficit of 6.2 percent of GDP and grew by 5 percent.
4. Australia had a current account deficit of 5.9 percent of GDP in 2003 and grew by 3.4 percent that year. Australia also had a current account deficit of 6.4 percent of GDP in 2004 and grew 3.2 percent that year.
5. Portugal ran a current account deficit of 5.7 percent of GDP in 1997, 6.9 percent in 1998, 8.5 percent in 1999, and 10.4 percent in 2000 while growing by 4 percent in 1997, 4.6 percent in 1998, 3.8 percent in 1999, and 3.4 percent in 2000.

Sincerely,

Kristin J. Forbes
Member, Council of Economic Advisers

Mr. ENGLISH. Okay. You had also testified that you would be reluctant to see the United States impose across-the-board tariffs on China on goods brought in from China, and I wonder, given that China has distorted its currency so as potentially some estimates suggest that distortion could be as much as 40 percent relative to where the market would place it. How would you distinguish an across-the-board—my time expired.

Chairman THOMAS. The gentleman's time has expired, and I would ask the witnesses that as Members—the Chair would appreciate written responses because we make them available to all Members because, as you will notice during the day, it is extremely difficult to have a long hearing and not only have all the Members in attendance, but the witnesses as well periodically. The gentleman from Massachusetts wish to inquire?

Mr. NEAL. I do. Thank you, Mr. Chairman, and thank you for holding the hearing, Mr. Chairman. You did indicate some months ago you would do this, and you have done the follow up on it. Dr. Forbes, recently in Springfield, Danaher Tool, the Craftsman tool maker?

Ms. FORBES. Yes.

Mr. NEAL. You know that great rack?

Ms. FORBES. Actually, we have a good family friend who works at Danaher, so I know the company well.

Mr. NEAL. Well, they used to work at Danaher. Danaher is closing—and 330 jobs. Now, Danaher was operating on three shifts a day, 7 days a week—330 jobs. Now, those jobs are going to Arkansas and to Texas job. How long can this go on when we are talking about $11 an hour for employees?

Ms. FORBES. Well, when companies decide where to locate, they look at a whole host of factors, not just the cost of labor. While other countries such as China may have cheaper labor costs, the U.S. offers a whole host of other advantages and reasons why companies would want to come to the U.S.

Mr. NEAL. Sears requires that that hand tool be made in America. The difficulty of this argument and what I am trying to get to is as long as this currency issue remains resistant to answer, it strikes me that we are going to have more of these situations. Those are the people that frequent the VFW halls, they are veterans, they are terrific people. You can't explain to them that the Chinese continue to undervalue their currency and that they have done work with a great product, but they are losing their jobs.

Ms. FORBES. We are very sympathetic to when workers lose their jobs, and that is why I discussed briefly in my comments why the Administration has put a priority on improving training programs to help people who are faced with that challenge. More importantly, as I also said in my testimony, many of the challenges your workers currently face are not just from trade with China. Even if China's exchange rate was revalued, even by the large numbers being thrown around, and we imported less from China in response, that does not mean the jobs would come back to the U.S. We would be likely to instead increase imports from other countries, especially other Asian countries.

Mr. NEAL. Let me try another perspective on this then, Doctor. Just your initial reaction to a machine tool manufacturer that is conducting three shifts a day for seven days a week and they are non-competitive? How do you respond to that? This has gone on with this plant now for years. Seven days a week, three shifts a day, but they are non competitive at $11 an hour.

Ms. FORBES. I have met with some people who have faced similar challenges, and it is an incredibly difficult situation. That is why we think it is very important to improve our job training programs so workers such as that can attain new skills and new technologies so that they can compete in the global economy in new areas.

Mr. NEAL. One last comment and I do thank you for your testimony. One problem with retraining and I think Members on the other side—for the 17 years I have been here and before that is really a hoax. You are retraining people for what, lower wages? Retraining people that have been to Iraq or they have been to Vietnam or retraining them for lower wages at 57 or 58-years-old? We are going to retrain them? It just does not work. Or let me put it this way it hasn't worked, and the Danaher information is something I am going to send you some information and hopefully you will take at look at it, perhaps respond to me.

Ms. FORBES. Just a comment. We do realize that our job training programs could be improved, and the President has actually been working to try to introduce some new initiatives and try to strengthen our job training programs because of some of the shortcomings. That is why he had proposed, for example, personal reemployment accounts, which are a new proposal that would give someone who loses their job a certain chunk of money that they can then use as they see best to try to help them prepare to get a new job. They could use it for training. They could use it to move to a new location. They could use it to cover health care expenses, child care expenses. So, that is one experiment to try to improve our job training programs. Also the President has announced a new community college initiative to try to strengthen training through community colleges, which is one job training program that as proven more successful in the past than others. So, we fully appreciate that our programs can be improved, and that is why we are trying to work with different approaches and are trying to see what works best so that we will be better prepared to handle some of these very difficult situations.

Mr. NEAL. Thank you. Thanks, Mr. Chairman.

Chairman THOMAS. I thank the gentleman, although the Chair is a little bit perplexed and perhaps I didn't hear the entire point of the Gentleman from Massachusetts. I understand that the tool company is required by the purchaser to have made in U.S.A. products. Your concern was that the company was moving from Massachusetts to Arkansas or Texas?

Mr. NEAL. Yes. I think in the bigger picture, Mr. Chairman, that the pressure on these companies now because of when they were such large conglomerates and they make all different sorts of products, I think the pressure on them now to drive down price because of international competition hampers severely their ability in a plant where again these folks have year after year won the Sears Excellence Award.

Chairman THOMAS. I understand that, but to a certain extent you may have to look at where the plant is. It is in the same State that was once a center of the textile industry. It is in the same State that was once the center of the shoed industry. At some point perhaps the good citizens of Massachusetts will pick up the drift, that there is going to be an area which attracts work that is already at one location either because of lower wages, better quality of life just in terms of where you live. I understand the point the gentleman is trying to make, but if his concern is that Arkansas and Texas is threatening Massachusetts' wellbeing, when we have a hearing on China.

Mr. NEAL. No. Let me say, Mr. Chairman, I believe it is international forces that are pressuring places like Danaher, and that what was suggested to me by the head of Danaher Hand Tool, in fact. Let me go beyond that. The quality of life in Massachusetts is extraordinarily high. I think everybody would agree with that.

Chairman THOMAS. There is no question it is high, and also are the taxes.

Mr. NEAL. Also, Mr. Chairman, I would also point out that we have always had a great and thriving middle class in Massachusetts, in large measure due to the unionized work force of many of those hand tool companies.

Chairman THOMAS. That there are states that don't require unionization, and, therefore, attractive to certain labor groups.

Mr. NEAL. That may be, Mr. Chairman. There is another point I think that has to be emphasized and that is that we have a broad middle class across this country because often times unionized work forces were able to successfully negotiate.

Chairman THOMAS. I think there are a number of factors that are associated with that, and I don't want to get into a parallel discussion here anymore than we have. I think it is useful, and that is the Chairman is interested in unfair competition. If we are going to define competition as unfair wherever it is and however it competes, then I think we are going to have a fundamental problem in terms of a reassessment of who we are. We like to say that if it were a level playing field, we can compete with anyone. One of the reasons I wanted to hold this hearing is the Gentleman complimented me on is that I do think we face an unprecedented situation of events associated with China. Never, in my understanding, of both human history and economics have you in such a short period of time presented such a massive expanse in the world labor force at such a high quality level in such a small world in which you can communicate technology and designs so quickly that they are able to offer a level of competition which fundamentally challenges not just the United States, but every industrialized country; and that the worst thing we can do at this point in the Chair's opinion is to get parochial in terms of a company moving from Massachusetts to Texas, because I am concerned about the survival of economies around the world, especially initially in those that deal in textiles, the entire economy rather than a narrow segment.

I know the Gentleman did not mean to do that, but what I am trying to do is elevate this Committee's discussion about—and I hesitate to use the word the threat of China—but if you look at it in terms of a potential direct threat to the economic engine of the United States, the greatest economic engine the world has ever seen, we have some issues that we have never had to deal with so fundamentally before. I want to at least see where we can go there, and I understand people want to make points as we go along, and I have no objection to that. I haven't been here for a while, and everybody else has been speaking, so I wanted to get back on the record. That is a joke.

Mr. NEAL. I dare say I have never seen that challenged here, Mr. Chairman.

Chairman THOMAS. That is a joke. If we don't figure this out in a relatively short period of time, beginning with textiles, but washing across major complex, technological devices like automobiles, we are going to be in a whole more trouble than we think we are in.

Mr. NEAL. That's precisely my point, Mr. Chairman. Thank you.

Chairman THOMAS. I am glad I made your point. The Gentlewoman from Connecticut.

Mrs. JOHNSON OF CONNECTICUT. Thank you, Mr. Chairman, and I am sorry that I missed the testimony of some of you, but I do want to bring to your attention the 2004 USTI Report on China's WTO Compliance. I just returned from a trip to China, and I am very discouraged by this report that basically says they are backsliding. We are not continuing to make the progress we were making. In fact, in 2004, we had to increasingly focus on China's effort to resort to policies that would limit market access by non-Chinese origin goods and that aim to extract technology and intellectual property from foreign rights holders.

They go on to say prime examples of these industrial policies in 2004 include China's discriminatory semi-conductor VAT policies, Chinese standards policies—I won't go into the detail, because I don't want to take the time—their procurement policies that now mandate purchase of Chinese produced software, the whole array of steps that they have taken to coerce technology transfer or to force the exclusion of foreign-made goods. Now, we have been so focused on correcting or stopping these backward steps in compliance that we are not working with China aggressively on the intellectual property rights issue. When I was over there, it became clear that they are very concerned about the growth in inequality, and so they are going to mandate on the small communities a K through 9 educational program and some other benefits, but they do not have a system like ours that flows Federal revenues down to these communities as far as I could make out, and I don't see the motivation for any local official to close down a counterfeiting operation when that local official needs the taxes of that person and the jobs of that person to make good on the mandates coming from the Federal level. I don't see us talking to them about that, and when it really got down to it, the Premier said well, we were going to have a national education program about this.

All the incentives in their society are against compliance with intellectual property rights. We instead of focusing on that, working with them on that, finding a way to toughen up on that, which is a fundamental problem, it is a kind of competition we cannot survive. We are busy turning back initiatives by the Chinese that are blatant violations of the WTO. So, particularly Mr. Freeman, what are we doing? Do we even understand that the incentives for compliance are at the base community level all against us, and as it was described to us when we were over there, pirating is just endemic. Corruption is endemic. My belief is that the tensions around trade issues now between the United States and China, but when you look at next year's figures and the way they are going, it is going to be Europe, too—are really going to cause, have an impact, on global growth and, thereby, on the wellbeing of the people I represent. So, what are you doing on intellectual property rights compliance?

Mr. FREEMAN. Well, Congressman Johnson, you have very effectively and coherently laid out precisely the problem. There really is in China the problem with intellectual property rights enforcement and piracy is rampant precisely because there are communities in China that are trying to fill jobs that are worried about the transition from command economy to a market economy. There is a market-oriented economy. There is a dramatic incentive to find jobs wherever they may come from. If that involves piracy, so be it, because we are going to find jobs for these people doing whatever is possible. The thing that we have been trying to do is work on three different levels with respect to intellectual property. One level I think is directly on point with that is you have to make sure the Chinese government, that Beijing, understands that they need to exercise the political will nationally to address the problem.

Mrs. JOHNSON OF CONNECTICUT. Our time is about to expire, and you and I both know how hard it is going to be for the Chinese government to exert the political will even if they have it, because it is a big country, and it is hard. We could force them to cut their tariffs of 10 percent on filtering machinery, 43 percent on automobiles, of domestic on domestic appliances, on 15 percent of machine tools. Since they are not complying and unable to comply with those they could open their markets to our goods, because that is the crowning insult when jobs get taken from manufacturers in my district and if they ship something to China, there is a 15 percent tariff on top of their higher costs. So, we have got to get far more aggressive is my message to you.

Mr. FREEMAN. I couldn't agree more, and I think that the key factor here is if China believes that and continues to want to do business in this market and export to this market, they need to understand that they are going to have to allow our companies to exercise our comparative advantage in their market on intellectual property, on manufactured goods, and on agriculture and other issues. So, I look forward to continuing to working with you.

Chairman THOMAS. The Chair thanks the Gentleman for his statement, but wonders when that press release will be forthcoming form the United States Trade Representative's Office so that we will have a firm understanding that we are in agreement. That was a rhetorical question. I don't want to get you in any hot water. Does the Gentleman from California, Mr. Thompson, wish to inquire?

Mr. THOMPSON. Thank you, Mr. Chairman, and I want to thank the panelists. I want to pick where Mrs. Johnson left off on the problems with the counterfeiting and take it a to a different level or another level, and that is the costs that we incur, not just the costs because we're losing out on the manufacturing, but the House Judiciary Committee just passed legislation that would increase enforcement against those who are counterfeiting.

This all comes at a cost. I was with Ms. Johnson in China on the trip she just talked about, and the Ambassador, the U.S. Ambassador to China said that he can't walk outside of his house without being approached by counterfeiters selling DVDs, and you can buy a stack of them for less than anyone of us can pay in this country. So, it seems to me that we need to be much more aggressive, and you guys need to be much more aggressive to bring about the crackdown in this area. It seems as though there is not much being done on a problem that everybody agrees is inappropriate, against all the rules of the trade agreements and the WTO and something that we clearly know where to find the problem, and we are dealing with a government that I guess it is probably an understatement to say that they are somewhat authoritarian. If they want to stop something from happening, they can clearly stop it from happening. As was mentioned, there is very little incentive on the local level to put small I guess entrepreneurs for lack of a better term out of work.

So, it is going to have to come because of a heavy influence from the Administration, and that is what we need. That is what we need to see. Those are costs that are—the enforcement costs and such—are costs that we do not see. There are other areas where we are experiencing costs that are rarely talked about, the increasing level of mercury pollution in this country as a result of air currents from China. This is a country that is moving toward more automobiles. They are pushing our pollution costs through the roof. They are consuming two million barrels of oil more today than they had been, and that is pushing our oil costs through the roof. They are consuming steel and cement at an unprecedented pace, which is costing our contractors and our construction projects a lot of money. Again, these are all costs that rarely get talked about, and the Administration has got to do something to intercede and recognizing, as was mentioned before, the importance of China as a trading partner, but we need to make sure that it is done in a more fair manner. Then the other thing—and I do not want to be accused of being parochial. Do you happen to know what na pa he gu means in Chinese?

Mr. FREEMAN. Perhaps my Chinese is not as good as yours. If you had a native speaker, you would be in real trouble.

Na pa he gu. I am not sure what——

Mr. THOMPSON. It means Napa Valley.

Mr. FREEMAN. Oh, na pa he gu. Oh, okay.

Mr. THOMPSON. That is a district that is within the district that I represent. There is a wine company in Beijing that is producing wine with the label Na Pa He Gu, which means Napa Valley. If there was ever a blatant violation of everything that we acknowledged as law, rules, regulations, and protocol, that is it. If we can't step in to stop that from happening—we really need a more aggressive position on behalf of this Administration to address these issues. Their wine is not made in the Napa Valley, by the way. The quality is a little low—a little less.

Chairman THOMAS. I thank the Gentleman. Does the Gentleman from Illinois wish to inquire?

Mr. WELLER. Thank you, Mr. Chairman, and I commend you for having this important hearing today as we closely watch China's WTO commitments and how we, of course, monitor and, of course, enforce trade disputes with China, particularly in the areas of IPR. I am going to take this opportunity to be like my colleague parochial. I want to draw attention with a question but also share some information regarding a company that is located in a district that I represent, which has a decades long battle with fraud by Chinese competitors, particularly unscrupulous shippers and chemical producers that are looking to dump what is called potassium permanganate on the United States market.

Carus Chemicals, a family-run business in the LaSalle-Peru area, goes back several generator. It has been an innovator in specialty chemical products. Carus Chemicals is the sole remaining U.S. domestic producer of potassium permanganate, a chemical that we use for water treatment, environmental remediation, and other purposes. For over the last two decades, the Commerce Department has had in place an anti-dumping duty order against unfairly traded potassium permanganate from China. Over the past several years, the Chinese producer has pushed for reviews of its anti-dumping orders. The evidence presented in these anti-dumping orders was materially false, misleading, and included forged documents, business licenses, and false document of unsafe tested shipments in containers which were labeled as toys and parts, not hazardous chemicals.

It is important to note that the anti-dumping orders have stayed in place, but Carus Chemical has had to expend precious time and resources to fight these utterly fraudulent cases. The other issue affecting this company is the customs and border protection report, which noted that that there is $633,291.99 in uncollected anti-dumping duties under the Chinese potassium permanganate order in fiscal year 2004. Carus Chemical has heard of indications that the Chinese importer may have defaulted on its payment obligations to CBP, and that at least one surety company may be seeking to avoid payment obligations under the customs bonds. These duties should be collected. I want to follow up with the CBP to inquire on the status of the collection of these duties. Mr. Chairman, I have a letter, which has been shared with me outlining these issues by Carus Chemical and with unanimous consent, I would like to insert it into the record.

Chairman THOMAS. Without objection.

[The information follows:]

April 13, 2005

Hon. Jerry Weller
108 Cannon House Office Building
Washington, DC 20515

Dear Mr. Weller:

On behalf of Carus Corporation and our 200 Illinois Valley employees, we are writing to identify a number of important international trade issues that should be considered by the Committee on Ways & Means as it examines U.S. economic relations with China and China's role in the world economy. As we have discussed in the past, a vital component of U.S.— China trade relations is assuring that U.S. trade laws will continue to defend Carus and other U.S. manufacturers from the effects of unfair dumping by Chinese and other foreign exporters.

Our small company is the sole U.S. producer of potassium permanganate, a chemical with important applications, including water treatment and environmental remediation. We have faced unfair dumping and outright fraud by Chinese competitors for over 20 years. As a result, Carus has a keen interest in the strong enforcement of effective U.S. antidumping ("AD") laws against unfair imports from China.

In particular, we would urge the following specific steps to assure that U.S. manufacturers can compete against unfair Chinese imports:

First, we urge the Committee to support and quickly enact WTO-legal legislation to suspend the posting of bonds for AD duty deposits for imports from "new shippers" and to require the usual cash deposits in such cases. This legislation unanimously passed the Senate in the 108th Congress (as S. 2991). New shipper bonds have been used in a number of AD cases by unscrupulous exporters from China to flood the U.S. market with dumped imports and to avoid payment of any duties eventually imposed by the Commerce Department. In our recent reviews, for example, the Chinese new shipper and importer Groupstars made substantial sales to the United States at dumped prices and appears to have disappeared after losing the cases, thereby avoiding the effects of the duty and leaving Customs and Border Protection ("CBP") to proceed against the customs bonds. This is of great concern to Carus, in view of CBP's inability in FY 2004 to collect some $260 million in AD duties, including duties on new shipper imports under bond. It is critical that Congress suspend new shipper bonding until it can assure that duties can be collected and new shipper bonding abuses can be stopped.

Second, the Committee should take all necessary steps to assure that CBP does a better job of collecting outstanding AD duties, particularly on unfair imports from China. In its most recent report, CBP reported that there were $643,291.99 in uncollected AD duties in FY 2004 under the order (A–570–001) governing potassium permanganate imports from China. The inability to collect these duties in FY 2004 is difficult to understand— the underlying cases were concluded in. 2003 and these new shipper imports should have been secured by single entry customs bonds. We would be pleased to provide you and your staff with whatever additional information you may require to inquire about the status of CBP's collection efforts in our case. We urge the Congress to press for improvement in this process.

Finally, Congress should not repeal the Continued Dumping and Subsidy Offset Act ("CDSOA"). As you know, the CDSOA authorizes firms that have been injured by unfair foreign trade practices to petition CBP for payments that can be employed to enhance the firm's competitiveness and aid its employees. Tho CDSOA is a powerful tool in the fight against unfair trade practices by foreign firms, particularly for small firms like Carus. In a recent series of AD reviews, Carus has faced extensive fraudulent conduct by Chinese respondents. Although Carus eventually prevailed in these reviews, this effort required Cams to incur extraordinary legal and other expenses approaching one million dollars. Much of this expense involved analysis and investigation that the U.S. Commerce Department was either incapable or unwilling to perform. As you can imagine, these extensive costs placed a significant financial burden on Carus.

Carus has received CDSOA disbursements for FY 2003 and 2004 and, based on past Chinese dumping, hopes to receive an additional CDSOA disbursement in December 2005. These funds are critical to Carus—they offset some of the extraordinary costs that fraud by Chinese parties in recent trade cases have imposed on our firm and can help assure that Cams and its employees can continue to compete effectively in a world market dominated by unfairly traded foreign chemicals.

Carus appreciates your longstanding help and support in assuring that our trade laws will protect Carus and other U.S. producers against unfair trading practices and fraud by unscrupulous Chinese parties. We would welcome opportunities to work with you to assure that our Nation's unfair trade laws are effective and fully enforced.

Again, on behalf of Carus Corp. and our Illinois Valley employees, thank you for your continuing efforts in support of fair and fraud-free trade.

Sincerely,

Aziz I. Asphahani
President

Mr. WELLER. Thank you, Mr. Chairman. I would like to ask the panelists for your thoughts on this issue, any recommendations on how we can improve the trade situation for companies such as Carris Chemical that face a continuous push from unscrupulous Chinese competitors and to ensure that anti-dumping duties are paid in full? I look to the panelists, particularly the Special Trade Representative's Office.

Mr. FREEMAN. Congressman Weller, as you know, and without trying to cop out on this, anti-dumping orders are administered by the Commerce Department. I would certainly be very happy to get together with your constituent and try to make sure that we can do all we can to see that their interests are taken care of. So, I would invite communication with your office and ours to see that happens.

Mr. WELLER. I appreciate that, and, Ms. Forbes, you are on the President's Council of Economic Advisors. Here is a company. It is a domestic producer. It is family business. It has been here for generations, and obviously they are being hurt by the situation, and, of course, it could potentially cost the jobs from a major employer in my district. What are your thoughts and how can we resolve this in a fair way and ensure China honors its agreements?

Ms. FORBES. I don't know the details other than what you just outlined of your situation, but I do know for a number of companies that we meet with what we find is most productive and the most helpful is actually to focus on what we can do in the U.S. at home to improve the competitiveness of operating in the U.S. So, that means things like making the tax relief permanent, passing a comprehensive energy bill to ensure an affordable and reliable energy supply, passing legislation to reduce health care costs, tort reform to reduce the cost of doing business——

Mr. WELLER. Ms., and I, of course, support that agenda, but today we are talking about a company that is endangered by unscrupulous importers willing to falsify information in order to bring a product to compete with a domestic producer, and specifically what is your response to that?

Ms. FORBES. Well, for those sorts of issues, then it is important to use our trade laws and use the WTO to address these sorts of issues if possible and enforce our trade laws. Again, for the specific details, I will—I think USTR and the Commerce Department is more adept at answering those specific questions.

Mr. WELLER. Well, thank you, Mr. Chairman. I would like very much to work with you and your staff in assisting this company in my district. Thank you for the opportunity.

Chairman THOMAS. I thank the Gentleman and any Member who has specific examples I think it is always helpful to make sure that we have an accurate factual record so that we can provide specific examples rather than hypotheticals as we are dealing with these trade issues. I think the Gentleman. Does the Gentleman from California, Mr. Becerra, wish to inquire?

Mr. BECERRA. Yes, Mr. Chairman. I don't know, Mr. Chairman, if Mr. Emanuel from Illinois should go first, though.

Chairman THOMAS. I tell the Gentleman the Chair called the Gentleman from California. If he wishes not to——

Mr. BECERRA. No. I will take the time, and I hope the——

Chairman THOMAS. Okay.

Mr. BECERRA. —the Gentleman——

Chairman THOMAS. Okay. I will bear the burden of dealing with the Gentleman from Illinois.

Mr. BECERRA. Thank you, Mr. Chairman. It could be a big one. Thank you all for your time and for being here for such a long time and being very patient about your testimony here. I guess everyone is expressing the same concerns. Obviously, coming from Los Angeles, I have deep concerns about the fact that there is so much piracy, so much violation of intellectual property laws—the film, the recording industries, our high tech industries. We're just losing billions, so I won't go into that a whole lot more. Let me ask, give me the most concrete that you believe at USTR, Mr. Freeman, that we are doing to try to prevent China from continuing to have piracy so dominate the market when it come to the sale and transaction and distribution of our products?

Mr. FREEMAN. Well, I wish there was one silver bullet, and there isn't unfortunately.

Mr. BECERRA. Okay. Just give me one, because I know we could talk for more than my 5 minutes just about what we are trying to do. Give me the one best thing that we are doing.

Mr. FREEMAN. The key thing that we can do is make sure that China actually proceeds by putting the people that are criminals in jail.

Mr. BECERRA. What are doing to make sure that China puts those folks behind bars?

Mr. FREEMAN. Last, year, what we did was ensured that China revised its judicial interpretations to make clear to prosecutors in China that here are the steps that they should use and here are the thresholds that they should use to put people in jail.

Mr. BECERRA. Okay. My understanding is I know that Congressman Sanders said the average wage in China is about 30 some odd cents an hour compared to our $21.45 a hour when you include benefits, average wage. My understanding is in their industrial heartland, where you expect higher wages, they are still averaging no more than about 60, 64 cents an hour. What are we doing to try to make sure that China does not continue producing products that we are buying by hiring folks—some would say they are compelling them to work—for 30 to 60 cents an hour?

Mr. FREEMAN. I don't think we are getting in that level of detail in terms of trying to set wage rates in China.

Mr. BECERRA. Why not?

Mr. FREEMAN. What I will say is that one of the things that is clearly happening, particularly in the coast in the areas that have had low wage rates or you have seen very, very difficult and some would say horrifying labor conditions, that you have actually seen labor prices increase. You have actually seen the ability for——

Mr. BECERRA. Let me ask you this: When will we reach the point where we can have a competitive relationship on trade with China where it is based on our natural comparative advantages. We have got a lot of particular resources so we will be able to manufacture goods based on those resources more than China would. China can do something more than can because of a natural comparative advantage. It is not natural to have an advantage on wages that are so disparate. Unless we try to do something to if not encourage certainly compel China to move forward and pay folks a decent wage, how can our workers ever compete in producing that widget compared to the Chinese?

Mr. FREEMAN. Well, Dr. Forbes can probably address relative efficiencies better than I can. I will say that we feel very comfortable that our economy is the most productive and efficient in the world, and we are fairly competitive in China. We are just trying to make sure that our natural advantages are able to be applied in China and not be subjected to the kind of government interference which is reducing our competitiveness.

Mr. BECERRA. So far, we have a trade deficit with China that continues to grow into the atmosphere. We have lost some 500,000 jobs in the textile and apparel manufacturing industry in the last 4 years since January 2001. We have gone from about a million jobs to about 675,000 jobs in textile and apparel manufacturing. What are we doing to try to stop the hemorrhaging there?

Mr. FREEMAN. Well, as you know, in 1995, the previous Administration negotiated the Agreement on Textiles and Clothing, which had a 10-year system by which quotas in textiles would be phased out, and we just passed that period. One of the key things that the previous Administration negotiated, because China was not a member of the WTO when the ATC was originally negotiated, was a special textile safeguard which allows us to put in place breaks on textile imports in the event that our textile markets are disrupted. We have been employing those safeguards. The Chinese government has told us that perhaps we have been engaging too aggressively. We don't think so. We will do what we can to make sure that we provide the space for our textile industry to transition.

Mr. BECERRA. I appreciate the testimony, Mr. Chairman. I know my time has expired, but I must tell that——

Chairman THOMAS. The Gentleman's time has expired.

Mr. BECERRA. —when we hear the statistic that for every six ships that come from China and unload products here, only one of those six ships returns to China with American products to unload in China. That is a problem. When you realize that if this statistic is correct the five out of the 10 fastest growing U.S. exports to China from 2001 to 2003 were waste products, like recyclable plastic, metals, aluminum, fiber and paper, we have got work to do. Thank you, Mr. Chairman.

Chairman THOMAS. The Chair wants to make sure that the record is as complete as possible, and the Chair, in part, brought up the question of counterfeiting early on in the hearing. The Chair is not sure where China at the current time stands in terms of its ranking as major counterfeiters. I don't want to go through a list of countries that have been number one on the list, some of them frankly in Europe. There are others. Is this of a new magnitude in counterfeiting or is it simply akin to what has occurred and continues to occur in other major countries? Do we have a feeling for the magnitude of this?

Mr. FREEMAN. I would tend to agree with you that is it unprecedented in human history. Where it ranks in terms of our overall priorities right now is——

Chairman THOMAS. No, with other countries. I guess I could mention India. Historically, Italy was a spot that was difficult, and it has gotten much better recently. I am hesitant to mention other countries, but I will if I have to. Do you monitor that sort of thing? Is China number one in this area as well as in another of other ones as they continue to grow?

Mr. FREEMAN. Well, as you probably know, we do come out with a Special 301 report at the end of the month which will give a full answer to that question so I don't want to pre-guess that. I will say in terms of——

Chairman THOMAS. Oh, nobody is watching. Go ahead.

Mr. FREEMAN. I will say that that certainly—intellectual property rights in China is at the top of our list in terms of what we are doing with China, and it certainly ranks among the very top few priorities for the Administration.

Chairman THOMAS. I don't want our Members to overstate the case if, in fact, it is not the case. I believe it is, and we look forward to your report, because it is so fundamental to one of the last bastions that we can hang on to. If they take away the physical stuff, if they are now also plagiarizing the mental, there is not a whole lot left. Does the Gentleman from Florida, the Trade Chairman, wish to inquire?

Mr. SHAW. To follow up on the Chairman's remarks with regard to counterfeiting, how much of the counterfeiting is actually imported into the United States and what are we doing about it?

Mr. FREEMAN. We are doing a fair amount. The issue right now is there are increasing numbers of counterfeit goods that are coming into this country. I think they are up 47 percent last year over the previous year. I know customs is working very actively to do something about it. Last year, the Administration initiated something called the Strategy Targeting Organized Piracy, which was specifically targeted at dealing with the export problem of intellectual property rights, not just goods that are infringing on intellectual property rights not just from China, but with China obviously being a major exporter of IPR infringing goods. China is clearly a key focus of STOP. So, the key there is to try to make sure that we are all organized as the administration between Customs, between Homeland Security generally, between USTR, between Commerce to make sure that we are dealing with the problem as aggressively as we can.

Mr. SHAW. I would bet you a lunch that we could walk up to Pennsylvania Avenue and buy a $50 Rolex.

Mr. FREEMAN. I won't take that bet.

Mr. SHAW. Thank you. I think that we need to start more enforcement in our ports and what not, and the shippers should have some liability for these type of things so when they knowingly take these counterfeit goods and bring them into the United States. The Chairman has remarked that the Chinese government is actually buying a lot of the counterfeit goods and using them to run their government. We are allowing them to be sold under our nose, so we have a certain amount of responsibility. Dr. Forbes, I was very impressed with your testimony in pointing out that actually for the Pacific Rim that the imports have not grown; that the China is sort of eating Japan's lunch, and that seems to be where the problem seems to be, and if you look at the Treasury bills that are owned by foreign interests, I think Japan is probably way above the top of the pile on that. Would you comment on that?

Ms. FORBES. Yes. Actually, I know the numbers. Japan's reserve holdings are above $800 billion. China's are now about $640 billion dollars. So, Japan does hold a larger amount of foreign reserve holdings than China.

Mr. SHAW. In my opening remarks, I mentioned the problem of visas. Now, I know that is not anybody's responsibility and certainly a member of this panel, but have you heard complaints about that? I have. That this has become an impediment to our exports, that Germany and some of the European countries they can very quickly supply visas which would allow prospective purchasers to come over and review the machines and to train their workers to operate them. That there's a real problem in getting that done here in the United States. Quite frankly, you lose a sale by that time it takes to get a visa. Would any of you all care to comment on that or have you heard those complaints before?

Ms. FORBES. We have certainly heard many complaints like that, and improving the visa procedure has been an important priority. Our State Department has been working very actively on that. I will also say from a broader economic viewpoint, we have also done some analysis to try to understand if there is a specific barrier in China against U.S. exports or is there something specific that makes it harder for the U.S. to compete? Based on all the broad economic analysis we have done, we really can't find evidence of that. We find that the U.S. has actually been quite successful competing in China's market. U.S. exports to China have grown by 15 percent between 2000 and 2004. That is much faster export growth than we have seen anywhere else in the world. Yes, the U.S. does run a large trade deficit with China, but it runs a large trade deficit with most countries in the world. At least from a purely macroeconomic viewpoint, it is very hard to find evidence of any special discrimination in China against U.S. exports. I think the visa issue is a very serious one, and, if anything, that might be more likely to complicate trade in the future, but at least so far we haven't seen in the macroeconomic data evidence that that is a significant factor.

Mr. SHAW. Thank you. I yield back my time.

Chairman THOMAS. I thank the Gentleman. Does the Gentleman from California, Mr. Herger, wish to inquire?

Mr. HERGER. Yes. Thank you very much, Mr. Chairman, for calling this hearing on this very important issue of trade with China, bilateral trade, and I think our panelists—I represent one of the richest agricultural districts in the Nation, the northern Sacramento Valley of Northern California. Mr. Freeman, I have two questions I would like to pose. I supported bringing China into the WTO because I believe the commitments China has made are crucial to our market access as we move forward, both for U.S. agriculture and other export-oriented industries. However, as you well know, the key is holding China's feet to the fire and making sure they live up to their commitments. My understanding is that while China has made great strides in WTO compliance, they have also learned from some of our other trading partners how to erect barriers to U.S. goods that supposedly meet WTO rules. SPS standards and manipulation of import licensing are some examples.

Could you identify for me what U.S. products, particularly agricultural commodities, have been most impacted by these non-tariff barriers? Question number two, and as a follow up, I have heard from honey producers as well as almond producers in my district about the problems customs is having collecting anti-dumping duties on dumped Chinese honey because of the current bonding requirements. These Chinese imports at below market prices are driving down the cost of honey and making it more difficult for honey producers to provide the pollination which is critical for Californians' almond crops and other crops. I understand that Chairman Thomas is working with customs to address this problem and other customs issues related to bonding requirements, and I would be interested to hear your views on this issue as well.

Mr. FREEMAN. Thank you, Congressman Herger. With respect to the latter issue, I will have to come back to you on that. I will go back to my customs colleagues and seek better information from them. It is not an area within my expertise, but I certainly would want to know more and do what we can to make sure your questions are answered. With respect to your broader question about SPS and other measures that the Chinese government has used to make difficult our market access, market access for our agricultural producers and commodities. That has been a major problem, and it is something we have been working on extraordinarily hard for the past few years, since WTO accession.

There have been a number of non-tariff barriers, levers, that Chinese quarantine officials have used which seem to always take place at times when their harvests are taking place. So, for example, when our soybean exports are ready to hit the shores, there seems to be a new scientific issue or quasi-scientific issue which is preventing them from being imported. We have seen a number of different regulatory contractual issues, licensing issues which have not been either scientific or particularly transparent. We have seen a number of things which are Catch-22 in nature with respect to import licensing. You can't get a license unless you have a contract, but, of course, you can't get a contract, unless you have a license, and requiring the two makes doing business with China very difficult. It is a very good market for U.S. agriculture, particularly for land-intensive agriculture like soybeans, cotton, wheat, and others, but the key really is to make sure it is a foreseeable market, and right now it is still far away from that. The regulatory process in China is far too opaque for us to make sure that on a year on year basis that we know market conditions changing as they do that we will be able to get our product to market. So, that has been a key function of our efforts over the last few years.

Mr. HERGER. Well, I thank you, and again this is very important obviously; and I think it is important that we do keep—when we make these agreements we want to make sure that we enforce them. That is what I always hear is that we don't mind being competitive as long as we are playing on a level playing field and one in which we are all obeying the rules, and so obviously this is very important. I want to reemphasize this. Thank you, Mr. Chairman.

Chairman THOMAS. I thank the Gentleman. Does the Gentleman from North Dakota wish to inquire?

Mr. POMEROY. I do, Mr. Chairman. Thank you. I will direct some inquiries to one of the charts the witnesses offered. These charts show import trends and trade imbalance trends through '04. I am wondering if we were to continue to chart based on the data we have in the first quarter of '05 where would our trend lines go? So, let us take the first one, imports as a percent of GDP. Where would we be looking at how we are coming into '05?

Ms. FORBES. Well, if we were to extend that graph, we would actually see a continuation of basically the patterns that have just happened recently since about the middle of '04. We would see on the bottom, the red line——

Mr. POMEROY. Like this one?

Ms. FORBES. Probably not quite that steeply, but we would—yes, we would see imports going up.

Mr. POMEROY. Actually a serious question. Have we seen that trend line leveling off a bit or have we seen fro the first quarter—my understanding is this year's data shows an even accelerated level of imbalance.

Ms. FORBES. We have seen imports—so we have also actually seen both numbers accelerating. The key point in this graph is yes, exports are accelerating.

Mr. POMEROY. How does that leave us on the net? Are we better than '04?

Ms. FORBES. No. Our trade surplus has been increasing this year.

Mr. POMEROY. Our trade?

Ms. FORBES. Trade deficit. I am sorry.

Mr. POMEROY. So, we are actually losing ground. We are exporting more, but we are importing more yet?

Ms. FORBES. Importing more. The key point of this is even though—yes, the line would be increasing.

Mr. POMEROY. All right. Let us talk about the China trend line. How are we doing on that one in the first quarter?

Ms. FORBES. That line also would be increasing.

Mr. POMEROY. At what rate would that be increasing do you think. Would that also be accelerating? Is it I level or?

Ms. FORBES. It probably has accelerated slightly since the beginning of 2005.

Mr. POMEROY. The Wall Street Journal reports on April 1st that we have seen a surge in textiles among—and I don't whether that—I would expect textiles because of the absence of tariffs. The tariffs that went away in the trade deal were perhaps the most dramatic in terms of the surge. Do you have an opinion on that?

Ms. FORBES. You are—textile imports have increased between January and February. The growth did slow in March. Again, you don't want to make too much of any single month's data. I do want to get back to key point of this graph even though imports have gone up, that black line, even though that trend has accelerated recently and even though imports from China, the red line, have accelerated, the unemployment rate in the U.S. has fallen.

Mr. POMEROY. Wait. Wait. Wait. Wait. Wait. Wait——

Ms. FORBES. As imports have gone up over time——

Mr. POMEROY. Wait. Wait. Wait. Excuse me, ma'am. We will ask the Secretary of Labor about unemployment rates. You are here to talk about trade with China. From what I hear you saying is China exports to the United States are increasing and the gap in terms of the trade relationship between the country is increasing; in other words, we are continuing to import more from China than we are selling. Is that correct?

Ms. FORBES. That is correct.

Mr. POMEROY. I would like to offer this Wall Street Journal article into the record, and it says some things I would like you to respond to.

[The information follows:]

Associated Pres
April 1, 2005

China Textile, Clothing Imports To U.S. Up Sharply—U.S. Govt

WASHINGTON (AP)—Preliminary Commerce Department data show that imports of textiles and apparel from China are up sharply in the first three months of this year after global quotas were lifted.

The data, released Friday, showed that textile and apparel imports from China totaled the equivalent of 2.86 billion square meters, up 62.5% from the equivalent of 1.76 billion square meters imported during the corresponding 3 months of 2004.

For different product categories, the increase in imports was even more striking, according to the Commerce Department data.

It said that 78.3 million cotton knit shirts had been imported from China during the first 3 months of the year, an increase of 1,258% from the same period a year ago. The report said that 74.1 million cotton trousers had been imported in the first quarter this year, an increase of 1,521%.

Officials of the textile industry said the new report provided strong evidence of their claims that the surge in Chinese imports is disrupting the U.S. market. The industry is pushing the government to restore quotas on imports of textiles and clothing from China, saying failure to act will cost thousands of U.S. jobs.

The quotas, in place for more than three decades, were lifted at the beginning of this year.

"Already 17,200 U.S. textile and apparel manufacturing jobs have been lost in 2005. These job losses will be just the tip of the iceberg unless the U.S. Government immediately self-initiates safeguards," said Auggie Tantillo, executive director of the American Manufacturing Trade Action Coalition, an industry trade group.

The industry is lobbying the Bush Administration to file its own cases to put in place quotas that would limit increases in various categories of Chinese textile imports to 7.5% this year, compared with the level of shipments in the previous 12 months.

"The release of preliminary data clearly demonstrates that the U.S. market is being disrupted as a result of imports from China," said Cass Johnson, president of the National Council of Textile Organizations, another industry group.

Friday's release of data on imports marked the first time the government has published preliminary data on textile shipments in advance of its monthly trade report.

Commerce Secretary Carlos Gutierrez announced a week ago he would begin accelerated releases of data to help government policy-makers and the industry keep track of textile imports.

The report showed that while shipments from China were surging, other countries who had enjoyed quotas to ship to the U.S. were now seeing decreases in their sales. Shipments of cotton trousers from Mexico fell by 5.24% in the first 3 months of the year, the report said.

Mr. POMEROY. Seventy eight point three million cotton knit shirts have been imported from China during the first 3 months of the year, an increase of 1,258 percent. Is that correct?

Ms. FORBES. To the best of my knowledge, yes.

Mr. POMEROY. All right. Is that in.

Ms. FORBES. I believe that USTR could also follow up on this, but USTR is investigating these types of cases.

Mr. POMEROY. Isn't that something Treasury has an opinion on?

Ms. FORBES. Well, yes, USTR is the lead agency in this. I actually work for the White House, not the Treasury Department.

Mr. POMEROY. You work for the White House. Oh, that is even better yet.

Chairman THOMAS. To remind the Gentleman. She is on the Council of Economic Advisors.

Mr. POMEROY. That is perfect, because I am wondering if the White House would view a 1,258 percent increase in imports as a surge?

Ms. FORBES. Yes, we would.

Mr. POMEROY. Would the White House then direct the executive branch to respond to the surge, because I understand we do have surge protection and surge response capability?

Mr. FREEMAN. As you probably know, the President has delegated responsibility for enforcement of textile trade to a Committee of—it is called SETA, which is——

Mr. POMEROY. The President has delegated responsibility for textile trade to a Committee.

Mr. FREEMAN. Enforcement of——

Mr. POMEROY. Now, I am asking if a 1,258 increase is a surge and if the White House—and the answer was yes. The White House believes it is a surge. I then asked if the White House has directed a response, and not a study, not a referral, a response. We have got surge protection under our law, and by golly where I come from 1,258-percent increase in 3 months is a hell of a surge. What is being done about it?

Mr. FREEMAN. The answer is that we have initiated the safeguard investigations that shall look to put in place safeguards if it is successful. So, I think we are doing everything possible to address that situation, sir.

Chairman THOMAS. The Gentleman's time has expired.

Mr. POMEROY. I thank the Gentleman.

Chairman THOMAS. The Chair recalls one of the standards of an administrative approach is that you can delegate authority but not responsibility, otherwise known as the buck stops here for the President. The Chair is looking at the clock, and I know additional Members wish to inquire and obviously they have the right to do so. We have a second panel, and the Chair would protect the Members who have not yet had a chance to inquire as being the first inquirers on the next panel. That is simply an offer that is being made, and the Chair doesn't know whether anyone will take the Chair up on the offer, but the Chair would now recognize the Gentleman from Kentucky, Mr. Lewis if he wishes to inquire.

Mr. LEWIS OF KENTUCKY. Thank you, Mr. Chairman. Just a quick question. It is my understanding there is 300 million tobacco users in China. I want to ask Mr. Freeman where are we at on market access for tobacco, American tobacco products in China?

Mr. FREEMAN. I would have to get back to you on that, sir. I don't know the specifics of tobacco trade with China.

Mr. LEWIS OF KENTUCKY. Okay. If you can do that, I would appreciate it. Thank you. That is all, Mr. Chairman.

Chairman THOMAS. Does the Gentlewoman from Ohio wish to inquire?

Mrs. TUBBS JONES. I am going to take you up on your offer, Mr. Chairman.

Chairman THOMAS. Thank you very much. The Gentleman from Wisconsin? The Gentleman from Georgia? Colorado? The Gentlewoman from Pennsylvania?

Ms. HART. As much as I would like to take you up on your offer, Mr. Chairman, I will be brief. I am sorry I haven't heard all the testimony, but because you are the folks who I think can help us, I have to inquire of you, because the next panel can't help me. My concern is that we have been—we the United States—have been great soldiers and great team mates to everybody as far as trade. A lot my colleagues have very eloquently expressed a lot of the concerns that I have so I am not going to rehash them regarding specific industries. I would like it—and I am not sure which of you can do this—it is probably Mr. Freeman or Dr. Forbes. Can you characterize for me what our next move will be as far as working together with the EU in the WTO regarding our problems that I think we are now sharing with the EU. Can either of you just address that kind of quickly?

Mr. FREEMAN. The bottom line is that we are increasingly working very closely with not just the EU, but with Japan and other trading partners to make sure that issues that we share with respect to China—and I am particularly concerned about market access issues and intellectual property rights enforcement—work for the other WTO members. This is taking—we are spending a significant amount of time actually consulting with the EU and with Japan trying to find cooperative approaches to deal with the issue in China, make sure that not only are we working in China together with other WTO members and in Geneva with other WTO members on these issues, but also that we find ways to put together cooperative programs that look at enforcement through multilateral measures. So, it is a new enterprise, if you will, with respect to China to join together in the multilateral community, but it is one that we are putting a lot of emphasis on these days, and one that I am very hopeful will yield results in a short order.

Ms. FORBES. If I could follow up on the issue of China's exchange rate, this is one we also have been working on with our European neighbors as well as countries around the world. For example, we have been working through the G7 process with other developed countries, and the G7 finance ministers have issued statements urging China to move to a more flexible exchange rate regime. Recently, senior officials in the U.K., Korea, and Japan have publicly made statements urging China to move to a more flexible exchange rate. Germany—the President of Germany yesterday just mentioned this issue publicly. The IMF we have been working with, with the other members of Europe and other members of the IMF to encourage China to move to a more flexible exchange rate, and even the Asian Development Bank. The new President of the Asian Development Bank, in his first press conference, publicly urged China to move to a more flexible exchange rate. So, we have really been working multilaterally with our major trading partners as well as through multilateral organizations in our effort to get China to move to more flexibility.

Ms. HART. I will leave you with one thought and that is that obviously I look at this from an American's point of view. I think many of us believe that the WTO has sort of victimized the United States in a lot of cases, and they don't seem to be as interested in enforcing their rules against others. I just would urge us to make sure that that isn't the case. I yield back. Thank you, Mr. Chairman.

Chairman THOMAS. I thank the Gentlewoman. Does the Gentleman from Illinois wish to inquire or reserve his spot for the next panel? I thank the Gentleman. The Chair wants to thank the panel, especially for your indulgence as we had to carry out the businesses of the day with votes. This is a very broad based subject. We will analyze testimony that has been given. Dr. Holtz-Eakin is on a shorter chain than some of you folk. We will certainly have him back. I think Members may be interested in having an additional hearing, in which perhaps we can focus some of the issues based upon developments between now and when we have the hearing, and look forward to hopefully your participation again.

One of the difficulties with these hearings is that we have one person come and then another person comes, and we don't get continuity. My hope is based upon Members' comments that this panel was a good one and we would hope that we could have continuity as we perhaps explore areas with a bit more specificity. The Chair thanks you again for your participation. The Chair would now ask Robert Wilkey, President of the Fisher-Barton Company, to come forward. He will be speaking on behalf of the National Association of Manufacturers. Jay Berman who is the Chief Executive Officer Emeritus for the Recording Industry Association of America; Robert Weil, II, who is Chairman and Chief Executive Officer of Weil Brothers Cotton Company, and he is Vice President of the National Cotton Council. Myron Brilliant is Vice President for East Asia, and he will be here for the U.S. Chamber of Commerce. Alex Gregory, President and Chief Executive Officer of YKK Corporation of America—they make zippers—Marietta, Georgia. Robert Stevenson, Chief Executive Officer, East Machine Company, Buffalo, New York. David Spence, Managing Director for Regulatory Affairs Legal Department here for the Federal Express Corporation.

The Chair wants to thank all of you for your extreme patience. This is an important issue and we are anxious to hear for the record people who as they say are where the rubber meets the road. The Chair will indicate that any written testimony you may have will be made a part of the record and that beginning on my left with Mr. Wilkey, we will move down the panel. The Chair urges you to observe the lights. Green says you are good. Yellow gives you a minute. Red says we would appreciate it if you would sum up so that we can move through the panel and have you available for questions. With that, Mr. Wilkey. You need to press the button on the microphone to activate it.

STATEMENT OF RICHARD WILKEY, PRESIDENT, FISHER-BARTON COMPANY, ON BEHALF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. WILKEY. Thank and good afternoon, Mr. Chairman and the Members of the Committee. My name is Dick Wilkey. I am President Fisher-Barton, a manufacturer of components for OEMs in the lawn and garden and agricultural industries. We have 500 employees in five plants. Four in Wisconsin and one in South Carolina. I am pleased to testify today on behalf of the National Association of Manufacturers. As vice chairman of the National Association of Manufacturers' China Policy Subcommittee, I have participated in the development of the 2005 China Trade Agenda that included a vigorous discussion and resulted in a consensus from both small and large NAM-member companies.

The fact that we developed a specific China policy separate from our overall trade policy shows how important this is to our 14,000 members. Mr. Chairman and Members of the Committee, I am here to tell you that manufacturing in the United States is in serious trouble, and we must address the China issue. We are in favor free and fair trade. The NAM seeks a positive and balanced trading relationship with China that reflects market forces as closely as possible. Without doubt, China has emerged as a leading world economy, yet we are treating them like a Third World country while they are cleaning our clocks. China is no longer a poor cousin. Many companies see prices of Chinese products so low that it is impossible to compete. Others see their customers moving to China and cannot find new ones to replace them. It is hard to find fault with moves off shore. You get labor for $4 a day. Our health care cost alone is $4 an hour. It looks like raw materials may be subsidized. The kicker is that after all this China has a currency advantage of up to 40 percent.

The fundamentals are simply out of whack. I have seen this with my own company. We have lost customers who have moved their production to China, and I may lose more. There is no way of knowing how many more companies are in the process of making this move. It is my view that what we are seeing today is only the tip of the iceberg. It is my experience that once the assembly of a product goes to China, it affects all of us in the supply chain because it is highly unlikely that the parts will continue to be sourced back here in the United States. I have a friend that makes electronic parts. They make 1,200,000 parts an hour, a huge number. There is virtually no labor in it. Their problem is that much of the electronics industry has moved away. They lost their market in spite of their superior technology.

We can overcome China's low-wage advantage through innovation and use of technology. My company is producing 20 to 30 percent more product with fewer employees than we did three or 4 years ago. We make parts without touching them. U.S. manufacturers can and will compete with China, but only with fair rules. We should not have to deal with subsidized production or deliberate currency undervaluation and our government is telling us that there is nothing they can do to see that the international rules are enforced. In 2004, the bilateral trade deficit with China was about $160 billion, the largest with any country. For the same period this year, the deficit has increased 47 percent and is on track to reach $240 billion.

The NAM believes that trade must be market-based without government interference. In China, we are seeing serious problems with currency undervaluation, possible widespread subsidization of industry, and the failure to implement its responsibilities under the WTO to prevent product counterfeiting and piracy. There is no doubt China is one of the largest trade forces in the world, but it is called trade because it is the exchange of goods and services. We buy from China, but to a great degree instead of their buying our goods and services, China buys our Treasury bills in order to keep its currency cheap and its exports under priced. The NAM believes that eliminating the severe Yuan undervaluation is essential to creating a more balanced and sustainable trade flow. Would a considerably stronger Chinese Yuan have beneficial effects? You bet it would for a lot of U.S. companies. We call on the Treasury Department and the IMF to cite China for currency manipulation.

In addition, there are concerns that China's industrial development may benefit from a wide array of government subsidies. The NAM supports a bill to address the problem that was introduced last month by Congressmen English and Davis. We hope that the Committee will look favorably on this legislation. China has become the world's epicenter of counterfeiting, costing U.S. companies billions of dollars, thousands of jobs, and threatening consumer health and safety. The NAM has recommended to USTR that the Administration develop a WTO case ideally in conjunction with EU, Canada, Japan and other countries whose countries are suffering from what NAM President John Engler calls China's grand larceny on a massive scale.

In addition, we believe that our government must launch a new and massive export program targeting China. The issues that I have outlined today are having serious negative effects on our manufacturing in this country. What about defense products? What we have an obligation to see that America's manufacturing base stays strong. We can do that within the rules of the international trading system, but we must not be timid in the insistence that those rules are in force. We know that free trade properly administered benefits all of us. We must see to it that the consensus for free trade is maintained in this country. We look to the Administration and Congress to see to it that China plays by the rules and that the system works. Mr. Chairman and Members of the Committee, give us a level playing field and with our innovative work force, entrepreneurial spirit, we will thrive and grow our economy. Thank you.

[The prepared statement of Mr. Wilkey follows:]

Statement of Richard Wilkey, President, Fisher-Barton Co., Watertown, WI, on behalf of the National Association of Manufacturers

Good afternoon Mr. Chairman and members of the Committee. Thank you for giving me the opportunity to participate in this panel. My name is Dick Wilkey, and I am president of Fisher Barton Inc., a small manufacturer of components for the lawn and garden and agricultural industries. We are located in Watertown, Wisconsin. I am pleased to testify today on behalf of the National Association of Manufacturers (NAM) at this hearing regarding U. S.-China Economic Relations and China's Role in the World Economy.

The National Association of Manufacturers is the nation's largest industry trade association, representing small and large manufacturers in every industrial sector and in all 50 states. As vice-chairman of NAM's China Policy Subcommittee, I oversaw the development of our 2005 China Trade Agenda that included vigorous participation from both small and large NAM member companies. The fact that we developed a separate China policy is an indication of its importance to NAM members. The entire agenda is available at www.nam.org/trade.

No other trade subject comes close to commanding the attention that China is getting from NAM companies. China is simultaneously the greatest concern of many of our import-competing members and the fastest-growing global market for many exporters large and small and for companies that operate internationally. The fastest growing economy in the world, China has emerged within a short span of two decades as a strong international competitor in a wide range of manufactured products and a key market for U.S manufactured exports.

More recently, China has also gained prominence as a huge consumer of industrial raw materials, with demand so large that it has significantly boosted world prices of important inputs such as steel and copper scrap, iron ore and coke used in steel production. It is not surprising then, that U.S. manufacturers pay close attention to China's trade and economic policies, and how they affect not only bilateral trade and investment, but the entire global marketplace.

Trade generally, and with China specifically, has to be put in the context of a recovery in many sectors of the U.S. manufacturing economy over the past 18 months. But, despite this recovery, a number of manufacturing sectors that have borne the brunt of China's emergence as an industrial power have continued to lose revenue and jobs. Thus the China challenge not only continues to be at the center of the NAM's trade agenda, but also is central to how U.S. manufacturing defines its own future.

The NAM seeks a positive and balanced trading relationship with China that reflects market forces as closely as possible. China as a participant in the global market is a fact of life. At some point, China will become the world's second largest economy. We as American manufacturers must take advantage of the opportunities offered by the large, emerging market in China, as well as be adaptive and innovative to maintain our competitiveness globally.

In this vein, it is important to note that while the rapidly-rising trade imbalance with China is a growing factor affecting U.S. manufacturing production and employment, it is not the only factor. Domestic costs like health care and litigation costs, slowly-recovering U.S. exports, dollar overvaluation with Asian currencies and regulatory pressures are also at work. China should not be viewed as a "scapegoat" and an excuse for not tackling the other problems. Nonetheless, the China currency situation, subsidization and other factors feeding our deficit with China must be addressed.

China's emergence as a leading world economy has meant significant new opportunities for many NAM members, including increased export and investment. However, these opportunities are not fully realized by all NAM members. These companies see prices of Chinese products so low that it is difficult for them to see how they can compete. Others see their customers moving to China and cannot find new ones to replace them.

I have seen this in my own company. As I said, we are a small manufacturer with 500 employees and five plants, four in Wisconsin and one in South Carolina. Our customers are large manufacturers of agricultural and lawn and garden equipment. I have lost customers who have moved their production to China and I may lose more.

Shifting production is a process that takes time. For most companies, it takes at least a year. First you have to find several sources for the product, get quotes, have tools built to manufacture your product, have samples made and sent to the United States for inspection and approval. Only then will a company begin buying from the supplier in China. It is my experience that once even assembly of a product goes to China, it affects all of us in the supply chain because it is highly unlikely that parts will continue to be sourced back here in the United States.

There is no way of knowing how many companies are in the process of making this move. It is my view that what we are seeing today is just the tip of the iceberg. We've also lost business to China because higher raw materials costs seem to have little impact on Chinese prices. The most important material in our production is steel. Steel is a capital-intensive industry and labor is not as important a factor as it once was in overall final cost. The price paid by a Chinese manufacturer should be roughly the same.

We can overcome the low wage advantage through innovation and use of technology. At Fisher-Barton, we are producing 20–30% more product with fewer people than we did 3–4 years ago. We make parts without touching them. In order to hold onto our business we have become more productive. Our customers also have to insist on greater efficiency in order for them to remain competitive. The skills required to work with this technology are more complex and we pay more for them. So there are still good jobs in American manufacturing that we want to preserve.

I must tell you that I have seen many companies around me driven out of business and some of them were my customers. Not all of these companies were dinosaurs—a number of them had made significant investments in technology and modern business methods to remain competitive. They had done all the right things, but were still faced with an environment in which the deck was stacked against them with regard to China.

There is no doubt that China is one of the largest trade forces in the world. But it is called "trade" because it is the exchange of goods and services. We buy from China, but to a great degree, instead of buying our goods and services, China is buying our Treasury bills in order to keep its currency cheap and its exports underpriced.

The NAM believes that trade must be market-based, without government interference. In China, we are seeing problems with currency undervaluation, widespread subsidization of industry and the failure to implement its responsibilities under the WTO to protect intellectual property and prevent product counterfeiting and piracy. As we developed our China Trade Agenda, these emerged as the most serious issues in our trading relationship with China, the three C's: currency, countervailing duties and counterfeiting.

Along these lines, the NAM is looking for ways to address these issues, working within established trade rules and our WTO and other international commitments. It is essential that we have a rules-based system that is adhered to and enforced.

Revaluation of the Chinese Yuan To Reflect Economic Fundamentals

China devalued its currency by about 30 percent in 1994 and has maintained that value for the last ten years—despite a huge increase in production capability, productivity, quality, production range, foreign direct investment inflows, and other factors that would normally be expected to cause a currency to appreciate. Economists estimate that the yuan is undervalued by as much as 40 percent. This undervaluation effectively taxes U.S. exports and subsidizes imports from China, exacerbating the growing bilateral trade deficit.

In 2004, the bilateral trade deficit with China was about $160 billion, the largest with any country and, at growth rates of the last few years, will almost triple in five years. (See Chart 1 attached) The latest data show the deficit growing even more rapidly. Data for Jan. and Feb. 2005 indicate a 47% increase in the U.S. deficit with China over the same months in 2004. If this rate of growth continues, our trade deficit with China could reach an astonishing $240 billion by the end of 2005. Furthermore, the undervalued yuan makes foreign investment in productive capacity in China cheaper and more attractive, thus encouraging the migration of investment to China.

The degree of upward pressure that the yuan would feel is amply indicated in the amount of reserves that the Chinese government has to accumulate to maintain its artificial peg. Foreign exchange reserve accumulation has been accelerating. Reserves grew a phenomenal $200 billion last year—to a total accumulation of $640 billion, or 40 percent of China's entire annual output of goods and services. That is an enormous amount to have in Treasury securities earning a couple of percentage points when China could be using those funds internally to build up the poorer parts of its economic infrastructure and stimulate domestic-led growth. Moreover, the $200 billion that China added to its reserves in 2004 significantly exceeded China's entire increase in GDP that year. Yet China has no choice but to continue this huge reserve buildup so long as it insists on maintaining a sharply undervalued currency.

It should be noted that, while a currency peg *per se* does not contravene International Monetary Fund (IMF) requirements, IMF Article IV proscribes "manipulation of exchange rates to gain unfair competitive advantage over other members—and this includes protracted large-scale intervention in one direction in the exchange market." With foreign currency reserves of $640 billion, China's action is clearly incompatible with the intent of IMF Article IV.

The NAM believes that eliminating the severely undervalued yuan is essential to creating more balanced and sustainable trade flows. A revaluation of the yuan to reflect underlying economic fundamentals would also create more favorable conditions within Asia, enabling other countries to free their currencies to better reflect market conditions. These multiple currency misalignments artificially depress U.S. exports to a substantial portion of the world and reduce the competitiveness of U.S.-based manufacturing in the U.S. market.

The Chinese currency is the key, not just because of the huge bilateral imbalance, but also because other Asian countries are all looking over their shoulders at Chinese competition and are reluctant to allow their currencies to move up against China's. China could take several actions immediately, including unpegging the yuan from the dollar and relating it instead to a basket of major trading partner currencies, establishing a large band around its current rate, and moving its peg upward.

Would a considerably stronger Chinese yuan have beneficial effects? Many NAM member companies have indicated that a 20 percent or more price shift would change the competitive situation dramatically. Others say their problems go beyond that. Some commentators state that Chinese wages are so low that no amount of appreciation would make a difference. Labor costs, however, are only one factor in the production process. In fact, production worker wages and benefits are only 11 percent of the cost of U.S. manufactured goods, on average. An exchange rate reflecting market forces would shift the competitive equation so that some Chinese industries would remain extremely competitive, while others would find their artificial advantage diluted. U.S exports would also grow more rapidly, helping to bring about a more sustainable trade position.

China's action in sustained one-way purchases of dollars to maintain its peg are inconsistent both with its obligations in the IMF to avoid currency action for purposes of gaining a trade advantage, as well as with its obligations in the WTO to avoid frustrating trade liberalization through exchange rate action and to avoid subsidization of exports or impairment of trade benefits.

We are aware of the efforts made by the Administration to raise the visibility of this issue and engage the Chinese government in working towards a market-determined currency and we appreciate those efforts. Unfortunately, after more than 18 months, there has been no movement in the value of the currency. Although we have seen the beginning of internal reforms of the banking and financial sectors in China, there has been no movement of the currency. If we wait for China to take every action required to reform its closed capital system and banking system riddled with non-performing loans before we see any change in their currency valuation, we will be here a long time from now having the same discussion. And, Mr. Chairman, we will have seen the unnecessary loss of many more of our companies and jobs, not from natural economic forces and shifts, but solely because China's has refused to live up to its international commitments.

The NAM urges the Administration to work with China and other countries to resolve this problem and thus avoid the dangers that misaligned exchange rates pose to the United States, China, Asia and the global financial system. Additionally, we are pressing the Treasury Department to recognize currency manipulation in its semi-annual report to Congress. It has declined to do so in earlier reports, but we believe China's massive currency purchases in 2004 clearly fall within the definition of manipulation. We also believe the Treasury Department should urge the International Monetary Fund to exercise its surveillance authority over exchange rates. We hope this will result in positive action but, if it does not, the IMF should be prepared to cite China under Article IV if progress is not made in consultations.

Last week, the introduction of Schumer-Graham legislation in the Senate, which the NAM opposed, indicated the level of frustration with the Chinese failure to take steps to bring their currency closer to its market value. I should note that the NAM opposed the amendment not because we do not believe this is an issue of critical importance. In fact, we were the first organization to raise this issue and we continue to make it a top priority, but any action taken must be done within WTO rules.

Application of Countervailing Duty Laws to China

The NAM hears from some companies that the price of competing Chinese imports is below their cost of raw materials. There are concerns that China's industrial development may benefit from a wide array of government policies that, in effect, result in subsidies. These include: government bank lending to enterprises without creditworthiness, export-based tax incentives, and the discriminatory application of tax rates and rebates.

The subsidization of manufacturing by the Chinese government extends beyond what might be considered normal bounds to include the acquisition of raw materials. An NAM member in the copper industry tells us that exports of copper and brass scrap to China have increased about 50% a year for several years, fueled in large part by a special subsidy of 30% of the VAT tax applied by the Chinese government to imports of scrap. This subsidy is given to the scrap consumer to invest in upgrading facilities. This subsidy amounts to about 7 cents a pound of the copper content in a market where the successful bidder may be determined by a margin of a quarter cent.

The WTO Subsidies and Countervailing Measures (SCM) agreement allows countervailing import duties to offset such subsidies. In fact, China's WTO accession agreement specifically outlines the process for assessing subsidies in China. A good deal of time was spent by former USTR Barshefsky negotiating this language.

In Beijing in September 2003, former Commerce Secretary Evans said, "There is simply no valid economic justification for many of the loans currently being extended to unprofitable businesses in China. Non-performing loans to state-run companies are a form of government subsidy." However, since 1984, the Commerce Department has not applied countervailing duties against imports from non-market economy countries such as China.

The NAM supports reversal of the Commerce Department's 1984 decision in light of the SCM Agreement and the terms of China's accession to the WTO, and supports legislation that was introduced last month in the House by Congressmen English and Davis (H.R.1216) and in the Senate by Senators Collins and Bayh (S.593). We hope that the committee will look favorably on this legislation.

With regard to the bill introduced last week by Congressmen Hunter and Ryan (H.R. 1498) that would make currency a countervailable subsidy, NAM needs to do further analysis of the bill. We won't take a position until our trade committee has digested it and expressed its views.

Strengthening and Enforcement of Intellectual Property Laws

Next to the exchange rate, the most serious problem NAM members have with China is its failure to curb intellectual property theft—particularly copyright piracy and product counterfeiting. China has become the world's epicenter of counterfeiting, costing U.S. companies billions of dollars and thousands of legitimate jobs, and threatening consumer health and safety. Because of this, our members have pressed us to do more, and the NAM, with the U.S.Chamber currently co-chairs the Coalition Against Counterfeiting and Piracy (CACP).

Despite bilateral and multilateral agreements with China to protect intellectual property rights, China's record of enforcement has been inadequate and seriously flawed. China has been taking positive steps; the laws are better, and there at least is a higher degree of official attention to the enforcement of those laws at the central government level. But it is enforcement that counts and China seriously fails in that regard. It is each WTO member's obligation to provide effective protection for intellectual property.

In spite of these official efforts, it is the general view that product and trademark counterfeiting and copyright piracy is not getting better, but worse. An inability or unwillingness to protect intellectual property strikes at the core of American competitiveness. If the products of our innovation and research and development are stolen, there will be little we can do to maintain our industrial base.

As a result, the NAM, in its submission to the USTR on the Special 301 out-of-cycle review of China, recommended that the Administration designate China a Priority Foreign Country and commence development of a WTO case, ideally in conjunction with the EU, Canada, Japan and countries whose companies are also suffering from what NAM President John Engler calls China's "grand larceny on a massive scale." We need to see the law enforced, with counterfeiters thrown in jail and the volume of counterfeiting significantly reduced. It is time to deal decisively with this problem.

U.S.-China Trade Deficit and Effect on Manufacturing

There is no doubt that China exerts the largest bilateral trade effect on manufacturing. In 2004, we had a trade deficit in manufactured goods of $490 billion. Two-thirds of that total is with Asia and 34% is with China. (See Chart 2 attached.) The surge in Chinese imports has been a serious problem in many sectors and anecdotal evidence indicates that there are underlying factors already discussed that we cannot afford to ignore. In addition, Chinese production has exerted a downward pressure on prices at a time when costs are rising. Companies cannot pass on those costs because of the so-called "China price," recently featured in a leading business weekly.

However, while China poses a very serious problem for many U.S. manufacturers, a problem that is growing rapidly, it is important to understand that China trade is not the only—or even the major—factor responsible for costing American manufacturing the three million jobs that have been lost since 2000.

Many factors went into that job loss. In fact, during the 2000–2003 period, when we lost those three million jobs, the most significant trade factor affecting employment was not China, but was the fall in our global exports. The U.S. manufacturing goods trade deficit worsened by $90 billion during those three years, but $70 billion of that decline came from falling exports, and only $20 billion of the increase in the deficit came from rising imports. Additionally, it should be noted that not all of the increase in imports from China has been displacing U.S. production. A significant proportion, particularly in computer and electronics imports, appears to have displaced other Asian country exports to the United States.

Nevertheless, it is clear that the largest trade challenge facing a growing range of U.S. manufacturers today is China. It is no exaggeration to say that for many U.S. companies their top three trade concerns are: 1. China; 2. China; and 3. China. The trade gap with China has widened considerably in recent years and particularly in recent months. Given all these factors, addressing our trade deficit with China is an imperative, but we must do so within international rules.

Development of Significant Export Promotion Effort Targeting China

In looking for positive ways to alleviate this imbalance, promoting the more rapid growth of U.S. exports to China certainly should be emphasized. The NAM believes there is substantial potential for Chinese economic growth to lead to a corresponding growth in the U.S. manufacturing economy. But that potential is far from realization.

Of the $560 billion of goods China imported in 2004, only 8 percent were from the United States, including agricultural products. In contrast, the European Union (EU) and Japan have been significantly more successful selling into the Chinese market. (See Chart 3 attached.)

Many manufacturers are taking advantage of China's rapid economic growth to sell more of their products there. In fact, for some member companies, China is their most important foreign market for increasing export sales. However, China remains a difficult place to do business and small and medium-sized companies, even those successful in other foreign markets, often have difficulty entering the Chinese market and developing profitable business relationships.

To help U.S. manufacturers reach their export potential in China, a new and greatly expanded export promotion initiative is needed. Current U.S. Government export promotion programs offer useful assistance but are not on the scale needed to make a sufficient difference in overall export trends. The U.S. Government and private sector must work together to launch a more ambitious program that provides more on-the-ground assistance in China and more trade outreach to potential U.S. exporters. A complete outline of NAM recommendations for this program can be found in the 2005 NAM China Trade Agenda. Our goal should be to achieve at least one-third growth in our exports to China each year. This would triple our exports in four years and quadruple them in five. To implement a program of this scale, the NAM will seek to obtain a doubling of the Commerce Department's China-specific trade promotion budget for FY2006.

Standards and Regulatory Market Access Barriers

In foreign markets around the world, standards and technical regulations as well as procedures established for conformity assessment have emerged as increasingly important market access barriers for U.S. manufacturers. In China we have seen disturbing developments that standards and technical requirements are being deliberately used to limit market access of foreign products and give Chinese producers unfair advantage. And these concerns need more attention.

China has been active in promoting standards in a number of information technology areas, for example, wireless encryption standards (WAPI), radio frequency identification tagging (RFID), Internet protocols and its own microprocessors. This indicates that the Chinese government has a longer-term plan to encourage the use of Chinese products and technology, particularly in high-technology sectors where the U.S. has competitive advantages, by gaining wide acceptance of domestically-developed standards.

U.S. manufacturers also face other market-access problems resulting from technical and regulatory requirements established by government authorities, and from costly and burdensome conformity assessment procedures. The process for approving new chemical products, for examples, is slow and unpredictable. Duplicate testing to meet overlapping technical requirements are common in a wide range of products, including medical equipment, personal care products, mobile phones and consumer electronic products.

We also hear frequent complaints about the application of requirements for a "China Compulsory Certification" (CCC) mark on 130 categories of products, such as appliances, electric motors and machinery, and information technology equipment. Only Chinese companies are authorized to certify conformity to the standards, and inspection of foreign factories is required. U.S. testing companies, such as Underwriters Laboratories and Intertek, cannot provide these services in China. The CCC process is costly, time-consuming and complicated, particularly for small manufacturers and producers of components.

As part of its WTO obligations, China has become a party to the WTO Technical Barriers to Trade (TBT) Agreement, which establishes disciplines aimed at preventing countries from using standards and technical requirements as trade barriers. The U.S. Government needs to work with the business community to ensure that China lives up to both the letter and spirit of this agreement and its commitments to open the Chinese market to foreign products and companies. We are concerned that China is not doing enough to meet is obligations in this area.

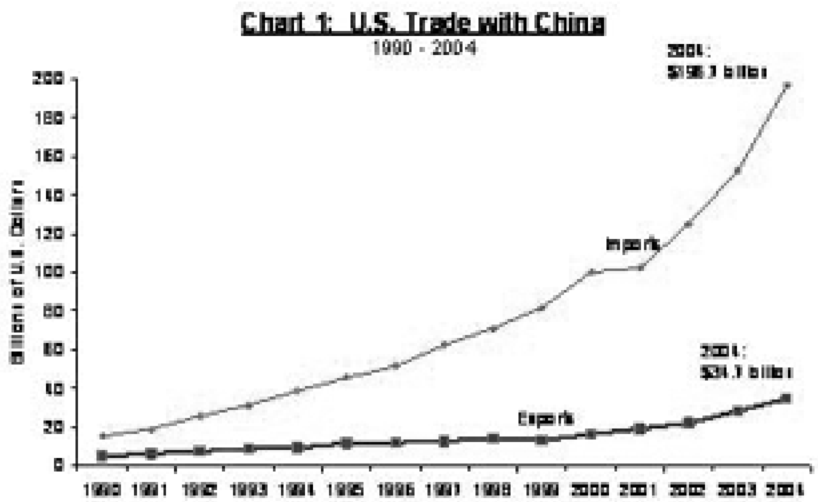
Conclusion

Mr. Chairman, let me reiterate that the NAM wants a strong economic relationship with China that provides mutual benefits. Now in its fourth year of WTO membership, China has made progress in opening markets and adhering to international rules, but the benefits of the relationship still remain heavily one-sided in China's favor. Manufacturers continue to face an unlevel playing field that works to limit U.S. exports to China and gives Chinese products unfair advantages in the United States.

Many U.S. manufacturers can and will deal with the fact of China's low wages and lack of worker benefits through innovation and technology. But what is not fair and what we should not have to deal with is subsidized production or deliberate currency undervaluation and our government telling us there's nothing they can do to see that international rules are enforced.

We do not have five years or ten years to solve this problem. The issues I have outlined today are having a serious and negative effect on manufacturing in this country. We have an obligation to see that America's manufacturing base stays strong. We can do that within the rules of the international trading system. But we must not be timid in the insistence that those rules be enforced. Without enforcement when major trading partners egregiously violate these rules, many will lose faith in the efficacy of the system. We know that free trade properly administered benefits all of us. We must see to it that the consensus for free trade is maintained in this country. We look to the Administration and Congress to see to it that China plays by the rules and the system works.

Thank you, Mr. Chairman.



Source: Census Bureau, U.S. Department of Commerce

Chart 2: U.S. Manufacturing Trade Deficit

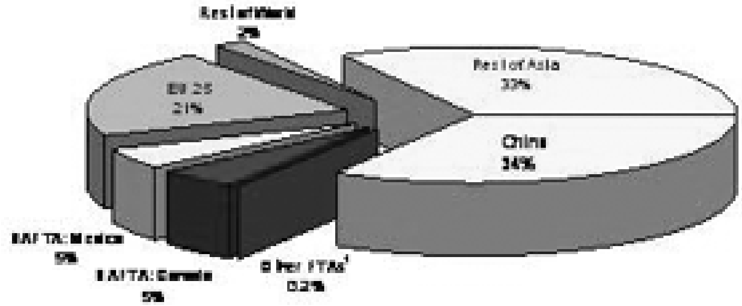
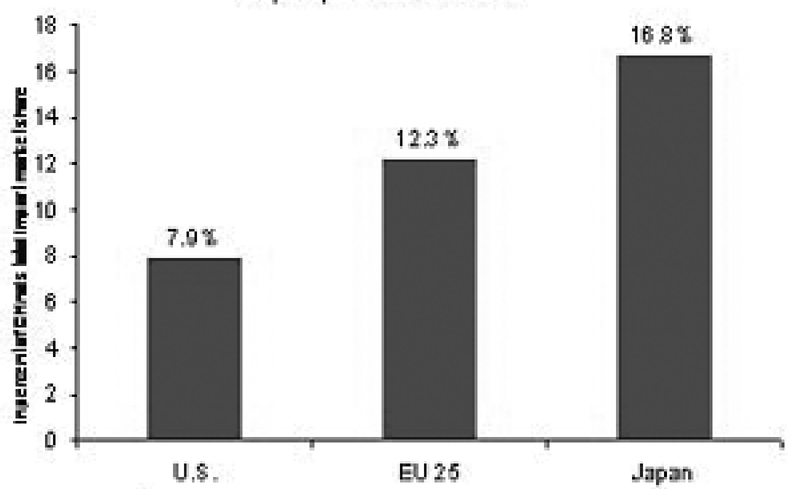


Chart 3: Foreign Share of China's Import Market 2004:
Japan, EU-25 and U.S.



Source: World Trade Atlas

Chairman THOMAS. Thank you very much. Speaking of counterfeiting. Mr. Berman?

STATEMENT OF JAY BERMAN, CHIEF EXECUTIVE OFFICER EMERITUS, INTERNATIONAL FEDERATION OF PHONOGRAM INDUSTRIES, ON BEHALF OR THE RECORDING INDUSTRY OF AMERICA

Mr. BERMAN. Thank you, Mr. Chairman. Let me start by answering the question that you posed to the previous panel, which I actually don't believe was answered and that where China ranks in the hierarchy of bad guys. It ranks number one. It has not ranked number one. In the three and half years since it has joined the WTO, it hasn't improved. That is the answer to your question. Mr. Chairman, thank you for—and Members of the Committee. Thank you for the opportunity to appear here today to discuss China's intellectual property regime, its current enforcement policies or to be more precise the lack of enforcement.

Let me start by going directly to the conclusion of my written testimony about the current state of affairs in China. While there has been some progress in terms of administrative and legal structure for enforcement and modernization of China's copyright law, not surprisingly this has produced very little in the way of results for expanded commercial opportunities for U.S. record companies. The reason simply is the lack of a credible sustained deterrent enforcement policy and the continued existence of market access barriers.

I say that, Mr. Chairman, notwithstanding the marked increase in sporadic rating of pirate operations and the actual seizure of hundreds of millions—hundreds of millions—of pirate discs. Why? The Chinese have made a conscious choice to rely exclusively on administrative sanctions. That means lots of inspections, lots of seizures, and if the pirate hasn't already been tipped off about the raid and fled the scene possibly a fine. China's organized crime gangs, the manufacturers, and distributors behind the face of poor street vendors consider these periodic seizures and fines as a mere cost of doing business. Indeed even with the destruction of product and the payment of fines, it is still a highly profitable business, particularly since the pirate is back on the street the next day.

Until China imposes truly deterrent criminal penalties for copyright piracy, nothing is really going to change for U.S. companies. China will remain in violation of its WTO obligations under Articles 41 and Articles 61, and it will have failed to fulfill its commitment to the United States under the U.S.-China Joint Commission on Commerce and Trade, known as the JCCT. The challenge for American industry and for the U.S. government is how to get the Chinese to actually live up to their promises. A second point in addition to the question of piracy and enforcement is that continued existence of market access barriers to U.S. entertainment companies. These trading barriers make it difficult for U.S. companies to realize the true commercial potential of the Chinese market. This is most definitely an underdeveloped, underserved market with vast potential for America's entertainment companies.

Unfortunately, it may well stay that way by design of the Chinese authorities. In light of the tremendous imbalance in U.S.-China trade, it is a matte of critical importance that America's most competitive industries, its intellectual property industries, be afforded a more level playing field. Let me cite one of these barriers, for example. Censorship. It is ironic but the irony seems to have been lost on China that excluding or delaying a U.S. work for political, cultural, or social reasons does not in any way affect the ability of pirates to have that same work on the street and available in large quantities very quickly after its U.S. debut. The fact that U.S. record companies cannot publish or release a recording in China without the permission of a state-owned publishing company and that we cannot operate through wholly owned companies manufacturing, distribution, or retailing operations artificially segments the market and makes it extraordinarily difficult to grow the market for U.S. recordings. The current system in China does not work. In fact, it cannot work, and it is designed to achieve precisely that result.

Unless the U.S. uses each and every option available to it, we will face this situation we do today for the foreseeable future, an overwhelmingly pirate market with limited opportunity for the legitimate U.S. companies. As I noted in my written testimony, we strongly support the initiation of WTO consultations with China on this matter. We were told that the great benefit of bringing China into the WTO was to bind it to the rule of international law. It is time to test that with respect to China's longstanding willingness to tolerate piracy. Thank you.

[The prepared statement of Mr. Berman follows:]

Statement of Jay Berman, Chief Executive Officer Emeritus, International Federation of Phonogram Industries, on behalf of the Recording Industry Association of America

Mr. Chairman and Members of the Committee, my name is Jay Berman and I am Chairman Emeritus of IFPI, and formerly served as Chairman and CEO of both IFPI and RIAA. I have been deeply involved in working to address piracy in China for nearly two decades, and I greatly appreciate the opportunity to appear before you today on behalf of the Recording Industry Association of America to discuss U.S. economic relations with China and the music industry's perspective on China's implementation of its WTO accession commitments. I will add, at the request of MPAA, some comments about the problems affecting the motion picture industry's ability to conduct business in China.

Before beginning to address the substance, I want to first highlight the excellent work that has been done, and is being done, by the Administration in attempting to tackle the piracy problem in China. USTR and the entire executive branch team has been vigilant, creative and relentless. The fact that China maintains unreasonable practices with respect to market access and piracy is something for which the Chinese Government is uniquely accountable. USTR, the Department of Commerce, the State Department, the U.S. Embassy in Beijing, and other executive branch agencies have demonstrated tremendous resolve in attempting to persuade the Chinese Government to address these practices, and their continued efforts are greatly appreciated by America's copyright industries.

International markets are vital to our companies and our creative talent. Exports and other foreign sales account for over fifty percent of the revenues of America's record industry. This strong export base sustains and creates American jobs. The core copyright industries—including music, movies, software and videogames—account for approximately six percent of U.S. GDP. The United States possesses a strong comparative advantage in the creation and sale of entertainment products.

However, America's creative industries are under attack. Piracy has grown in recent years with the advance of digital technology that facilitates both physical and online piracy. Indeed, this is especially so in China where high levels of piracy in conjunction with market access barriers plague our industry The combined effect of China's massive piracy and rigid market access restrictions severely limits our ability to take advantage of our industries' comparative advantage in China at the same time that China's exports of other products surge into the United States. It is unfair and no longer tolerable that extremely competitive U.S. businesses are effectively banned from operating on fair and non-discriminatory terms in China.

As I will elaborate below, China's intellectual property laws have some deficiencies, but even more important is their failure to enforce those laws effectively. We thank you Mr. Chairman and the Committee for holding this important hearing, and welcome this opportunity to explore mechanisms for ensuring China's compliance with its WTO and bilateral obligations to the United States.

Our Problems in China

Last year, despite China's various bilateral and multilateral commitments to the United States, the record industry lost over $200 million in China to pirate sales. 85% of the sound recordings sold in China were pirated. This means an astounding 17 of every 20 sound recordings sold in China are sold by pirates. Our colleagues in the motion picture industry face an even grimmer picture. They inform us that they lost $280 million to piracy in China last year, a 95% piracy rate.

There are five significant and related problems in China:

1. China is swamped with pirated recordings and motion pictures because the penalties imposed on pirates are simply ineffective. Chinese authorities might raid a manufacturing facility, a warehouse or a retail store and seize the pirate product, but the resulting penalty, if any, is generally just a small fine. Pirates are entrepreneurs who see raids and seizures as a cost of doing business and the occasional interruptions are built into the business model. The penalties do not deter or punish or incapacitate the thieves.
2. China is a net exporter of our music and movies. The pirates produce the copies in China, and then export to the surrounding countries and beyond. MPAA tells us that Chinese pirated DVDs have been seized in the United States, the United Kingdom, Australia, Hong Kong, Sweden, Thailand, and the United Arab Emirates. Exports of pirated music sound recordings have been found in several Southeast Asian countries. This practice had stopped after the 1995/96 trade agreements with the U.S., but resumed about three years ago and has been an increasing problem ever since, especially in the case of motion pictures.
3. Market access and investment barriers prevent our members from serving the Chinese market in a timely manner. As a result, legitimate product gets to the consumer weeks or months after the pirates have successfully exploited our products. Thus, a solution to piracy requires relief from the barriers we face just to enter the Chinese market. Until China closes this exclusive window of opportunity for the pirates to offer our products to Chinese consumers while we are barred from doing so, efforts to combat piracy will not succeed. We understand the cultural sensitivities of Chinese society, and do not intend to challenge the maintenance of fair, timely and transparent censorship regulations. However, it is essential that any such censorship regulations do not operate as a disguised barrier to entry, and that they do not result in commercially prejudicial delays in securing approval for release of products. Interestingly, the Chinese Government doesn't appear to be too troubled by the avalanche of piratical products for which no censorship approval has been secured, suggesting that present rules limiting the scope of market access have little to do with cultural sensitivities.
4. Given present imbalances in our trading relationship, it is time for the U.S. government to insist that China expand the opportunities for U.S. businesses to operate in China in sectors where the United States is competitive—particularly in the music and film sectors. We permit access for Chinese enterprises to operate in the United States. As stated in the introduction of my testimony, it is unfair and no longer tolerable that extremely competitive U.S. businesses are effectively banned from operating on fair and non-discriminatory terms in China.
5. Internet piracy is growing rapidly in China. Many websites offer the unauthorized downloading of music files, some for a financial charge, others for free. Certain China-based ISPs have become online "warehouses" for international pirate syndicates. Many of the legal deficiencies that enable physical piracy to flourish in China plague the on-line environment as well.

Demand for American musical recordings and filmed entertainment in China is enormous, as evidenced by the massive piracy of our products across China. The result has been a colossal lost opportunity for American writers, performers and record and movie producers to benefit from the fast growing Chinese society and economy. To put this in economic terms, the United States has a tremendous "comparative advantage" in creating and producing entertainment products that we want to make available to China's citizens. But we are unable to do so as result of the continuing piracy and market access restrictions described in my testimony.

Frankly, Chinese writers, performers and producers—indeed Chinese culture more generally—is undermined by the massive Chinese piracy of their own music recordings and filmed entertainment. China's culture is also harmed by the market access restrictions China maintains which seriously restricts the ability of our world-class companies to bring to our modern recording technologies and distribution techniques to the delivery of music recordings and filmed entertainment products in China.

Chinese Law and Treaty Obligations

The entertainment industries have a long history of working with the Congress and the Administration to protect and defend this uniquely successful sector of the U.S. economy. We very much appreciate the efforts of this Committee as well as the dedicated officials within the various agencies. As a result of a lot of hard work, today the U.S. copyright industries can look to three primary mechanisms for protecting intellectual property in China—a 1995 bilateral agreement, the WTO and JCCT.

I personally worked very closely with the Office of the U.S. Trade Representative on the intellectual property negotiations with China in 1995 and 1996 pursuant to Section 301 investigations. Those efforts resulted in bilateral agreements that obligated China to: 1) close factories producing pirated CDs, and 2) stop the exports of pirate CDs that were causing catastrophic disruption of our global markets and other actions.

These 1995 and 1996 agreements were largely successful, and the Chinese government closed many of these plants and halted the exportation of pirate products. However, we are concerned that exportation of piratical goods is once again on the rise, and our hopes that China's self interest in being a significant player in world trade and the information society would lead to a significant reduction of piracy across the board have not yet been fulfilled.

China's Commitments in the WTO's Agreement on Trade-Related Intellectual Property Rights—aka the "TRIPS" agreement

The WTO's TRIPS Agreement is basically divided into two parts: (1) substantive norms (e.g. what rules must be in a copyright law) and (2) requirements that members enforce the law and provide remedies that are adequate to deter further infringements of these norms. China is not in compliance on a number of counts, particularly as regards effective enforcement.

For example, the enforcement section of TRIPS—Article 41—states that "members shall ensure that enforcement procedures . . . are available under their law so as to permit effective actions against any infringement . . . covered by this Agreement, including expeditious remedies . . . which constitute a deterrent to further infringements." China's excessive reliance upon administrative sanctions in the form of the seizure of infringing product and, if the guilty party doesn't flee, the imposition of small fines, do not deter further infringements.

China also fails to comply with Article 61 of the TRIPS Agreement, which specifically requires that criminal penalties "be applied in cases of willful trademark counterfeiting or copyright piracy on a commercial scale." China has conducted few prosecutions and made very few convictions for copyright piracy. China has persisted in defining "commercial scale" through the use of complicated numerical thresholds and ambiguous definitions which, despite the new Chinese "judicial interpretation" described below, make it highly unlikely any pirate will face criminal penalties.

Moreover, the remedies provided in China's criminal code are only available in those instances where the pirate is making a profit. Ironic, isn't it, that the concern is the pirate's profitability and not the fate of the legitimate business. In addition, the profit test is actually more difficult to meet than the commercial scale requirement. For example, someone intentionally posting online a single copy of a copyrighted recording on the internet without authorization, will cause serious economic harm on a commercial scale if that recording or motion picture is downloaded over and over again. It would not, however, meet China's "for profit" test. In addition, a "profit" test violates the TRIPS Agreement.

China's Commitments in the U.S.-China Joint Commission on Commerce and Trade—the "JCCT"

In April 2004 during a meeting of the U.S.-China Joint Commission on Commerce and Trade—the JCCT—China made several potentially important commitments to improve intellectual property enforcement.

- First and foremost, China committed to "significantly reduce IPR infringement levels". Under any measure, this has not happened. The legitimate market, while it has improved somewhat over the past year, is still under siege. Piracy is down from an astounding 90% to about 85% in sound recordings. Piracy of motion pictures remains at 95%.

- China also committed to increase penalties for IPR violations by taking the following actions by the end of 2004:

—increase the scope of IPR violations subject to criminal investigation and criminal penalties;

—apply criminal sanctions to the import, export, storage and distribution of pirate product;

—apply criminal sanctions to online piracy;

One reason why piracy and counterfeiting have remained so high for so long is that China almost never criminally prosecutes anyone for committing these acts, no matter how extensive the piracy or counterfeiting may be. An important outcome of the JCCT was China's commitment to revise substantially its "judicial interpretation" governing application of its criminal code to copyright piracy—and to trademark counterfeiting—so that criminal prosecutions and convictions would more readily occur against these acts.

As mentioned, China has long relied upon a complex system of numerical thresholds and ambiguous definitions for deciding when to criminally prosecute and convict for copyright piracy and trademark counterfeiting. We have long advocated that China abolish this system, or at least simplify and substantially lower these thresholds.

China did issue a new judicial interpretation in December 2004 that does reduce many of these thresholds. However, China has maintained its complicated and ambiguous definitions that leave us uncertain as to whether criminal prosecutions and convictions are any more likely now than in the past. Vice Premier Wu Yi, who is responsible for IPR and led the Chinese JCCT delegation, may be serious about bringing about a significant reduction in piracy, but the police, prosecutors and criminal judges still seem to regard IPR violations as activities that do not merit their serious attention..

- As part of the JCCT China agreed to mount a nationwide enforcement campaign to stop the production of pirate product and punish violators.

A one year campaign was launched last September that resulted in noticeable increases in the number of inspections and product seizures. However, the usual remedies are being still applied—product is seized and modest administrative fines are sometimes levied. Not only is this campaign ineffective, it is set to expire in September!

- Improve the protection of electronic data by ratifying the WIPO Internet Treaties as quickly as possible. To date, while there have been some promising public announcements about China's intention to ratify the Treaties, there has been no demonstrable progress on this, and this legal issue must be viewed against a background that has witnessed a proliferation of sites offering unauthorized recordings.
- Increase customs enforcement actions against imports and exports of pirate products and provide easier remedies for rights holders to secure effective enforcement at the border. Again, there is no indication that is underway.

Our Recommendation

China's current reliance on the threat of administrative inspections, seizures and modest fines does not work. China's criminal enforcement authorities are not seriously involved in intellectual property enforcement. Unless this changes, we foresee unacceptably high rates of copyright piracy in China for years to come.

At its own initiative, the U.S. Government is conducting a Special 301 "out-of-cycle review" of China's compliance with its obligations to the United States under the 1995 bilateral agreement, the WTO and JCCT. It is impossible to conceive that USTR could conclude anything other than that China is not in compliance with these important obligations.

Given that China is now in the WTO, the U.S. government is no longer free to unilaterally impose the type of sanctions that worked in the mid-1990s. Options available to the U.S. appear to be (a) initiating a WTO dispute settlement case; (b) placing China on one of the Special 301 lists (priority foreign country, priority watch list, watch list); (c) imposing some form of trade sanction that is consistent with our WTO obligations and/or (d) more discussions in the JCCT and elsewhere.

The U.S. recording industry, joined by its sister organizations in other copyright sectors, strongly recommends that the U.S. government request initiation of consultations with China in the WTO over China's failure to comply with its obligations to provide deterrent remedies and criminal sanctions against willful copyright piracy, as required by the TRIPS Agreement. USTR should also use any and all other pressure points available to it to press our concerns on this matter. This includes bringing into the WTO process other countries whose companies are suffering from this scourge. China must come to realize that the United States—and hopefully other countries—will not tolerate the continued piracy of our products.

Market Access Restrictions

My testimony to this point focuses specifically on China's massive copyright piracy and the damage this causes American and Chinese legitimate performers and producers of sound recordings and motion pictures. However, solving China's piracy problem will also require significantly improved market opportunities for our industry and other U.S. copyright industries, so that we can conduct the full range of commercial activities that are integral to our businesses.

U.S. record companies' possess great expertise in developing and recording new artists, and distributing, promoting, and advertising their recordings so that the public is aware of them. RIAA member companies work with local talent to refine and enhance their skills and market their new sound recordings to local consumers. That is what we do. Today China severely limits the ability of American record companies to engage in developing, recording and distributing the music of Chinese performers, and in fully participating in developing the Chinese marketplace.

This is done in a number of ways:

Content Regulation and Review*:*

(1) Chinese government officials are required to review the content of *foreign-produced* sound recordings before their release. Domestically produced Chinese sound recordings face no such oversight process. Of course, pirated product—be it domestic or foreign—is not censored either and thus has free reign of the Chinese market while our legitimate products are tied up in the Censorship Office. China should at minimum terminate this discriminatory process between imported and domestically produced product.

(2) Censorship offices are understaffed, causing long delays in the distribution of new recordings. In recent months, we have seen some improvement and a new recording takes an average of two weeks to be approved. But that still gives the pirates a crucial two week head start over the legitimate retail channels. The best result would be for censorship to be industry-administered, as it is in most other countries. If this is not an acceptable option, the Chinese should be encouraged to find some other mechanism that allows legitimate music to be marketed in a timely manner.

Producing and publishing sound recordings in China*:*

Another onerous restriction requires that a sound recording be released through an approved "publishing" company if it is to be brought to market. Currently only state-owned firms are approved to publish sound recordings. China should end this discrimination and approve foreign-owned record publishing companies.

Further, production companies (even wholly-owned Chinese ones) may not engage in replicating, distributing or retailing sound recordings. The extra layers eliminates synergies and needlessly cripples the process of producing and marketing legitimate product in an integrated manner. China should permit the integrated publishing, production and marketing of sound recordings and allow such companies to have foreign investors.

In addition, U.S. record companies may market non-Chinese sound recordings only by (1) licensing a Chinese company to produce the recordings in China or (2) importing finished sound recording carriers (CDs) through the China National Publications Import and Export Control (CNPIEC). China should permit U.S. companies to manufacture, publish and market their own recordings in China and to import directly finished products.

Distributing sound recordings:

Foreign sound recording companies may own no more than 49% of a joint venture with a Chinese company. However, the recently concluded Closer Economic Partnership Agreement (CEPA) between China and Hong Kong permits Hong Kong companies to own up to 70% of joint ventures with Chinese companies engaged in distributing audiovisual products. China should grant at least MFN status to U.S. record producers per the terms of the CEPA.

Market Access barriers affecting filmed entertainment:

On the film side, you have probably heard that China only allows the distribution of twenty imported films per year. In addition, MPAA states that China maintains a state enforced monopoly on the import of foreign films. Only a small number of Chinese companies are permitted to distribute imported films. These barriers result in long lag times between the worldwide release of a film and its début in China; last summer, that lag time reached three months—a period when the films were widely available in China, but only in pirate format!

Conclusion

Sound recording and film piracy in China remains rampant. Much more needs to be done by China in order for it to meet its bilateral and multilateral enforcement obligations to fight piracy. In addition, it is time for the Chinese government to acknowledge the nexus between meaningful market access and the ability to effectively fight piracy. Piracy cannot be defeated or effectively deterred by enforcement alone—it must be accompanied by market-opening measures. The continuous vacuum left by China's closed market will always be promptly filled by pirates. We urge the United States—and the rest of the international trading community—to bring greater pressure on China through the WTO and other processes to much more effectively combat the rampant piracy in China and to open the Chinese market to our legitimate products. Congress should deliver a clear message to the Chinese Government—that they cannot expect to continue to exploit their wares in the United States while maintaining practices that effectively prevent the entry of our most competitive industries. Present Chinese policy contributes to an imbalance of trade by severely restricting our economic opportunities in sectors where we are most competitive. This must not be allowed to continue. It has already gone on for far too long.

Mr. SHAW. [Presiding.] Our next witness is Robert S. Weil, II. He is the Chairman and Chief Executive Officer of Weil Brothers Cotton Co. in Montgomery, Alabama, and Vice President of the National Cotton Council. Mr. Weil?

STATEMENT OF ROBERT S. WEIL, II, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, WEIL BROTHERS COTTON COMPANY, MONTGOMERY, ALABAMA, AND VICE PRESIDENT, NATIONAL COTTON COUNCIL

Mr. WEIL. Thank you, Mr. Chairman. In addition to that, my company has been merchandising and exporting U.S. cotton for 127 years. With changing trade patterns dictated by WTO, the lapse of the multi-fiber agreement, various free trade agreements, and the changes within China, the landscape of trade with China has been altered profoundly. As a result the U.S. cotton industry is exporting substantial quantities of cotton to China, and must continue to grow this important relationship. With its rate of increase in cotton production, consumption, and export of textile goods into the world markets, China is the dominant force in the world cotton market.

I will focus my testimony on four main areas. One, access to China's market. Two, ability to enter into contracts. Three, issues of quality. Four, evolving terms of trade. My written testimony details our concerns with China's implementation of its tariff rate quota commitments, particularly the distinction it draws between private mills and the processing trade.

Essentially, the processing trade category is not true market access, as required by the terms of the U.S.-China WTO Accession Agreement. A dedicated effort by industry and the U.S. government has improved this situation, but not solved it completely. However, China's growing need for cotton fiber has caused it to increase its import quota above WTO requirements, relieving the need for immediate changes. We continue to monitor this issue along with the U.S. government. Initially, there was significant confusion within the U.S. cotton merchandising sector concerning the legal authority of any specific cotton textile mill in China to enter into a contract. Overall, however, China has loosed up on the ability of mills to contract. However, these same mills have a steep learning curve and don't always appreciate the sanctity of their contractual commitments. In short, Chinese business culture and ethics differ from western business culture and ethics, which is based on English law.

Since trading margins are based on certainty of completion of contract—that is, the assessment of risk—it is critical to the whole of the U.S. cotton industry from the producer through the ginner and warehouseman to shipper that these differences be bridged satisfactorily. As our cotton exports to China have grown, China's mills have begun to raise quality issues with U.S. cotton. These complaints stem from a number of factors, namely fundamental differences in the way cotton is harvested and ginned in the two countries, a lack of understanding of those differences, and inconsistency in China's classification system, which remains primarily a manual system. China has recently announced an ambitious plan to transform its system to instrument classification. We commend China for this effort, and we will continue to work with them and the USDA specialist to help it develop a consistent workable classification system.

Finally, our recent experience in China shows a critical need for improvement of the rules that govern terms of trade. Quality complaints are not handled equitably. Contract sanctity is not readily enforced, and negative price movements can cause significant cancelation of contracts. We currently do not have a lot of faith in the Chinese dispute settlement system. We believe that in order to quickly improve these issues, China should look to internationally recognized bodies that have developed terms of trade over an extended period of time and use their experience. These organizations, such as the International Cotton Association, could help China revise its outdated and one sided purchase contracts and help reform rules governing the settlement of contractual disputes.

Interestingly, the National Cotton Council recently hosted an intern from the China Cotton Association to assist their understanding of our business systems and our terms of trade. The National Cotton Council intends to send an intern to China this year to work with the China Cotton Association in an effort to continue this exchange of information.

There are few international relationships more complicated or dynamic than that of U.S. Cotton and China. The U.S. cotton industry is exporting an ever increasing quantity of cotton fiber to China. At the same time, our longstanding customer, the U.S. textile industry, continues to erode financially in the face of competition from textile imports, and there is no more competitive textile and apparel manufacturer in the world than China. It is imperative that the U.S. cotton industry continue to cultivate China as a good customer of our fiber. I am certain this will happen, and despite the bumps in the road, I am convinced we will sell more cotton to China in the years ahead. Thank you, sir, for allowing us to testify today.

[The prepared statement of Mr. Weil follows:]

Statement of Robert S. Weil, II, Chairman and Chief Executive Officer, Weil Brothers Cotton Company, Montgomery, AL, and Vice President, National Cotton Council

Mr. Chairman, I would like to thank you and the members of this committee for inviting me here today to discuss trade with China. My name is Robert Weil. I am the Chairman and CEO of Weil Brothers Cotton Company, located in Montgomery, Alabama. Weil Brothers has been merchandising and exporting U.S. cotton for 127 years. We sell cotton all over the world. I am also Vice President of the National Cotton Council of America and have been a member of an Agricultural Technical Advisory Committee in this Administration as well as the two previous ones.

My testimony today focuses on a cotton merchant's perspective of doing business with China; how our business has grown; how we have worked to develop that business; and how we hope our business relationship will evolve.

There are few international trading relationships more complicated or dynamic than that of U.S. cotton and China. The U.S. cotton industry is exporting an ever-increasing quantity of cotton fiber to China. At the same time, our long-standing customer, the U.S. textile industry, continues to erode financially in the face of competition from textile imports —and there is no more competitive textile and apparel manufacturer in the world than China.

A few numbers demonstrate the dynamic nature of this trading relationship:

- In 1998, China imposed a quota on cotton imports and imported 359,000 bales of cotton from the world. In 2002, China announced the first tariff-rate quota allocation in keeping with its WTO accession agreement. In that marketing year, China imported 3.1 million bales of cotton from the world and 234,000 bales from the United States, a total amount roughly equivalent to its tariff rate quota.
- We are still recording sales for the 2004 marketing year. So far, China has about 2 million bales in commitments from the U.S. and is expected to import up to 8 million bales from all sources. It also produced a record 29 million bales of cotton in calendar year 2004 and exported almost $55 billion dollars of total textile and apparel products, an increase of 50% since 2002. The projections developed for the 2005 USDA Ag Outlook show China importing 14 and one-half million bales for the 2005 marketing year—an increase of more than 6 million bales over 2004.
- This growth should be taken in context with the demise of the U.S. textile industry. In the 1998 crop year, the U.S. still maintained double-digit mill use of cotton. In that year, the U.S. and China combined to register 29 million bales of mill use. As we enter 2005, a scant 7 years removed from 1998, it is projected that China alone will spin about 41 million bales of cotton in its mills—12 million bales over the combined total of the U.S. and China in 1998. Meanwhile, U.S. mill use has fallen to around 6 million bales a year, 40% below the rates that existed throughout the 1990s. I know that this committee is very familiar with the economic situation confronting the U.S. textile industry and the need for appropriate measures to ensure its survival.

The numbers I have recited show very clearly that the United States has a new, very important customer, China. The U.S. cotton industry is currently exporting substantial quantities of cotton to China, and China must continue as an important customer. With its rate of increase in cotton production, cotton mill use and cotton purchasing, China is the dominant force in world cotton. If you ask me or any other merchant around the world about the direction of the cotton market, our first question will be "what will China do?" I have attached to my testimony an analysis of China cotton production taken from the Economic Outlook report developed by the Economic Services department of the National Cotton Council in January of this year for further background in this area.

Mr. Chairman, I will focus my testimony today on four main areas: 1) access to China's market; 2) ability to enter into contracts; 3) issues related to cotton quality; and 4) evolving terms of trade.

Market Access—Implementation of the Tarrif Rate Quota

After being shut out of the China market in 1998, the U.S. cotton industry welcomed the WTO accession agreement and China's commitment to establish a tariff rate quota of over 3 million bales. While China announced that quota fairly promptly in February 2002, the National Cotton Council raised serious concerns with the way in which the People's Republic of China was implementing its commitments. Our primary objection has been China's allocation of a significant portion of the cotton TRQ to the "processing trade." By allocating quota to the processing trade, China is requiring that apparel made from that cotton be re-exported. Essentially, the processing trade category is not true market access as required by the terms of the U.S.—China WTO accession agreement.

As a result of our concerns, the U.S. Trade Representative's Office and USDA's Foreign Agricultural Service (FAS) conducted numerous discussions with China officials in an attempt to get China to modify its implementation of the tariff rate quota (TRQ) for cotton. In 2003 China announced revisions to its regulations that simplified the process and improved matters, but did not eliminate the processing trade distinction.

However, other events in U.S.—China cotton fiber trade have overtaken implementation issues. China has grown to be the largest importer of U.S. cotton in the world; it has increased its import quota above WTO requirements; and it is expected to continue to purchase imports well in excess of its WTO commitments. This level of trade with China is beneficial to the U.S. cotton industry and relieves the immediacy regarding changes in China's tariff rate quota implementation.

Despite this beneficial trade, the United States and the U.S. cotton industry must remain vigilant and continue to push for reform in the TRQ system. Should internal pressures to purchase foreign cotton subside within China, this private/processing trade distinction could once again become a significant barrier to U.S. exports.

Finally, I should note that specific terms of implementation are not the only means by which China can influence imports. The government of China can still exert a significant amount of influence over the availability of credit to importers. By tightening up on credit, China can (and has) quickly cause imports to subside.

Ability to Enter into Contracts

Initially, there was significant confusion within the U.S. cotton merchandizing sector concerning the ability of any specific cotton textile mill in China to enter into a contract directly and on their own behalf with a foreign merchant. The accession agreement called for a phase-in of the legal ability of companies to enter into business contracts, but the status of that phase-in and the legal status of individual companies was not very clear.

Overall, however, China has loosened up on the ability of mills to contract and appears to be moving forward with this aspect of their commitments. However, those mills are new to doing business this way. They have a steep learning curve and don't always appreciate the sanctity of their contractual commitments. I will discuss this a bit more when I discuss the evolving terms of trade.

Quality Issues

As our cotton exports to China have grown, China's mills have begun to raise quality issues with U.S. cotton. These complaints stem from a number of factors.

First, cotton produced in China is hand-picked and ginned using much older technologies. The result is a different bale of cotton. U.S. cotton has different characteristics as it is machine-harvested and ginned in modern gins, the result of higher implicit labor and capital costs in the U.S.

As a result of these differences, we believe Chinese mills often over-penalize U.S. qualities. They seem to have more trouble spinning U.S. cotton than do mills in other parts of the world. We don't think this is because U.S. cotton is of inferior quality, but because of the differences mentioned above.

Further, all cotton in China, whether produced domestically or imported is still classed manually, which can produce inconsistencies. For example, a cotton sample sent to Shanghai might receive a different grade from one sent to Oingdao.

In 2003 the China Fiber Inspection Bureau (CFIB) announced an ambitious plan to transform the current manual classification system to an instrument based system. The plan is to be completed in 5 years beginning in August 2005. The plan proposed use of High Volume Instrument (HVI) inspection on all Chinese cotton bales with primary emphasis on use of rapid instrumentation testing similar to that used by the U.S. CFIB currently operates 172 classification facilities or inspection bureaus across China that together class all of the 25–30 million cotton bales produced in China each year. Many details are yet to be resolved.

Mr. Chairman, I commend China's efforts to reform its classification system and we will monitor their efforts closely. It is in the best interest of the U.S. if China adopts standards and testing protocols consistent with those we currently use. China's classification reforms coincide with activities by several other non-U.S. cotton producing and consuming countries to consider adoption of new standards that could be significantly different than the longstanding U.S. system. Though we don't believe such a shift is likely, it would complicate our export efforts significantly should it occur.

Reliable standards are essential for orderly export and marketing of U.S. cotton. Experts from USDA's Agricultural Marketing Service (AMS), FAS, and Agricultural Research Service (ARS) have partnered with Cotton Incorporated and the National Cotton Council to provide technical advice, consultation and assistance to the CFIB. This collaborative effort helps to ensure China grading standards, protocols and parameters are based on sound engineering, scientific and statistical principles consistent with U.S.. In 2004 the U.S. was host to two CFIB technical delegations; furthermore the U.S. team met with the CIFB in Beijing to further the technical collaboration. Additional discussions are planned for later this year with a follow up visit of CFIB technologists to the U.S. The delegation will spend up to one week in intensive technical discussions with the USDA's AMS, ARS and industry.

Evolving Terms of Trade

Contract disputes are the unfortunate result of new market participants, inconsistent quality classification systems, and volatile markets. Our recent experience in China shows a critical need for an improvement of the rules that govern the terms of trade. Quality complaints are not handled equitably. Contract sanctity is not readily enforced and negative price movements can cause significant cancellations of contracts. We currently do not have a lot of faith in the Chinese dispute settlement system.

Chinese business culture and ethics differ from Western business culture and ethics (that based on English Law). Since trading margins are based on certainty of completion of contract, i.e., the assessment of risk, it is critical to the whole of the U.S. cotton industry from the producer through the ginner and the warehouseman to the shipper that these differences be bridged satisfactorily.

To this end, the U.S. merchandizing community has had meetings with the Department of Agriculture, the Trade Representative's Office, the State Department and the Commerce Department. We have met with U.S. officials both in the U.S. and in China. They have been most helpful to us, but they have been divided in their recommendations on ways to improve the trade situation existing within China. Likewise, we have met with government officials in China and representatives of their major trade associations. Again, we have heard different advice from almost all quarters.

Our main problem in dealing with terms of trade in China is not the presence of a big, monolithic government that is intent on thwarting our efforts. Rather, our difficulty seems to stem from an inability to find a common purpose or analysis either within the U.S. or among China officials.

We believe that in order to quickly improve enforceability of contracts, solve quality differences, and improve other critical components of the terms of trade, China should look to internationally recognized bodies that have developed terms of trade over an extended period of time and use their experience. These organizations, such as the International Cotton Association (formerly the Liverpool Cotton Association) could help China revise its outdated and one-sided purchase contracts and help reform rules governing the settlement of contractual disputes.

Interestingly, the National Cotton Council recently hosted an intern from the China Cotton Association to assist their understanding of our business systems and our terms of trade. The National Cotton Council intends to send an intern to China this year to work with the China Cotton Association in an effort to continue this exchange of information.

Conclusion

While the entry of China into the World Trade Organization coincided with renewed cotton purchases by China, it is my opinion that securing a tariff-rate quota was not the primary reason for the increase in trade activity. China's ever-increasing mill use of cotton is driving its demand for cotton well beyond its current TRQ. China is the dominant factor in the world cotton and textile markets. It is imperative that the U.S. cotton industry continue to cultivate China as a good customer of our fiber. I am certain that this will happen and, despite the bumps in the road, I am convinced we will sell more cotton to China in the years ahead.

ATTACHMENT A—TESTIMONY OF ROBERT WEIL, II

Excerpt from National Cotton Council Annual Economic Report—2005 China Cotton Production

The People's Republic of China continues to be the dominant factor driving the world cotton market. China remains the world's largest cotton producer with an estimated 2004 crop of 29.00 million bales. This year's crop is roughly 6.70 million bales higher than last season's crop mainly due to much improved weather conditions throughout the growing season. Other factors include an increase in planted acres for the 2004 crop year. USDA's latest estimates indicate an 11.50% increase over 2003, putting acreage at the highest level since 1992.

Xinjiang remains the dominant cotton-producing province followed by Hebei and Shandong. Among the leading cotton-producing provinces, Hebei has the highest growth rate, in terms of planted acres, at about 30.0%, followed by Shandong (19.0%). In the Yangtze River Reaches, except Anhui, where very low yields last year prompted farmers to reduce rather than increase planted area, others are to increase with the highest being Jiangsu at 23.6%. In the Northwest, the growth in planted acres averaged roughly 8.6%.

Improved production practices also played a role in China's increased production. Seedling transplanting was used on 95.0% of the planted area and the use of plastic film as a cover reached 44.0%. In Xinjiang's state-run Production and Construction Corp (PCC) farms, high planting density, standardized varieties planted on a relatively large scale, together with improved irrigation systems, have reduced water waste and ensured stable yields. Non-PCC farms, however, produced lower yields, mainly due to poor field management practices. Regarding seed variety, transgenic Bt cotton planting continued to expand in China, however, it remains difficult to predict the real area share of Bt varieties. Although only officially approved for planting in four provinces, Bt varieties are, in fact, grown much more widely. As a result, estimates for Bt cotton acreage vary from as low as 22.4% to over 70.0%.

In general, the Chinese government took a flexible policy approach toward cotton production and encouraged production based on the Ministry of Agriculture's (MOA) Regional Plan for Agriculture Products announced in February 2003. The plan identified three major cotton regions with the greatest growth potential and designated them as primary cotton producing regions. They are: 1.) the Yellow Basin; 2.) the Yangtze River basin; and 3.) the Northwest region, including Xinjiang. By 2007, China hopes to reach the following objectives. First, in the Yellow River Basin, China officials would like to expand the cotton planting area to 30.00 million mu (roughly 5 million acres) and production to reach 2.10 million metric tons (MMT) (over 9.50 million bales). This area is targeted to be the main production base for cotton which produces yarns of 40 counts.

For the Yangtze River Valley, officials plan to expand plantings up to 15.00 million mu (2.50 million acres) and production up to 1.20 MMT (5.50 million bales). This area is targeted to be the main production base for cotton which produces yarns of 50 counts and over and of 20 counts and under. Finally, in the Northwestern Area, planting area is projected to reach 12.00 million mu (1.90 million acres) with production goals of 1.20 MMT (5.50 million bales). The area is targeted to be the main production base for cotton which produces yarns of 32 counts. Given the limited land availability, in the short term, cotton area is most likely to be relatively stable and remain in line with MOA's Regional Planning.

Lower cotton prices should lower Chinese acreage in 2005. Grain supplies have tightened over the past few years in China so there will be continued efforts by government officials to ensure adequate grain acreage. As a result, Chinese production is expected to fall to roughly 27.24 million bales in 2005.

Mr. SHAW. Thank you, Mr. Weil. Our next witness is Mr. Myron—is it Brilliant?

Mr. BRILLIANT. Yes, it is.

Chairman THOMAS. Well, I expect great things of you. Who is the Vice President of East Asia in the United States Chamber of Commerce. Mr. Brilliant?

STATEMENT OF MYRON BRILLIANT, VICE PRESIDENT FOR EAST ASIA, U.S. CHAMBER OF COMMERCE

Mr. BRILLIANT. Thank you, Chairman Shaw and other Members of this Committee. The U.S. Chamber of Commerce appreciates the opportunity to appear at this important hearing on U.S.-China economic relations. The U.S.-China commercial relationship is of immense and increasing importance to the U.S. Chamber and the American business community.

As an illustration of our commitment to this relationship, Tom Donahue, our President and chief executive officer, will lead a high-level Chamber delegation to China in May to exchange views with the Chinese leadership and business leadership on the full range of issues in the commercial relationship. We note that the U.S.-China trade relationship has boomed in recent years. In 2004 China was again the third largest trading partner for the United States, and as pointed out already, U.S. exports to China have grown by 114 percent since 2000, five times faster than to any other country.

On the other hand we also recognize that concerns are rising in many quarters over the U.S. trade deficit with China, market access concerns, rising competition from Chinese imports, and Chinese currency regime. To help address these concerns the U.S. Chamber feels strongly that China must comply fully and on time with its WTO commitments and diminish the role of state intervention and industrial policy in designated strategic sectors of China's economy. While China's continuing economic emergence presents many challenges for certain segments of the U.S. economy, the U.S. Chamber of Commerce continues to believe in the policy of engagement. We were strong supporters of China's accession to the World Trade Organization, and this is fostering positive changes in China's trade and investment regimes.

China has made important progress in key areas, particularly in tariff reduction, in revising existing laws and drafting and passing new ones to comply with its WTO requirements. There are clearly areas where additional progress is needed. In the interest of time let me just comment on three specific areas: IPR, standards and government procurement policy. It remains clear that the protection of intellectual property which China, according to companies of all sizes, fails on the whole to meet the standards of effectiveness and deterrence set out in the World Trade Organization. IPR violations now severely affect all industries of our economy. The scope of copyright piracy and counterfeiting in China including the manufacture, distribution, sale and export of counterfeit goods has worsened for our member companies over the years. We acknowledge steps undertaken by the Chinese government, under the leadership of Vice Premier Wu Yi, to improve coordination among relevant agencies responsible for IP protection and enforcement. Yet it is also equally clear that enforcement of IPR will not be effective until civil, administrative and criminal penalties are routinely applied to IPR infringers. The U.S. Chamber is working closely with the U.S. Administration and the Chinese Government on policy and capacity building efforts, but we must, must see more enforcement and customs actions at the provincial and local levels within

China, and we must see China pay for foreign IP it illegally uses today.

The U.S. Chamber is further concerned about China's use of discriminatory standards and government procurement practices that erect barriers to fair competition and are in violation of its WTO obligations. For instance, China has moved to develop, adopt and increasingly mandate unique national technology standards across a wide range of technology products. China's adoption of the mandatory national technology standards that are out of step with international standards efforts and don't consistently respect intellectual property are troubling to U.S. Chamber members, many of whom have significant investments in China. Similarly, we are concerned the that government procurement sector in China may be substantially closed off to foreign suppliers of goods and services in light of recent developments. The Chamber feels strongly that China's implementation of its procurement law should not exclude or diminish the ability of foreign companies to fully participate in China's procurement market. We urge the Administration's continued attention to this important issue.

Finally, let me turn my attention briefly to the issue of currency. China's status as a large developing economy that is not yet fully market based posed special challenges to world trade and financial systems. We believe that no country, no country should manipulate its currency to gain a competitive advantage. The U.S. Chamber believes strongly that China should move to an exchange rate system that allows market forces to determine the exchange rate of the renminbi, but it should do so in ways that will not shock their financial system and result in unintended consequences. China is moving rapidly to deregulate interest rates, develop a government bond yield curve and strengthen its banking system. All of these measures suggest China is preparing the way for a market-driven exchange rate.

The U.S. Chamber has and will continue to support the Administration's engagement of the Chinese Government individual discussions of such matters as currency levels, trade flows, investment regimes and compliance of international agreements. While in some circles patience is growing short, we strongly discourage punitive or unilateralist legislative approaches such as those that call for WTO unauthorized assessment of massive tariffs on Chinese exports. Such measures would not achieve the intended goals. We believe that if the United States starts unilaterally imposing additional tariffs when we do not like other governments' policies, imagine the multitude of circumstances in which other countries could do the same with enormous consequences for the global economy. In conclusion, I would note that there are many cases in which Chinese authorities have worked closely with the U.S. business community to implement WTO commitments as well as to resolve disputes that have arisen during the implementation process, but China must do more. The U.S. Chamber will continue to lend our strong voice to ensure that China fully adheres to market principles and WTO disciplines. Thank you for the time and attention today, Mr. Chairman.

[The prepared statement of Mr. Brilliant follows:]

Statement of Myron Brilliant, Vice President for East Asia, U.S. Chamber of Commerce

Mr. Chairman, members of the committee, good morning. The U.S. Chamber appreciates your invitation to appear at this important hearing today on U.S.-China economic relations.

As the world's largest business representing more than 3 million members, the U.S. Chamber is keenly aware of both the opportunities and challenges that the U.S.-China commercial relationship presents to our companies. Our testimony today will focus on both these opportunities and challenges as well as identify priority areas where the U.S. Chamber believes that the People's Republic of China (PRC) government needs to take further steps in the near term to enhance its own economic development, bolster its credibility in the global trading community, and most importantly, address pressing issues in the bilateral commercial relationship. In particular, China should fully and consistently implement its World Trade Organization (WTO) obligations and continue on the path toward a clear and transparent rules-based regulatory environment that values equally the contributions of both domestic and foreign companies.

In May, U.S. Chamber President and CEO Thomas Donohue will lead a senior U.S. business delegation to Beijing for high-level discussions with China's government and business community. In particular, the Chamber looks forward to building upon the recent discussions that we have been having with Chinese officials in Washington, D.C. and to exchanging views directly with China's leadership on the full range of issues in the commercial relationship.

On the currency issue, the Chamber wishes to state at the outset that we believe strongly that China should move as quickly as possible to an exchange rate system that allows market forces to determine the exchange rate of the renminbi. But we also believe that legislation in both the U.S. House of Representatives and U.S. Senate that would unilaterally retaliate against PRC currency practices by mandating tariff increases on Chinese products is an ineffective tool to increase U.S. manufacturing employment and pressure the PRC government to move in the direction on currency that we all continue to seek. Furthermore, these proposed measures that would impose WTO-unauthorized tariffs on PRC exports would legitimize almost certain PRC retaliation against billions of dollars in U.S. exports to China and would amount to a steep tax on millions of American consumers.

Before returning to the currency matter at the end of our testimony, we would first like to address both the opportunities and challenges that China presents for our members and highlight U.S. Chamber priority issue areas in the bilateral commercial relationship for this year.

China as an Opportunity and a Challenge

It is now trite to say that the U.S.-China commercial relationship is of immense and increasing importance to both the U.S. and Chinese business communities. U.S.-China trade has boomed in recent years. The United States ranked second among China's global trading partners in 2004, and China was again the 3rd largest trading partner for the United States. U.S. exports to China have grown by 114% since 2000—five times faster than to any other country. In particular, flourishing U.S. agricultural trade with China is one of many recent success stories for our exporters. The following statistics are illustrative, if not breathtaking, in their sheer magnitude:

- From 2000 to 2004, U.S. agricultural exports to China increased approximately 224% from $1.7 billion to $5.5 billion. Meanwhile, U.S. exports to the rest of the world increased only 4% during the same period.
- Or put another way, from 2000 to 2004, U.S. agricultural exports to China accounted for approximately 50% of the increase in total U.S. agricultural exports to the world.
- The U.S. in 2004 enjoyed a $3.9 billion agricultural trade surplus with China.
- U.S. cotton exports to China increased by 86% from $769 million in 2003 to more than $1.4 billion in 2004.
- Soybean exports to China in 2003 and 2004 constituted the largest on-record exports of U.S. soybeans to any country.

Year-on-year increases of U.S.-manufactured exports from 2003 to 2004 reveal similar trends: exports of U.S. power generation equipment increased by 34%; exports of electrical machinery and equipment increased by 27%; and exports of optics and medical equipment jumped by more than 30%. These statistics underscore the opportunities that China offers to U.S. exporters, to investors, and, more broadly, to U.S. economic development.

In contrast, we also recognize that concerns are rising in many quarters over the U.S. trade deficit with China, rising competition from Chinese imports, and concerns about China's currency regime. The U.S. Chamber feels strongly that China must do significantly more to comply fully and on time with its WTO commitments in critical areas such as intellectual property rights (IPR).

We also share the concerns of many over the continuing role of state intervention in designated strategic sectors of China's economy. For example, China's continuing inability to establish independent regulators in the telecommunications and express delivery services sectors is symptomatic of continuing resistance within the government to fully divorce itself from key decision making that affects the commercial environment for both foreign and domestic companies.

And China's post-WTO accession use of industrial policy—including the use of targeted lending, subsidies, mandated national technology standards rather than voluntary, industry-led international standards, discriminatory procurement policies, and potentially, antitrust policy—to structure the development of strategic sectors is also of mounting concern.

But while China's continued economic emergence undoubtedly presents many challenges for certain segments of the U.S. economy, the U.S. Chamber continues to believe that engagement is preferable to unilateralism and that the economic and commercial relationship was and still is the core of our engagement. This core must be nurtured. China has demonstrated a willingness to work with us, but we need to see continued, visible progress in the near term.

WTO Implementation

Now in year four of China's WTO implementation, the U.S. Chamber believes that the process by which the business community in both China and the United States and their governments are working together to fully implement China's WTO commitments is fostering positive changes in China's trade and investment regimes. We agree with the United States Trade Representative's (USTR's) December 2004 report to Congress, which stated that China "deserves due recognition for the tremendous efforts made to reform its economy to comply with the requirements of the WTO." Moreover, we continue to believe firmly that engaging China in the rules-based trading system has resulted in important progress in key areas, particularly in tariff reduction, revising existing laws and drafting and passing new ones to comply with its WTO requirements, and educating its officials and companies about its WTO obligations.

Positive steps by China to implement its outstanding and new WTO commitments not only improve the Chinese business environment to the benefit of U.S. and Chinese companies alike, but they also underscore China's broader credibility in the global trading system. If China falters in meeting its commitments and its adherence to WTO disciplines, such as in the areas of intellectual property (IP) and transparency, there will be ramifications that will constrain the full potential of this relationship to the detriment of both countries as well as companies from both countries.

As examples of progress, we note China's early phase-in of trading rights for wholly foreign-owned companies on July 1, 2004; decisions by China's insurance and commercial regulators to reduce burdensome capitalization requirements for foreign investment in the insurance and trading sectors; and increased transparency in the Ministry of Commerce's (MOFCOM's) regulatory drafting process. China has also made progress in addressing a range of problems with the implementation of its tariff-rate quota (TRQ) system, including poor transparency, delays in announcing quotas, insignificant and uneconomic quota allocations, and restrictions on foreign enterprises that are not required of domestic producers or merchants. As noted at the outset, U.S. agricultural trade to China is booming, and this reflects, at least in part, regulatory improvements and enforcement executed by China in accordance with its WTO commitments.

But despite notable progress in some areas, problems remain in others, and after more than three years in the WTO, China should work to eliminate what we termed in our most recent WTO report "the cyclical nature of its implementation efforts." More specifically, even as China has made positive regulatory changes that appear to presage greater market access for foreign companies as specified under its WTO commitments, China is simultaneously adopting new policies that undercut these changes in sectors of significant interest to our members.

China's continuing reliance on high capitalization requirements to restrict the market access that it promised in its accession agreements and use of proprietary standards and other industrial policy tools that discount foreign IPR and shield emerging domestic players from global competition are examples where China appears is undercutting meaningful implementation of its WTO commitments. Even as we tout progress in the area of agriculture, we note that Announcement 73, which was not properly notified to the WTO and which appears to provide China's General Administration for Quality Supervision, Inspection and Quarantine (AQSIQ) with blanket authority to annul or void import permits in the case of a government-issued warning or ban, remains in effect. We are concerned, in particular, that Announcement 73 could result in government-sanctioned defaults on contracts for imported agricultural products similar to those that occurred in 2004 when a host of Chinese importers defaulted on soybean contracts on a massive scale. The U.S. Chamber hopes that China's courts will fully enforce the forthcoming decisions by arbitration panels in London on those defaults. Without consistent and enduring improvements in the course and spirit of implementation, there will be political consequences as well as a possible souring of business views about the China market.

Equally important, the U.S. Chamber believes that China should actively adopt measures that open its market in ways that comply with the spirit of its WTO obligations, even if it is not strictly bound to do so under its WTO commitments. New PRC policy directives that affect sectors of strong interest to U.S. Chamber member companies could greatly limit their ability to provide goods and services in the China market. These include Decrees 113, 114, 159, and 200 in the area of construction services, recently released regulations for autos that classify for tariff purposes imported vehicle components as finished vehicles, and just-released draft regulations on PRC government procurement policies for software. At a minimum, China should not adopt policies that are more restrictive than those in place prior to its WTO accession, as it has done in the case of construction and engineering services and as it is threatening to do in the area of government procurement. In these cases, U.S. goods and service providers face a rolling back of the market access they have enjoyed.

To further highlight this issue and by way of example, we wish to call the committee's attention to the distorted playing field on which U.S. film producers and distributors currently operate in China. In addition to lax enforcement of IPR, an equally important—and indeed often related—factor preventing the media and entertainment industry from realizing its full potential is the range of market access restrictions that inhibit content providers from building a legitimate market and satisfying Chinese consumer demand for legitimate product. Film import quotas, the import monopoly, and release delays for distribution of approved film and video products create a vacuum filled by copyright violators. This negatively impacts the entire value chain of the industry in China, from importation to distribution to exhibition.

Equally striking, at the same time that the absolute box office generated by U.S. films in China remains anemic, U.S. companies are importing PRC films into the United States and other markets and repatriating considerable revenues to Chinese producers. PRC films have performed well in the United States, grossing tens of millions of dollars and benefiting handsomely from strong marketing and wide distribution arranged by U.S. distributors in our market. *Crouching Tiger Hidden Dragon* grossed more than $125 million in the United States, *Hero* opened #1 in the United States on its first week of release and grossed a total over $50 million, and *House of Flying Daggers* has generated more than $10 million to date.

In sharp contrast, the total box office generated in China by all U.S. films last year, of which U.S. companies receive only the government-determined 13% to 14%, was about $60 million, or only slightly more than one PRC film (*Hero*) earned in the United States. To further put this figure in context, in Hong Kong, which has less than 1% of China's population, the top 10 U.S. films alone generated just over $25 million in the box office. If this trend continues, it is possible that the balance of trade could shift in favor of Chinese films in a sector where U.S. film companies have traditionally enjoyed a competitive advantage.

The U.S. Chamber is fully engaged in representing the business interests of our entire membership across the full range of industrial and services sectors. We wish to focus your attention today on five priority areas where we believe U.S. companies are continuing to face difficulties in the China market.

Intellectual Property Rights

Notwithstanding China's agreement to fully comply with Trade Related Aspects of Intellectual Property Rights (TRIPS) Agreement obligations upon its accession to the WTO over three years ago, it is clear that the protection which China is actually providing to companies of all sizes fails to meet the standards of "effectiveness" and "deterrence" set out in the TRIPS. IPR violations now severely affect virtually all industries, from consumer and industrial goods, medicines, autos and auto parts, food and beverages, and cosmetics to copyright works, including entertainment and business software, movies, music, and books. In sum, the scope of counterfeiting and copyright piracy in China worsened for most of our member companies in 2004, and we believe that this problem has reached epidemic proportions.

IP violations are not just affecting the PRC market. But China is the single largest source of counterfeit and pirated products worldwide, and the failure to control such exports is eroding our companies' profit margins, diminishing brand value, and, in many cases, endangering public safety. U.S. Customs statistics showed an increase of 47% in the value of counterfeit goods seized in the year ending October 31, 2004. Statistics compiled for 2004 by other governments are expected to reflect a similar trend.

Increasingly, counterfeiting in China is harming small and medium-size U.S. businesses, many of which do not even have operations on the Mainland and must confront a flood of Chinese knockoffs in the U.S. market or in third-country markets where they export. Smaller companies clearly have fewer resources to deal with investigations and legal actions against pirates in China and their middlemen in other countries, and thus the need for more convincing and proactive government intervention is becoming increasingly apparent.

The U.S. Chamber was heartened by the promises of Vice Premier Wu Yi at the April 2004 Joint Commission on Commerce and Trade (JCCT) meetings on the intention of the Chinese government to significantly reduce IPR violations. And we acknowledge that the PRC government, at the central level and under the leadership of Vice Premier Wu Yi and the Market Order Rectification Office of the Ministry of Commerce, is taking important and constructive steps to improve coordination among relevant agencies responsible for IP protection and enforcement.

The U.S. Chamber also notes some recent progress in the Chinese government's willingness to engage directly with companies and industry associations in addressing problem cases and cooperating on capacity-building. In a further positive development, China's Supreme People's Court and Supreme People's Procuratorate issued a long-awaited Judicial Interpretation on December 21, 2004. This interpretation included a number of important changes that can strengthen the deterrent impact China's criminal enforcement efforts in the IP field.

Regrettably, though, the Judicial Interpretation contains a number of problems that leave potentially gaping loopholes for infringers, and industry is closely monitoring their impact. Key examples include the following:

- Unclear methods for calculating case values, including the lack of standards for valuing semifinished products and raw materials.
- Lack of clarity whether trading companies caught dealing in fakes can be held criminally liable for counterfeiting and piracy.
- Lack of provisions to clarify the conditions under which vendors and accessories meet the requisite knowledge requirements to be held criminally liable.
- Lack of provisions to criminalize repeat offenses by smaller-scale infringers.
- Whether sound recordings are even covered by the Judicial Interpretation.
- Significantly higher monetary thresholds for enterprises than for individual persons.

As the U.S. Chamber stated in its fall 2004 report on China's WTO implementation record, enforcement of IPR will not be effective until civil, administrative, and criminal penalties are routinely applied to IPR infringers. While China's government modestly improved its regulatory environment for IPR protection and carried out raids and other enforcement actions at the central, local, and provincial levels in 2004, administrative penalties—mainly limited to fines and confiscation of fake products—remain too small to create deterrence. Despite some signs that new efforts are under way and an increased level of arrests and raids, China has not "significantly reduced IPR infringement levels" as Vice Premier Wu Yi promised at last year's JCCT meetings.

The U.S. Chamber remains concerned that the limited legal reforms and enforcement campaigns commenced in 2004 are insufficiently bold, and that more focused action plans are needed at both the national and local levels in order to bring counterfeiting and copyright piracy under control. While it will take time to design and implement such plans, we do not yet see a commitment on the part of the Chinese to developing them.

Based on inadequate levels of IPR protection and enforcement in China and their adverse impact on U.S. economic interests, the U.S. Chamber recommended earlier this year that the USTR request consultations with China in the WTO and place China on the Priority Watch List in its upcoming 2005 Special 301 Report.

The Chamber also believes that the USTR should conduct a second Special 301 Out-of-Cycle Review for China later this year to assess China's implementation of the Judicial Interpretation and other enforcement efforts, including success in adding additional police resources in regions where this is most needed, in criminalizing export-related cases, and in introducing new enforcement guidelines that will significantly boost fines and other penalties imposed by administrative enforcement authorities.

The Chamber and its members are seeking convincing evidence in 2005 from Chinese authorities that the IPR climate is improving and creating a climate of deterrence, including through data that confirms a much more substantial increase in proactive government investigations into cases, and substantial increases in prosecutions, convictions, and incarcerations of counterfeiters and copyright pirates.

Aside from liaison with China in the WTO context, the U.S. Chamber strongly supports the continuing efforts by the U.S. government to address China's failure to comply with its IPR commitments through the JCCT, other bilateral forums, and multilateral policy mechanisms.

We are eager to support capacity-building efforts in China this year at the central and provincial levels and we are now working with the PRC government to carry out a coordinated IPR educational and public awareness campaigns. To achieve these goals, we have placed people in China to identify appropriate opportunities and projects.

The Chamber is also working closely with U.S. and foreign governments, our corporate members, and counterpart associations, including with AmCham network in China, to benchmark China's progress in implementing the new Judicial Interpretation through monitoring the number of judicial prosecutions, convictions, and jail sentences for IP crimes in 2005. In addition to monitoring the criminal enforcement, we will collaborate with these partners to track enforcement by administrative authorities, including administrative fines, confiscations of production equipment, export enforcement, and the success of the government in transferring cases from administrative enforcers to the police for criminal prosecution.

A reduction in China's piracy and counterfeiting levels in 2005 will ultimately hinge on the political will of local governments, as well as the national government. Police investigations into new cases need to be proactive and adequately resourced in order to send a proper message to criminal networks that are increasingly behind the problem.

The sincerity of China's pronouncements that it is serious about protecting and enforcing IP rights will further be tested by its willingness to eliminate loopholes for infringers in existing and new regulations and to resolve high-profile cases, such as the Pfizer patent case on Viagra and the General Motors auto case, that impact domestic and foreign IP owners.

Full protection under PRC law and enforcement of IPR in China as set forth in China's TRIPS obligations are critical to the interests of foreign and PRC companies in China, as well as to China's public health and safety, the integrity and attractiveness of China's investment regime, and its broader economic development goals. We hope that the PRC government will accelerate IP enforcement in 2005 by further enhancing national leadership and dedicating additional capital and resources. Only through the exercise of even more aggressive measures will China's IPR protection enforcement regime be effective and respected.

China's accession to the WTO afforded it an opportunity to sell increasing quantities in the United States of the products where it has a comparative advantage. But by tolerating massive counterfeiting and piracy, China is denying U.S. companies the chance to do the same in China. Moreover, by tolerating the export of such counterfeits, China strips our companies of the opportunity to exploit their comparative advantage—and thus WTO benefits—in third countries as well. Ultimately, it is essential that China purchase the foreign IP-based products it is illegally using. That would translate into billions of dollars of sales and exports by U.S. and other foreign companies and more accurately reflect the balance of trade between the U.S. and China.

Distribution

China's full and consistent implementation of its distribution services obligations is also of critical interest to our members. The U.S. Chamber applauded China's early phase-in of trading rights for wholly foreign-owned companies on July 1, 2004. And we had hoped that MOFCOM would release by December 11, 2004, the date set forth in China accession commitments, implementing regulations that clarified how new and existing wholly foreign-owned businesses in China could acquire distribution rights to allow foreign businesses to begin distribution services. Regrettably, the U.S. Chamber and its members are still waiting for China to implement fully and transparently this core commitment.

We are encouraged that recent discussions in Beijing have yielded some progress on this matter, and we anticipate that China will act to remedy its non-compliance soon. But we are distressed that many of the domestic issues now cited by the PRC government as excuses for slow implementation—tax, business scope, and zoning—were raised by our business community with PRC authorities years ago. Unlike most WTO members, China negotiated phase-in periods to gradually implement its commitments; other countries that have sought to join the WTO have not had this luxury. Going forward, the U.S. Chamber expects that China will address relevant regulatory issues in advance of key implementaion dates instead of using them as an excuse to delay timely implementaion and promised market access.

China's market access commitments under the WTO also include its commitment to permit sales away from a fixed location, which is also known as direct selling. The implementing regulations, which have not yet been formally released but which have been shared with several companies, will not permit direct selling to operate as it does around the world. The U.S. Chamber has asked the Chinese government to adopt final regulations that allow directs selling companies to conduct their operations by paying for both sales and marketing services provided to the companies by independent contractors as opposed to employees.

Standards

The U.S. Chamber is further concerned about China's use of discriminatory standards to erect barriers to fair competition and in violation of its WTO obligations. China's recent performance in this area has been mixed.

China has moved to develop, adopt, and increasingly mandate unique national technology standards across a wide range of technology products. Examples include a mandated encryption standard for wireless communications devices and the development of unique national standards for AVS for media/TV, IGRS for connectivity, TD–SCDMA for telecom, and EVD for recording media. Competition, innovation, and interoperability are best served by standards developed by market forces.

China's adoption of mandatory national technology standards that are out of step with international standards efforts and that don't consistently respect IP are troubling to U.S. Chamber members, many of whom have made significant investments in China. With its strong manufacturing capabilities and rapidly growing consumer base, China will play an increasingly important role in the development of the Asian and global IT industry.

In particular, the U.S. Chamber believes that compulsory patent licensing should not be used to resolve patent-infringement issues, even for China's mandatory national standards. For standards based on open and voluntary participation to be successful, IPR of patent holders must be respected, including the right to derive reasonable compensation (e.g., royalties or one-time payments) from IP. Compulsory licensing of patents is inconsistent with that fundamental principle and undercuts the value of Chinese patents both for foreign patent holders and even more so for Chinese technology companies. We believe that the best way to address patent infringement issues and create superior standards is to encourage wide participation of patent holders in the standards-development effort and also allow them to recover reasonable and nondiscriminatory patent licensing revenues from their R&D investments in technology and innovation.

The Chamber was pleased by China's decision in April 2004 to suspend indefinitely its unique standard for WLAN products. But we remain concerned that China's WLAN encryption standard is but a leading example of a clear and disturbing trend across many technology products. The Chamber hopes that the PRC government will consider its decision as a precedent to be extended more broadly to standard setting in China's IT sector, as well as to other industrial sectors that are considering the development of unique standards that are incompatible with their international counterparts.

Use of standards as a tool to protect local industry and force technology transfer is harmful to China's interests. Keeping foreign goods and services out of China will only hold back China's economic development and deny its government, people, and businesses of some of the best tools available to fuel growth and productivity. Foreign companies can help China achieve many of its development goals if they are permitted to compete fairly in the marketplace and if their IP is protected.

Transparency

Regulatory transparency remains a key concern of U.S. Chamber member companies. China has made important progress in improving the transparency of its rulemaking and other regulatory activities since its WTO accession in 2001, but China must do much more to ensure that it develops and implements laws and regulations in a manner consistent with international practices and WTO commitments. The U.S. Chamber applauds the measures that MOFCOM adopted at the end of 2003 to promote the ministry's compliance with China's WTO transparency commitments, specifically those that require PRC authorities to provide a "reasonable period for comment to the appropriate authorities" before trade-related measures are implemented.

Other PRC ministries and agencies, however, have been far less progressive in their approaches to circulating draft regulations to foreign companies and in providing a reasonable window for comment. We urge the Chinese government to have all its rulemaking ministries and agencies follow MOFCOM's example in fulfilling China's transparency obligations under the WTO. Abrupt issuance of draft regulations by many ministries in China are still far too often followed by one-week windows for public comment. The Ministry of Finance's release three weeks ago of draft regulations on government procurement for software, for which a 10-day comment period was provided, is the most recent and pressing example of this practice.

Government Procurement

In its ongoing effort to combat corruption, the U.S. Chamber welcomes China's efforts to achieve greater transparency and to provide greater market access in the area of government procurement. China became an observer to the WTO's Agreement on Government Procurement upon its accession in late 2001 and agreed at that time to enter into negotiations to join the agreement as soon as possible. China's passage in late 2002 of its new Government Procurement Law that aimed to improve transparency, limit corruption, and remove local protectionism marked a step forward in these areas.

The U.S. Chamber is highly concerned, however, that the government procurement sector in China will be substantially closed off to foreign suppliers of goods and services through the implementation of the Government Procurement Law, which requires government entities to procure only domestic goods, services, and public works, with limited exceptions. The Chamber feels strongly that China's implementation of its procurement law should not exclude or diminish the ability of foreign companies to fully participate in China's procurement market. In particular, we are very concerned that the recently issued Trial Implementing Regulations on Government Procurement of Software (Implementing Regulations) are a significant step backwards. Of equal concern, it is our understanding that the draft Implementing Regulations are the first of what will likely be a series of sectoral rules promulgated by the Chinese government to implement the new Government Procurement Law.

The proposed Implementing Regulations would severely restrict market access by non-Chinese companies in a manner that goes far beyond the procurement practices of the United States and other nations. In a market where more than 90% of software is pirated, costing U.S. companies billions of dollars in lost exports, such a discriminatory procurement regime would effectively close the door for most, if not all, U.S. companies—and for that matter, non-Chinese companies—to sell software products and services to China's largest purchaser, the Chinese Government. Effective denial of the ability to sell to China's government market would also render meaningless to U.S. and other foreign software companies China's stated goal to promote the use of legally purchased software in its government.

The Government Procurement Law and the Implementing Regulations strike us as moving in precisely the wrong direction from China's WTO accession pledge, yet unfulfilled, to "initiate negotiations for membership in the GPA [Government Procurement Agreement]... as soon as possible." We are particularly concerned that now, more than three years from its WTO accession, China has yet to begin the process for GPA accession and has proposed procurement regulations that severely restrict access by non-Chinese companies.

As concerns in the United States increase over the growing U.S. trade deficit with China, the Chinese government's closure of its government procurement market in software and other industries appears to undermine Premier Wen Jiabao's pledge to foster an improved U.S.-China trade relationship based on increasing, not restricting, market access for U.S. exports, and to be inconsistent with the spirit of openness China embraced in joining the WTO. We hope that the Chinese government will quickly renew its commitment to open, inclusive, nondiscriminatory and transparent procurement policies by commencing negotiations to accede to the GPA and suspending adoption of the *Implementing Regulations* and any similar discriminatory procurement rules.

An open, competitive, transparent, nondiscriminatory and technology-neutral government procurement regime is in China's interest and in the interest of China's trading partners. This would encourage investment and active participation by leading foreign companies in China's economy and bring the best products and services for the best value to China's government and consumers.

The Chamber hopes that China's new procurement rules in this area will not discriminate between domestic and foreign suppliers. At a minimum, we expect that China's decision as to what constitutes a "domestic manufacturer" will adhere to the principle of national treatment so that Chinese subsidiaries of foreign companies will enjoy the status of domestic suppliers in the market.

Currency

China's status as a large, developing economy that is not yet fully market-based poses special challenges to world trade and financial systems. The Chamber encourages China to pursue economic reform and development through reliance on market principles.

We also believe that countries should not manipulate currencies to gain a competitive advantage. The U.S. Chamber has and will continue to support the Administration's engagement of the Chinese government in discussions on such matters as currency levels, trade flows, investment regimes, and compliance with international agreements. In addition, the Chamber supports the increased attention of the International Monetary Fund and the Group of Seven industrialized nations to China's exchange rate policies.

And as stated at the outset of our testimony, the U.S. Chamber believes strongly that China should move as quickly as possible to an exchange rate system that allows market forces to determine the exchange rate of the renminbi.

But we also submit that our relationship with China should not be managed by a unilateralist approach. Unilateralist approaches, such as those that call for the WTO-unauthorized assessment of massive tariffs on PRC exports, would not have the intended result, particularly given the complexity of the issues involved, as made clear by testimony to Congress by the nonpartisan, objective Congressional Budget Office and the Congressional Research Service (Testimony of Douglas Holtz-Eakin, Director, Congressional Budget Office, "The Chinese Exchange Rate and U.S. Manufacturing Employment" (October 30, 2003); "China's Currency Peg: Implications for the U.S. and Chinese Economies," Wayne Morrison and Marc Labonte, CRS (September 29, 2003). In fact, the imposition of massive U.S. tariffs on Chinese exports would only undermine efforts to achieve the critical objective of a Chinese currency exchange rate determined by market forces.

The United States was a chief architect of the WTO in large part to prevent unilateral actions that would close markets abroad to the detriment of U.S. farmers, manufacturing and service companies, and their workers. Our companies have worked with successive Administrations and members of Congress to ensure that a fair and objective system was put in place to protect U.S. interests both at home and abroad. A unilateralist approach would abrogate decades of work by having the United States engage in a violation of its WTO commitments. If the United States starts unilaterally imposing additional tariffs when we do not like another government's policies, imagine the multitude of circumstances in which other countries will do the same to U.S. agricultural and industrial exports, with enormous consequences for the U.S. economy as a whole.

A unilateralist approach on currency would likely result in massive retaliation on U.S. exports to the detriment of farmers, exporters, and workers throughout the entire United States. U.S. exports to China, which have grown by 114% since 2000, would be hit by retaliatory tariffs or other actions. American businesses and consumers would face higher prices, and the U.S. trade deficit would likely increase as Americans import the same goods at higher prices. Moreover, American strategic interests in North Korea and the war on terror could be undermined. At the end of the day, the United States would lose much more than we could ever hope to gain from such an approach. Endorsement of this approach would be used for years to come as an example that even the United States does not believe in playing by the rules of global trade—of which the United States is perhaps the largest beneficiary.

Conclusion

The U.S. Chamber and our members appreciate the opportunity to participate in China's continuing development. We applaud the many cases in which Chinese authorities have worked closely with the U.S. business community to implement WTO commitments, as well as to resolve disputes that have arisen during the implementation process. As stated at the outset of this report, China is now the fastest-growing trading partner of the United States. Rapidly expanding bilateral economic and commercial ties underscore the market opportunities that China offers to U.S. exporters and investors, which support the creation of high value-added jobs at home.

But China can and must do more. The U.S. business community and others that vigorously advocated China's WTO membership premised their support on expectations that China is evolving into a more open and transparent market based on the rule of law. China's unsuccessful efforts to consistently enforce its IPR laws and to vigorously deter IP theft represent the most visible examples of these expectations remaining unfulfilled. Similarly, China has continued its reliance on state guidance and industrial policies—capitalization requirements, mandated national technology standards, procurement preferences and subsidies—in key sectors. Not only is this a breach of China's market access commitments or the spirit of openness China embraced when joining the WTO, but it also gives credibility to China's critics who doubt China's commitment to create a business environment that values equally the economic contributions of domestic and foreign companies.

At the same time, the Chamber underscores that for all the fits and starts, for all the examples of China's sluggish WTO compliance, none of these trumps the value of engaging the world's most populous nation in the rules-based trading system. For all those who care about the future of our economy, jobs for Americans, stability and peace in the world, the protection of global health, and the advancement of environmental quality and human rights, we must continue to encourage China to become an active and committed member of the world trading system. Working within the WTO framework remains the most promising path to progress and is vastly superior to approaches that seek to punish and isolate this emerging global power.

Premier Wen Jiabao told us during his visit to Washington D.C., in December 2003, "The way forward in our trading relationship is to increase U.S. exports to China... not restrict Chinese imports into the United States." The only way this strategy can succeed is if China opens its markets further and more rapidly to U.S. goods and services. We fully expect China to implement Premier Wen's strategy.

The U.S. Chamber, the world's largest business organization, will remain fully engaged on these critical issues on behalf of American business. We will continue to lend our strong voice to ensure that China fully adheres to market principles and WTO disciplines.

Thank you, Mr. Chairman and members of the committee, for this opportunity to express the views of the U.S. Chamber on these important matters.

Mr. SHAW. Thank you, Mr. Brilliant. The next witness is Mr. Alex Gregory, who is President and chief executive officer of the YKK Corporation of America in Marietta, Georgia. Mr. Gregory?

STATEMENT OF ALEX GREGORY, PRESIDENT AND CEO, YKK CORPORATION OF AMERICA, MARIETTA, GEORGIA

Mr. GREGORY. Thank you, Mr. Chairman. Good afternoon. My name is Alex Gregory. I am President and CEO of YKK Corporation of America headquartered in Marietta, Georgia. YKK is best known, as Mr. Chairman said earlier, by the billions of zippers we manufacture globally, but we also make a number of other fastening products, as well as architectural products for commercial and residential buildings. Headquartered in Japan, YKK has had a presence in this country since 1960. We opened our first significant manufacturing plant in Macon, Georgia in 1974. I was among the first employees hired for that plant, so manufacturing is very dear to me. For almost 4 years I have been responsible for YKK's 16 companies in the United States, Canada, Mexico, Central America and Colombia South America. We have more than 3,000 employees, 1,600 of whom live in Georgia.

YKK has a manufacturing presences in 68 countries, including China of course, and every other major garment producing country in the world. I am here today to speak on behalf of our employees in the United States. In the past 30 years YKK has invested more than a billion dollars in manufacturing plants in the United States. We are very proud of these beautiful vertically-oriented plants, and we are equally proud of our employees who have done a really fantastic job. At our peak in production about 5 years ago our zipper plants were as productive and efficient as any plants in the world. Unfortunately, in recent years we have suffered considerable pain caused by imports. Many of our customers—and these are the owners of the brands of jeans, pants, jackets and other apparel products—have stopped manufacturing in the United States and are sourcing garments from contractors in Mexico, Central America, and in increasing frequency, from China and other parts of Asia. We have had to make significant changes in how we do business at YKK. Employment in our national Manufacturing Center in Macon has declined steadily from around 1,100 just 5 years ago. We are proud that we have been able to continue providing jobs for 900 employees in Macon and another 500 in Kentucky, Tennessee and Alabama. We have been able to do this because now we are able to ship product from our 2.4 million square foot facility in Macon to our customers in the United States of course, but also the ones who are in Central America, Mexico, the Dominican Republic and South America.

Also for the past two years we have worked with our employees on a competitive YKK Macon initiative, to try to become as competitive as possible before all the business goes to China. We have written off millions of dollars worth of excess manufacturing capacity. We packaged up perfectly good zipper making machines and shipped them to other parts of the world where garments are now being sourced. We have reduced wages and salaries, including my own. We have cut our work force as a very painful last resort. Our hope is that be reducing the cost of our products we can positively influence our customers' decisions to continue sourcing from this hemisphere. We are petrified by the acceleration of imports from China. Prices from China are falling dramatically and imports are skyrocketing. In the two pants categories primarily affecting our business, imports from China are up over 1,500 percent in the first quarter of 2005, compared with the first quarter of 2004. That is a 16 time increase in 1 year. If this trend continues, our customers say they will have to close additional plants.

We do have a competitive advantage in this hemisphere, however. This advantage is speed to market. Thanks to frequent fashion changes and a shift from basic styles to premium higher-priced garments, speed to market has become our best friend. Strong alliances are forming among American retailers, brand holders, contractors and suppliers such as YKK to reduce dramatically the time it takes to develop new products and deliver them to retail shelves. CAFTA can go a long way toward maintaining a strong garment manufacturing presence in this hemisphere, especially if it is combined with efforts to bring China onto a level playing field. We need relief in the form of strong safeguards against unrestricted imports from China, but CAFTA is the critical and necessary element to strengthening the collaborative effort within the rapidly growing alliances in this hemisphere. Restraints on China, coupled with fair trade and fairly valued currencies, are important to undertake of course, but if we do not pass CAFTA we will do a disservice to this industry. CAFTA can help us save the jobs of our employees in the United States. I have heard our customers here and in Central America plea for approval of CAFTA. Without a doubt, they recognize CAFTA's profound importance. On behalf of our customers and our employees in the United States of America, I urge you to support swift passive of CAFTA and also somehow to bring Chinese imports under control. Thank you.

[The prepared statement of Mr. Gregory follows:]

Statement of Alex Gregory, President and Chief Executive Officer, YKK Corporation of America, Marietta, GA

My name is Alex Gregory. I am president and CEO of YKK Corporation of America, headquartered in Marietta, Georgia. YKK is best known for the billions of zippers we manufacture globally, but we also make many other fastening products, as well as architectural products for commercial and residential buildings. YKK is headquartered in Tokyo, Japan, with manufacturing operations in 68 countries. YKK has had a presence in the United States since 1960. We opened our first significant manufacturing plant in Macon, Georgia, in 1974. I was among the first American employees hired for that plant . . . a Georgia Tech Textile Engineer just out of the Navy, so manufacturing is near and dear to me. For going on four years now, I have been responsible for YKK's 16 companies in the United States, Canada, Central America, and Colombia, South America. We employ approximately 3,000 Americans across five time zones in the western hemisphere, 1,600 of whom live in Georgia.

YKK has a manufacturing presence in many countries, including China and every other major garment-producing country in the world, but I am here today to speak on behalf of our employees in the United States. In the past thirty years we have invested more than $1 billion in manufacturing plants in the United States. We are very proud of the beautiful plants we have built around this country, many of which we continue to operate, and we are very proud of the fantastic job our employees in the United States have done and are doing. At our peak in production, only five years ago, our zipper plants were as efficient and as productive as any others in the world.

Unfortunately, in recent years, we have suffered many painful events caused by imports, mainly from China. Over the past decade, in response to cheap imports from Asia, many of our customers who are owners of major brands of jeans, pants, jackets, and many other apparel products have transitioned from manufacturing their own products in the United States to sourcing, in varying degrees, products from contractors in Mexico, Central America, and, in increasing frequency, from China and other parts of Asia.

Because our customers are sourcing their products from different parts of the world, we in YKK have had to make significant changes in how we do business as well. Employment in our National Manufacturing Headquarters in Macon has declined steadily from around 1100 five years ago. But we are proud that we have been able to continue to provide jobs for 950 employees in Macon, Georgia, and another 500 in Kentucky, Tennessee, and Alabama, even though many of our customers long ago closed their manufacturing operations in this country. From our 2.4-million square foot facility in Macon, we now ship zippers and other fastening products to our customers and their contractors in Central America, Mexico, South America, and, of course, to those who remain in the United States.

But we have had to make many other painful sacrifices as well. In support of our customers, for the past two years we have worked together with our employees on a Competitive YKK Macon initiative to become as competitive as possible—right now, before all the business moves to China. To become more competitive, we have written off millions of dollars worth of now-excess manufacturing capacity; we have packed up perfectly good zipper-making machines and sent them to other parts of the world where our customers are now sourcing their garments; we have reduced wages and salaries, including my own; as a last resort, we also have reduced our salaried and hourly workforce (sometimes painfully, but when possible, by attrition), to reduce the cost of our fastening products. We embarked on this initiative so that our customers would make the decision to continue to source garments from within this hemisphere; we want them to know they have our support in competing with the flood of cheaper garments from China.

And believe me when I say we are petrified about the acceleration of imports from China. Prices from China are down significantly and imports are sky-rocketing. In the two pants categories which primarily affect our business, 347 and 348, imports from China are up over 1600% in the first quarter of 2005 compared with the first quarter of 2004.

There has been an absolute explosion of imports in the first quarter of this year. Our customers tell me that if this trend continues, they will have to make some dire decisions, including the decision to close plants. I do not want that to happen because it means that we will lose more jobs in America, and I am doing everything in my power to keep that from happening. Something positive must occur going forward or more plants will close and more jobs will be lost.

A main point I wish to make is that market forces exist today which give garment manufacturers in this hemisphere a real competitive advantage. This advantage is "speed to market." Thanks to rapid fashion changes and a shift from basic styles to premium, higher priced products, the marketplace in some instances has become a friend to garment manufacturers in this hemisphere. The key is speed, and we are partnering with our customers to reduce dramatically the time it takes to develop new products, sew them, and deliver them to retail shelves. Strong clusters, or alliances, are forming among American retailers and brandholders, and the suppliers of the materials which go into their garments. We are participating in these alliances with enthusiasm, as proximity to the U.S. market is one of few advantages remaining to us in this hemisphere. Together with our customers and other vendors and suppliers, we have reduced lead times significantly.

CAFTA can go a long way towards helping us maintain a strong garment manufacturing presence in this hemisphere, especially if it is combined with efforts to bring China onto a level playing field. We need relief in the form of strong safeguards against unrestricted imports from China. But CAFTA is an essential element—indeed it is the critical and necessary element—to strengthening the collaborative effort within the rapidly growing alliances in this hemisphere. Restraints on China, coupled with fair trade under fairly valued currencies are important to undertake, but if we do not pass CAFTA, we will do a disservice to this industry. CAFTA can help us save the jobs of our employees in Georgia, Kentucky, Tennessee, and Alabama.

Last week I attended a meeting with many of our top sales professionals in this hemisphere, and each of them stressed to me how important CAFTA is to our customers. They expressed the strong sentiment they have heard from most of our customers, many of whom are well-known U.S. brandholders. I have heard that same plea for approval of CAFTA in my own discussions with customers here and in Central America. I was in El Salvador just yesterday, as a matter of fact, and in Costa Rica the day before that. It seems as if everyone related to our business, and especially our customers, recognizes CAFTA's profound importance.

On behalf of YKK's employees in the United States of America, I urge you to support swift passage of CAFTA and also somehow to bring Chinese imports under control.

Thank you.

Mr. SHAW. Thank you, Mr. Gregory. Our next witness is from Buffalo, New York, so I would yield to the gentleman from Buffalo, New York to introduce Mr. Stevenson.

Mr. REYNOLDS. I thank the chairman. It is my pleasure to welcome to the Committee a witness from my area of Western New York, Mr. Robert Stevenson, the chief executive officer of the Eastman Machine Company in Buffalo. As we will hear today, Eastman Machine, which is a family-owned business operating in Buffalo for over 100 years, manufactures world renowned cloth-cutting machines. During a visit to Mr. Stevenson's facility, I heard firsthand how technology investments by this small family-owned business are being pirated by Chinese manufacturers. I am grateful that the Committee has been able to include Mr. Stevenson as a witness today at the hearing. Mr. Stevenson, I am grateful to you for your willingness to come here and share your story with us. Thank you, Mr. Chairman.

Mr. SHAW. Mr. Stevenson.

STATEMENT OF ROBERT L. STEVENSON, CHIEF EXECUTIVE OFFICER, EASTMAN MACHINE COMPANY, BUFFALO, NEW YORK

Mr. STEVENSON. Thank you, Congressman Reynolds, Mr. Chairman and Members of the Committee. Thank you for this opportunity to provide a real-world perspective on the impact of U.S. trade relations with China. It touches upon all levels of testimony that we have heard here today. I represent five generations of family ownership of the Eastman Machine Company that goes back to 1892. We employ 120 people. We manufacture manual and automated fabric cutting machines that are sold worldwide, with over 50 percent of our sales exported.

As I sit here today before this honorable Committee, our union factory workers are in the fifth week of a labor strike. Management and labor have been unable to find common grounds and a new three-year collective bargaining agreement because our workers, who average 50 years of age, 25 years of seniority and $50,000 in wages and benefits, are seeking a job security that I simply cannot give them. As much as I appreciate their everyday hard work, their loyalty and their skill, I cannot guarantee their jobs will exist beyond tomorrow because of the uncertainty of the role that China plays. Even our union's UAW leadership concedes that this economic reality is a situation that only Washington can address. Although at times the union's drumbeat that jobs are being exported to China because of cheap labor may apply to multinational corporations, it misses the mark for small often family-owned businesses like mine. The panacea is not trade barriers. Our world today, the global world of the Internet, is not the world that saw Smoot-Hawley.

What we need today are not tariffs to protect us, nor currency, cheap labor, the overriding concerns. To be sure, labor costs and tariffs are part of the story. Indeed, my people on the Eastman floor average $27 an hour in wages and benefits, while their Chinese counterparts are paid $2.00 a day. A 36 percent tariff that is slapped on our U.S. produced machines is a major impediment. However, the real issue and the real problem is intellectual property pirating. We sell a manually-operated fabric cutting machine that has been, with some functional improvements, considered the Cadillac in the U.S. and the foreign apparel markets for over a century. That changed with the appearance of the first Chinese manufacture of what we call Eastman clones in the early '90s. Surprise would not be adequate as my reaction to the look of these knockoffs. The design, the model numbers, the trademarks are all practically the same. Even the names on some of the Chinese machines were virtually identical. In one instance, which I think is in the record before the Committee, they just changed the name from Eastman to Westman. Over the last 10 years we went from a company that employed 150 union workers and sold 20,000 of these machines worldwide to a company that now only employs 58 workers and sells less than 8,000, while Chinese manufacturers who copied our machines, used our trade, our technology, our innovations and patents sell over 100,000 of these units per year.

For my company and the other small to mid-size U.S. manufacturers, the overwhelming problem that frustrates any hope to dent this still burgeoning market is the almost nonexistent intellectual property protection available in the People's Republic. This situation results not I think from a conscious policy of the Chinese government, but from the impossibility of enforcement in such a geographically vast and populated country. It is this single factor alone that is sufficient to quash a company's incentive to evolve as a business. We are not alone. The lifeblood of any innovative manufacturer, no matter its size, is to continue to develop new technologies for broader niche markets. Indeed, in the last 10 years, as we have seen the sales of our manual machines that have been copied and cloned and those sales plummet, we have also invested millions of our dollars to develop new technology that automates the cutting process. This product line of automated cutting machines has established in its single decade of existence a reputation that justified this investment. We are still just a small manufacturer, averaging 25 million a year in sales, and we are truly afraid—I think petrified, as my colleague to the right of me said—that our research and development efforts will shortly be pirated as well as we start to sell these machines into China and the global market. The simple fact of the matter is that companies our size do not possess the resources that can be devoted to fighting the outbreak pilfering of our design innovations a half a world away. Not only do we lack the on-the-ground awareness of the thievery, but even if we did, we lack the hard cash to legally engage such interlopers.

Mr. Chairman and Members of the Committee, I am not here to employ your intervention into areas over which, frankly, you have as little control as I do. What the U.S. Government can do for the very survival of our domestic manufacturing base is to help us protect the entrepreneurial genius that made America great. There remains an expanding place for the Eastmans of this country. We can market and sell worldwide but only if our investment in research and development can be protected to provide half a chance to establish itself in the marketplace. In my view that is the indispensable role of our government, and that effort can't be intermittent, polite, politically superficial. It must be real. I believe the foundation of the U.S. economy and the continuing existence of the American middle class is at stake. Should our government be absent and unwilling to protect this national base, then our efforts as manufacturers to develop new technology, new products, or even to remain in business, will ultimately prove to be a waste of time and energy, not to mention money. In closing, I implore this Committee to focus its effort on protecting technology and protect our investments of those truly domestic companies that seek to provide American families with an opportunity to raise their children, pay their taxes and be good citizens, an ideal that my family has sought to emulate for the past 120 years. Thank you, Mr. Chairman, for the opportunity to testify today. I look forward to answering any questions you may have later.

[The prepared statement of Mr. Stevenson follows:]

Statement of Robert Stevenson, Chief Executive Officer, Eastman Machine Company, Buffalo, NY

Mr. Chairman, Congressman Rangel, and members of the Committee, thank you for this opportunity to provide a real-world perspective on the impact of U.S. trade relations with China. My name is Robert L. Stevenson, and I represent four generations of family ownership of the Eastman Machine Company. Established in Buffalo, New York in 1892, Eastman manufactures manual and automated cutting machines sold worldwide that are the definition of quality.

As I sit here today before this honorable committee, Eastman's union factory workers are in the fourth week of a labor strike. Management and labor have been unable to find common ground on a new, three-year collective bargaining agreement because our workers—who average 50 years of age, 25 years of seniority, and $50,000 in annual wages and benefits—are seeking job security that I simply cannot give them. As much as I appreciate their loyalty, skill, and everyday hard work, I simply cannot guarantee that their jobs will be there tomorrow any more than I can bank on mine when I wake up tomorrow morning. Even our union's U.A.W. leadership concedes that this economic reality is a situation that only Washington can address. Although the union's drumbeat that jobs are being exported to China because of cheap labor may apply to the giant auto industry, it misses the mark for small, often family-owned, businesses like mine. Labor's panacea is trade barriers. But our world today—the global world of the Internet—is not the world of Smoot-Hawley.

To be sure, differences in labor costs are part of the story. Indeed, my people on the Eastman plant floor average $18.39 *an hour* in wages alone, while their Chinese counterparts are paid $2.00 *a day*. This disparity in the cost of labor is only one of several factors affecting Eastman's and other U.S. manufacturers' ability to be serious global players, however, and it will likely become a less-dominant factor in the future. Even today, as hard as it is to imagine, there are reports of factory labor shortages in the provinces south of Shanghai that will inevitably cause wages to rise. Even the 36% tariff slapped on our U.S.-produced machines is not the major obstacle to sustained access to that market in the future.

Eastman sells a manually operated electric-powered cloth-cutting machine that had been, with little significant functional change, the Cadillac in the U.S. and foreign apparel markets for half a century. But that changed with the appearance of the first Chinese Eastman-clone in the early '90s. Surprise does not describe my reaction at the look of those knockoffs—the design, the model number, and the color were all the same. Even the name on the machine was virtually identical, changed only from "Eastman" to "Westman." Over the last ten years, we went from a company that employed 150 union workers and sold 20,000 straight knife machines worldwide, to a company that now employs only 58 union workers and sells less than 8,000 of these machines. Today, we are almost a non-player on Mainland China, where 75% of the world's cutting machines are to be found and over 100,000 pirated Eastman-clones are sold annually.

For my company and the other small to mid-sized U.S. manufacturers, the overwhelming problem that frustrates any hope to dent this still burgeoning market is the almost non-existent patent and trademark protection available in the People's Republic of China. This situation results not from a conscious policy of the Chinese government—for surely China is not a monolith—but from the impossibility of enforcement in such a geographically vast and populace country.

It is this single factor that, in my opinion, alone is sufficient to quash Eastman's incentive to evolve as a business. And we are not alone. The lifeblood of any innovative manufacturer, no matter its size, is development of new technologies for broad or niche markets. In the last ten years, as we have seen our manual machines copied and cloned and our resulting sales plummet, we have also invested millions of our dollars to develop new technology that automates the cutting process. This product line of automated cutting machines has established in its single decade of existence a reputation that justifies that financial leap of faith. But we are still just a small manufacturer averaging $25 million a year in sales. And we are truly afraid that our research and development efforts—all the hard work and effort to bring these machines to market—will shortly be pirated as well as we start to sell these machines in the Chinese market.

The simple fact of the matter is that companies our size do not possess resources that can be devoted to fighting the outright pilfering of our design innovations half a world away. Not only do we lack the on-the-ground awareness of the thievery but, even if we did, we lack the hard cash to legally engage such interlopers. It is a looming fear of industrial life for those U.S. manufacturers seeking to establish operations in the Chinese market that a Shanghai partner today will become a competitor tomorrow when he sneaks out the back door with U.S. technology and sets up his business literally down the street.

Mr. Chairman and members of the Committee, I am not here to implore your intervention in areas over which, frankly, you have as little control as I do. What the U.S. government *can* do for the very survival of our domestic manufacturing base, however, is to help us protect the entrepreneurial genius that made America great. There remains an expanding place for the Eastmans of this country. We can market and sell worldwide, but only if our investment today in research and development can be protected to provide half a chance to establish itself in the marketplace. In my view, that is the indispensable role of our government at this point in commercial history. And that effort can't be intermittent, polite, or politically superficial—I am not talking about the niceties of trade delegations or hollow formal gestures.

I believe that the very foundation of the U.S. economy and the continued existence of the American middle class is at stake. Should our government—which surely is the only entity capable of protecting such innovation—be absent and unwilling to protect its national base, then our efforts as manufacturers to develop technology, or even remain in business, will ultimately prove to be a waste of time and energy, to say nothing of money.

In closing, I implore this committee to focus its efforts on protecting the technology investments of those truly domestic companies that seek to provide America's families with an opportunity to raise their children, pay their taxes and be good citizens: an ideal that my family has unabashedly sought to emulate for the past 120 years.

Thank you for the opportunity to testify today, and I look forward to answering your questions.

Mr. SHAW. Thank you, Mr. Stevenson. Our final panelist is Mr. David Spence. He is the Managing Director for Regulatory Affairs, Legal Department, Federal Express Corporation, Memphis, Tennessee. Perhaps you might be able to give Mr. Stevenson some advice. Mr. Spence.

STATEMENT OF DAVID SPENCE, MANAGING DIRECTOR FOR REGULATORY AFFAIRS, LEGAL DEPARTMENT, FEDERAL EXPRESS CORPORATION, MEMPHIS, TENNESSEE

Mr. SPENCE. Thank you, Mr. Chairman and Members of the Committee. The purpose of my testimony is to highlight the experience that FedEx has had in exporting our services to the Chinese market and the importance of U.S.-China trade to U.S. businesses including FedEx. From FedEx's perspective, there is no doubt that China's membership in the WTO and its greater participation in the world economy greatly benefits U.S. businesses and the global economy as a whole. Since our inception in the early 1970s FedEx has grown to now serve over 220 countries and territories. Today the FedEx family of companies has annual revenues near $24 billion and a work force of over 250,000 employees and contractors worldwide. FedEx is heavily vested in global trade and the future of the global economy.

FedEx has been providing U.S.-China express services since 1984 and began operating our own aircraft there in 1996. Having long recognized the economic promise of Asia, FedEx began planning accordingly. We conceived the idea of an international network decades ago when we purchased in 1984 a courier company that had offices in Europe and Asia. In 1989 FedEx purchased Flying Tigers, an all-cargo airline with flying rights to 21 countries including China. In 1995 we acquired the all-cargo route authority to serve China, becoming the sole U.S.-based all-cargo carrier with aviation rights to China. The U.S.-China Air Transport Agreement signed in 2004 provides U.S. cargo carriers with 111 new flights. So far FedEx has obtained 15 of those flights, maintaining our lead as the U.S. cargo carrier with the most rights to fly to China.

Globally, over 40 percent of the world's trade moves by air when measured by value. The value of China's exports and imports carried by air is growing rapidly, soon to catch up to that level. In 2004 approximately $60 billion worth of goods left China by air, and another 61 billion worth of goods entered China by air. As global markets expand U.S. businesses are seeking ways to participate in those markets and so grow their companies at home. Exports are critical if our companies are to participate in global markets, whether it is finished products for consumption abroad, or as components to add into U.S. businesses' global supply chains. To compete effectively, American companies must stay constantly ahead of the development curve. One of the most important tools a U.S. business has, whether it seeks to export to China or work with its Chinese based subsidiaries or partners there, is an integrated, global air express network. Such a network carries the products, components, samples and documents necessary to bring U.S. businesses closer to those markets, improve their supply chain management, and establish and strengthen their trading and business relationships.

U.S. exports to China, although still lagging behind imports from China, continue to grow rapidly, and the two-way trade relationship is vital to U.S. economic growth. Together the U.S. and China were responsible for half of the world's GDP growth last year. In the past 3 years U.S. exports to the world grew only by 9 percent, while its exports to China rose by 76 percent. The transportation of goods by air continues to be the service of choice for high-value, high-tech goods. Air cargo is an increasingly important mode of transport for China as it imports high-value components and exports high-tech products. China's key imports are products that America excels in making: electronic components, telephones, data processors, semiconductors and optical and medical instruments. Those products need air transportation to move them fast while the value of the innovation reflected in their designs is still high.

As the world's sixth largest economy and the third most active trading nation, China's role in the global economy is a fact of life, and one that FedEx welcomes. Certainly, trade relations with China are not without issues and challenges. Yet Beijing has shown sincere efforts to liberalize its economy and remove barriers. Despite the challenges that we may face its economic significance is such that we must continue to engage China and ensure that China's role in the global economy is one that continues to be an engine for global growth. The express industry connects China and the U.S. with the rest of the world. Our industry and FedEx as a company benefit from China's economic growth. As a large U.S. exporter of services, express delivery services, FedEx unequivocally believes that U.S. trade policy should continue to be one that leads the world in advocating for free trade and global market openness. Thank you.

[The prepared statement of Mr. Spence follows:]

Statement of David Spence, Managing Director for Regulatory Affairs Legal Department, Federal Express Corporation, Memphis, TN

Introduction

Thank you Mr. Chairman. Thank you for this opportunity to appear before this committee to testify about the important issue of U.S.-China economic relations.

My name is David Spence and I am the Managing Director for Regulatory Affairs in the Legal Department at Federal Express Corporation.

The purpose of my testimony is to highlight the experience that FedEx has had in exporting our services to the Chinese market and the importance of U.S.-China trade to U.S. businesses, including FedEx.

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FedEx in China

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China's Importance to U.S. Businesses

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To compete effectively, American companies must stay constantly ahead of the development curve. One of the most important tools a U.S. business has, whether it seeks to export to China or work with its Chinese-based subsidiaries or partners there, is an integrated global air express network. Such a network carries the products, components, samples, and documents necessary to bring U.S. businesses closer to those markets, improve their supply chain management, and establish and strengthen their trading and business relationships.

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The transportation of goods by air continues to be the service of choice for high-value, high-tech goods. Air cargo is an increasingly important mode of transport for China, as it imports high-value components and exports high-tech products. China's key imports are products that America excels in making: electronic components, telephones, data processors, semiconductors and optical and medical instruments. Those products need air transportation to move them fast while the value of the innovation reflected in their designs is still high.

[1] "Common Interests between China and the U.S. Isn't Decreasing: Official," People's Daily Online, September 30, 2004, *available at* http://english.people.com.cn/200409/30/eng20040930_158849.html

The Future of U.S.-China Relations

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Mr. SHAW. Thank you. I thank all the panelists. Mr. Reynolds, do you care to inquire?

Mr. REYNOLDS. I thank the Chairman. One of the things that both in the testimony and having been to the plant and seen both the cutting machine made by Eastman for 100 years with modifications as science and ability and research and development has modernized their equipment, is to see the Westman knockoff that was sitting side by side. They are a duplicate of technology presentation, using distributors and others. Could you—I believe we have these for the record. We have made distribution. Just confirm that the copy that I have and some of those that were handed out are in fact identical knockoffs to what you have and to again talk about the fact while many multinational companies might have a law shop that could defend and protect their patents in a world court or whatever, you are trapped in the size of a small business that are unable to go after the infringement you have seen and actually have on display in your plant?

Mr. STEVENSON. That is correct, Congressman. The brochure you have in front of you says Westman Model 829. Our machine is an Eastman Model 629. All the—to a layman, actually to an expert it would be very hard to tell the difference. This is a case where again form does not have to follow functionality. There is many different ways you can create a reciprocating cutting machine. Our concern is, and our problem has always been, by duplicating the trademarks of our machine, duplicating the colors, duplicating a certain technology and patents we have on the machine, that it ends up confusing the end user. China's manufacturer of these machines, not only sell them into China, they also export them into other market such as South America, Central America, even into this country. Now, we are successful in defending ourselves with the help of Customs and with the help of Government in sales of these machines into the United States. However, to undertake a legal battle on a worldwide scale is simply beyond our resources. We do not have the tens of thousands of dollars needed to engage attorneys, and even if we did, it seems to me it sometime is a case of that old carnival game that, the little things pop up and you try and pound them down, and as soon as you have beaten one into the ground, another one seems to emerge. There are numerous of these competitors that engage in this practice, and they all trade on our reputation and trade on our technology and our innovations that we have spent over 100 years in developing.

Mr. REYNOLDS. Another question I just would have is if China and other countries were attacking American intellectual property like your patents for cutting machines, would you be selling into those countries or looking in a more aggressive aspect throughout the world?

Mr. STEVENSON. Yes, we would. If we had the ability to protect ourselves in that way we certainly would be able to sell more machines and we certainly would be employing more people in our plant in Buffalo.

Mrs. TUBBS JONES. Mr. Chairman?

Mr. SHAW. Mrs. Tubbs Jones, would you like to inquire?

Mrs. TUBBS JONES. Thank you, Mr. Chairman. I was one of those who opposed China WTO opportunities, and as I sit here and listen to the 7 of you, a few years ago it would have been the flip. I would have been saying what you are saying has happened in China. It is almost like "I told you so." You know, your mother used to say, "I told you so if you do so and so." I am not trying to place myself in that role, but as we go down this next road—and I am going to direct my initial question to Mr. Wilkey from NAM, because I have been working with NAM in my congressional district, Cleveland, Ohio, where we lost 60,000 jobs from 2001 to 2004 in the city of Cleveland alone. You didn't perceive, didn't even contemplate that what is happening with China was going to happen, Mr. Wilkey? Was it in your mind at all?

Mr. WILKEY. It seems to me that when we developed this relationship we set some rules. What I can't perceive is why aren't we enforcing those rules? We wouldn't have this same problem if we had enforced some of the rules. Fundamentally, we have to get—when you set a rule, when you are playing a game——

Mrs. TUBBS JONES. That is if you believe in rules, Mr. Wilkey, though. Pirates don't believe in rules. That is why we call them pirates.

Mr. WILKEY. There are ways of enforcing those rules.

Mrs. TUBBS JONES. Okay. You believe that the resolve for you or those members of the National Association of Manufacturers, is for the United States to use the tools that they have to enforce the rules, either through the WTO, the International Trade Commission, or one of those, to resolve some of your issues; that is what you think, sir?

Mr. WILKEY. Absolutely, and trade, we believe that free and fair, quote, unquote, is critical, because I think that we can do it. Now, I think that it has done a lot for our economy and we need trade, we cannot get along without trade, but we need to have a level playing field.

Mrs. TUBBS JONES. Okay. A lot of people talk, use the term "level playing field." What does level playing field for you, Mr. Eastman? I have forgotten your first name, sir.

Mr. STEVENSON. We are able to compete in a world where we feel like our innovations are protected. If I may just comment briefly. Our machines were cloned—that is the expression we use—or copied prior to any treaty by the WTO. This started back in the early '90s. We actually felt that having China in the WTO might bring this issue to heel a little bit and protect us somewhat, because we depend on exports. Over half our business is exports, indeed our major market is the Pacific rim and we would love to have back some of the number of machines that are sold in China.

Mrs. TUBBS JONES. So, you believe that having them under an enforcement too would have helped you, but in reality that is not what has occurred.

Mr. STEVENSON. In reality you are correct. It has not occurred and that is why I urge our Congress, our government to do something to let us enforce the rules that are in place. Now, a level playing field, there are other issues. Certainly for my people the issues are rising health care costs in this country, it is a tremendous burden on a small manufacturer like myself to have to pay the entire burden, and we are trying to negotiate a fairness with that with our union shop. I think there are other issues which we have discussed. Again, we have various rules and regulations on operating a factory in terms of environmental protection, in terms of Occupational Safe and Healthy Act that other countries don't have. So, therefore we are automatically burdened with a cost that other countries don't——

Mrs. TUBBS JONES. Right. Listen to——

Mr. STEVENSON. I think we need to level the playing field to——

Mrs. TUBBS JONES. I only have a little bit of time, Mr. Stevenson, if I can cut you off, please, sir. My question to you is—none of you are advocating that even though in other countries there are fewer labor standards, there are no environmental standards, that you are not required to maintain a safe environment in which your workers work; none of you are advocating that, are you?

Mr. STEVENSON. No.

Mrs. TUBBS JONES. Thanks. Let me go to Mr. Spence because I am about to run out of time. The yellow light is on. Mr. Spence, how much more product do you bring to the United States than you take back to China? Is it like this?

Mr. SPENCE. No. I don't have a specific number. We export, we are a very large exporter, but we also bring much back in.

Mrs. TUBBS JONES. Is that an answer you could send to me?

Mr. SPENCE. Yes, absolutely.

Mrs. TUBBS JONES. I would appreciate it. You know how to find me.

Mr. SPENCE. Yes.

Mrs. TUBBS JONES. Gentlemen, thank you very much. We don't get but 5 minutes. We appreciate you coming before the Committee and I admit that I am prepared to do what we need to do to deal with China, though I am not in charge. I am going to do my best though. Thanks, Mr. Chairman.

Mr. SHAW. Thank you. Mr. Beauprez. I would ask the Members—I have been advised that our vote is going to come right around 3:00 and it is the intention of the Chair not to recess but to conclude the hearings when we have to go vote. So, Mr. Beauprez?

Mr. BEAUPREZ. Thank you, Mr. Chairman. I want to comment the panel. I think this has been an exceptional panel and I very much appreciate your testimony. It is quite helpful. Mr. Wilkey, you made the point very strong that we need to enforce. Mr. Berman, you seem to have considerable knowledge of the Chinese market and some painful experience about dealing with the Chinese. It crossed my mind with the first panel we had—I unfortunately wasn't able to question them, so I will pose the question to you. One, do you believe the Chinese have the will to enforce, and two, if the answer happens to be yes, do they have the ability, do they have the infrastructure to accomplish it?

Mr. BERMAN. Based on my painful experience, Congressman, I would say what China has the will to do is the point of least resistance. What does it take to remove this as an irritant in the U.S. trade dialog, and how long can that be strung out? I would say if you go back in the history of intellectual property protection in China, there is a singular event in that history when the Chinese actually produced the result, and that was when the United States took a decision to impose trade sanctions on China for intellectual property violations. The Federal Register lists of Chinese exports to the United States was published and because of goods in transit the effective date of that was 30 days from the data of publication in the Federal Register. One billion dollars in Chinese export to the U.S. would have been subject to tariffs based on the estimated losses to U.S. companies due to intellectual property violations. The day after that notice appeared in the Federal Register, Ambassador Barshefsky was asked to go to Beijing and to conduct a negotiation. That is the singular event that moved the ball forward. There has not been anything since.

Mr. BEAUPREZ. I am going to make an assumption that the United States is not unique in the world in countries that trade with China to experience the pirating, the counterfeiting, the stealing of intellectual property?

Mr. BERMAN. No. The EU has said most recently that 60 percent of the goods seized by EU customs officials in the year 2003 came directly from China. The difference, Congressman, is that the EU, through its instrumentality, which is the European Commission, seems to be somehow removed from the reality of the companies that are represented in the European member countries of the EU, so there doesn't seem to be the same sense of "we have to fix this problem." It is much more a "yes, there is a problem and, yes, we need to do something about it, and, yes, we have to have a process, and yes, we should have a discussion with them and a dialog, and we should meet again 3 months from now." That is the process that moves along in the EU. We ask more of USTR and sometimes we get it.

Mr. BEAUPREZ. Keep asking.

Mr. BERMAN. Thank you.

Mr. BEAUPREZ. Mr. Stevenson, question to you. Looking at this document you have provided us, who stole your technology? Was this another private enterprise as we would determine or define a private company in China, or quasi-government?

Mr. STEVENSON. I believe most of them, Congressman, are quasi-governmental companies.

Mr. BEAUPREZ. I was afraid you would say that.

Mr. STEVENSON. On the other hand there are—there is a proliferation of them. I would say right now there is about 10 different manufacturers of what I consider our machines in China. Some of them now are privately owned. Many of them are owned in cooperation with the local provincial governments, which we have heard testimony earlier today that they are under pressure to employ people. Apparel is such a big business in China that obviously they want to manufacture the hardware that goes along with the apparel.

Mr. BEAUPREZ. I am looking at five pages I believe that you have supplied. How many of those pages indicate machines technology that you have developed, invented that have been pirated?

Mr. STEVENSON. All of them.

Mr. BEAUPREZ. All five of these are basically clones with a different tag on them.

Mr. STEVENSON. Right. I think No. 5 is actually our machine, and if experts can't tell the difference——

Mr. BEAUPREZ. That is the one that looks like it has "Eastman" on it. Everything else looks like it has been stolen.

Mr. STEVENSON. That is right.

Mr. BEAUPREZ. Gentlemen, thank you very much. Mr. Chairman, I yield back. This has been most helpful.

Mr. SHAW. We have been called for a vote, so I would ask the remaining questioners if you could limit your time we could get to everybody. Mr. Becerra.

Mr. BECERRA. Thank you, Mr. Chairman, and I will do so. Gentlemen, thank you for the testimony, very enlightening, and—I am sorry, Mr. Chairman?

Mr. SHAW. I am sorry.

Mr. BECERRA. I am fascinated by something. Anyone here believe that China is living up to its terms of the agreement when it acceded to the WTO? If you believe so, please raise your hand. Okay. Anyone believe that if they tell us that they are going to tell us that they are going to start enforcing whatever rules they may already have in place that we should be willing to trust them? Raise your hand if you would believe them. I sense then that all of you believe that we have got to have some teeth in our enforcement mechanism to make sure that they do what they are supposed to do and not simply live on some good intention, good faith or handshake that they may give us in terms of their competition with us; is that fair to say? Okay. Mr. Stevenson, I thank you for your testimony perhaps more than anyone else's because you bring to light the difficulty that employers face and that employees face. I think those employees that have been around with you for decades that are earning a pretty decent wage, from what you said, still want to continue to make it up the ladder. For you it is probably very difficult to consider increasing those wages because you are talking about competition where they are paying $2.00 a day, as you said, in China. I don't see how that does anything but force you to compete against China by trying to keep the wages where they are if not diminish them, which I think is terrible for American workers when you have to engage in that race to the bottom. My question is this, because, Mr. Gregory, you said that you supported CAFTA.

Mr. GREGORY. Yes, sir.

Mr. BECERRA. Have you had a chance to read the CAFTA agreement?

Mr. GREGORY. I have not read it in its entirety, no, sir.

Mr. BECERRA. You haven't?

Mr. GREGORY. No, sir.

Mr. BECERRA. Let me suggest to you that you read it because would you agree that we should deal with the Central American countries and the Dominican Republic—which by the way, have a lot of their operations in textile and other areas in the maquila—that are owned, operated or controlled by a lot of the same Chinese companies that are ripping you off right now. Do you believe that we should operate in a free trade agreement where we open up our markets to the Central American countries based on a handshake?

Mr. GREGORY. Well, certainly there can be some teeth put into the agreements but——

Mr. BECERRA. Okay, but no, no. There could be but there weren't. You can't—the trade agreement that we have before us that we will vote on, we don't get to renegotiate.

Mr. GREGORY. Yes, sir. We have looked at the agreement and we feel like——

Mr. BECERRA. So, where are the teeth in the agreement that will make sure that China doesn't continue paying a $2.00 wage or that those Central American countries don't pay a $2.00 wage so that Mr. Stevenson can have workers and produce products that can compete against Central American or Chinese goods?

Mr. GREGORY. I can't answer that, sir.

Mr. BECERRA. It is not in there. I ask you, how can you agree to an agreement, how can you support an agreement where we have turned over the keys not just to the Central Americans, because remember—and you have probably been down to Central America, some of you——

Mr. GREGORY. I was there yesterday.

Mr. BECERRA. A lot of those operations in Central America are now owned by Central Americans. They are owned by some of the same Chinese and other Asian interests, along with some of the Central Americans. If we have nothing that forces them to compete in ways that are fair, you have just opened up the door for that further race to the bottom, and that is what CAFTA does. So, I was startled to hear you say, given all the testimony, that you support a CAFTA agreement. You know what it says with regard to, for example, wages, what they are going to do in Central America to make sure that they don't descend to the bottom to try to compete with China's wages, because that is what they would have to do, right? Otherwise, China would take them. The only protection we have is a provision in the agreement that says, "You must not fail to enforce your laws on labor." So, if they have deficient laws, guess what? That is all they have got to do is enforce deficient laws. If they decide to reduce the protections in their laws, if they decide to reduce their wages, under CAFTA we can't do a thing about it. Is that good for competition for Mr. Stevenson?

Mr. GREGORY. In many ways we see CAFTA as our only hope to compete against China.

Mr. BECERRA. Okay, but as you know, any agreement can be negotiated to make it better. We found out with side agreements in NAFTA that it doesn't work. I made a commitment to the Chairman to not take up more time. Let me close. You all were very good. I appreciate your testimony. Mr. Chairman, let me yield back my time.

Mr. SHAW. I would say to the gentleman from California that the intellectual property enforcement rights in CAFTA is stronger than it is in the WTO.

Mr. BECERRA. Chairman, you are absolutely right, it is a double-barrel shotgun, but we use a pea shooter when it comes to labor and the environment.

Mr. SHAW. Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman. I look forward to exploring CAFTA when we actually have a hearing on CAFTA. I would like to, if I could, gravitate back to China trade, which I am delighted at the testimony we have received today from this particular panel because it is extraordinarily helpful. Mr. Stevenson, the story you have told about intellectual property rights is almost identical to a similar experience of a small manufacturer in my district. What I have discovered is that small manufacturers in the United States have very little recourse even with the assistance that the Administration is clearly trying to provide on intellectual property rights. There are few opportunities for a small manufacturer with a patent to go into China and really receive an opportunity for a hearing and to be made whole. So, I sympathize with the extraordinary experience you have gone through. You are not unique in this regard.

May I have a quick show of hands? How many of you think China should move toward floating its currency the way I believe WTO standards oblige it to? Pretty much everybody. That is very helpful. At the same time how many of you feel that there is a real imperative to improve the structure of the legal system in China to allow intellectual property rights to be more properly enforced? I guess the other issue that I haven't heard a lot about—and I would throw this open to any of the panelists quickly—clearly China has been involved in discriminatory practices as far as its tax system, and we realize that China's tax system is currently undergoing an evolution, but they have clearly dictated some preferences to their neighbors under their tax system, which permit neighboring countries to send products tax free into the Chinese market, whereas products manufactured in the United States face a discriminatory tax. Have any of you experienced this problem or wish to comment on it? No one on the panel. Thank you. Mr. Chairman, I have a number of other questions, but as per your understanding, I would like to simply thank the panelists for giving us some real ammunition to move forward on the China front and a sense of what we need to prioritize.

Mr. SHAW. Thank you.

Mr. Levin.

Mr. LEVIN. Just quickly, thank you for coming. Let me just then make an observation. I was going to ask you a question. There really isn't time. On currency and IPR I think the problem is, except for you, Mr. Berman, who I take it would support a WTO case?

Mr. BERMAN. I would.

Mr. LEVIN. You do. The NAM has not, so even when there is WTO legal action, you tend to hedge. For example, when we filed a 301 petition we didn't have the NAM's support, and that is a real problem because they don't hear clearly when you don't speak clearly. Also, Mr. Brilliant, your testimony on this, which is aside from liaison, the U.S. Chamber strongly supports the continuing efforts to address China's failure to comply with IPR commitments through the JCCT and other bilateral and multilateral mechanisms. Would you support the filing of a WTO case?

Mr. BRILLIANT. We actually, in our submission to the U.S. Trade Representative Office, did call for WTO consultations. It is on the record.

Mr. LEVIN. So, you support—the consultations come after the case is filed.

Mr. BRILLIANT. No, before.

Mr. LEVIN. Before.

Mr. BRILLIANT. What we support is treating China as a priority country as well as WTO consultations.

Mr. LEVIN. So, you support a WTO action?

Mr. BRILLIANT. We support WTO consultations, not WTO cases.

Mr. SHAW. We have 4 minutes to get over to the floor.

Mr. LEVIN. On currency? On currency, what is your position?

Mr. BRILLIANT. Well, on currency our position is as I stated, we support China moving rapidly toward a market-based exchange system. We do not support legislative unilateralist measures to impose tariffs.

Mr. LEVIN. How about consultations, section 301, WTO process; you support that?

Mr. BRILLIANT. We will consider that.

Mr. SHAW. I am going to have to conclude the hearing. I appreciate each one of you for giving your time. I have some questions too. I may submit them to you in writing. I think this hearing has really shown us a lot. It has pinpointed some of the problems that we have, and I think we will probably go forward in a bipartisan way to try to find solutions because this is about American jobs and American business.

We are adjourned.

[Whereupon, at 3:15 p.m., the hearing was adjourned.]

[Question submitted from Representative Thompson to Mr. Freeman, and his response follows:]

Question Submitted by Representative Thompson

Question: Thank you for holding yesterday's Full Committee hearing on United States-China Economic Relations and China's Role in the World Economy. I would like to submit a follow-up question to Mr. Charles Freeman, Assistant USTR for China. The World Trade Organization's Agreement on Trade-Related Aspects of Intellectual Property ("TRIPS Agreement") protects geographical designations, such as Napa Valley. Specifically, I would like to know what the USTR is doing to address misuse of geographical indications in China? As I indicated to Mr. Freeman, 2 years ago, the Napa Valley Vintners Association filed actions in Chinese court to prevent the registration of the brand name "Na Pa He Gu," or Napa Valley, by Beijing's Hongye Grape Wine Co. The name is identical to the way wine producers from my district translate Napa Valley on wines exported to China.

[Response not received at the time of printing.]

[Statements for the record follow:]

Statement of Meena Khandpur, Advanced Medical Technology Association

AdvaMed and its member companies would like to thank the Committee for holding this important hearing. China continues to be a growing market for medical devices. We are grateful that the U.S. and Chinese Governments are working with our industry in a number of constructive ways to address issues affecting sales on the Chinese market. Resolution of these issues would benefit the U.S. economy, as well as the health and welfare of the Chinese people.

AdvaMed represents over 1300 of the world's leading medical technology innovators and manufacturers of medical devices, diagnostic products and medical information systems. Our members manufacture nearly 90% of the $83.4 billion in health care technology products purchased annually in the U.S., and nearly 50% of the $175 billion in medical technology products purchased globally. Exports in medical devices and diagnostics totaled $22.4 billion in 2003, but imports have increased to $22 billion— indicating a new trend toward a negative trade balance for the first time in over 15 years.

The medical technology industry is fueled by intense competition and the innovative energy of small companies—firms that drive very rapid innovation cycles among products, in many cases leading to new product iterations every 18 months. Accordingly, our industry succeeds most in fair, transparent, global markets where products can be adopted on their merits. We face both challenges and opportunities in the China market.

Global Context

Innovative medical technologies offer an important solution for nations that face growing health care needs and constraints on resources, including the demands of aging populations. China will be the first developing country to experience an aging work force. Advanced medical technology cannot only save and improve patients' lives, but also lower health care costs, improve the efficiency of the health care delivery system, and improve productivity by allowing people to return to work sooner. Our industry saves lives and money.

To deliver this value to patients, our industry invests heavily in research and development (R&D), and U.S. industry is a global leader in medical technology R&D. The level of R&D spending in the medical device and diagnostics industry, as a percentage of its sales, more than doubled during the 1990s, increasing from 5.4% in 1990, to 8.4% in 1995, to 12.9% in 1998. In absolute terms, R&D spending has increased 20% on a cumulative annual basis since 1990. This level of spending is on par with spending by the pharmaceutical industry and more than three times the overall U.S. average.

AdvaMed greatly appreciates the support we have received from U.S. government agencies. Trade agencies—such as the Office of the U.S. Trade Representative (USTR), the Department of Commerce (DOC), and the Department of State, with strong support from U.S. Embassies and Consulates—have helped us open markets for our products around the world, including in China. Regulatory agencies, such as the Department of Health and Human Services and the Food and Drug Administration, have worked with foreign governments, including China's, on improving the regulatory environment for our products.

AdvaMed believes the USTR, DOC and Congress should monitor regulatory, technology assessment and reimbursement policies in foreign health care systems and push for the creation or maintenance of transparent assessment processes and the opportunity for industry participation in decisionmaking. We believe China is making progress on these important procedural matters. We welcome China's willingness to continue to improve its administrative and regulatory processes.

AdvaMed strongly supports trade liberalization globally and throughout the Asia-Pacific region. We believe China can and should play a key role in this effort. As a prominent member of the World Trade Organization (WTO) and a substantial beneficiary of the global trading system, China should lend its weight to further trade and investment liberalization. In this regard, the Doha Development Round of the WTO offers a major opportunity to continue to reduce tariffs and address non-tariff measures.

AdvaMed also recognizes that international negotiations and discussions occur in variety of venues. We seek medical device regulatory regimes that conform to these guiding principles:

- acceptance of international standards;
- transparency and national treatment;
- use of harmonized quality systems or Good Manufacturing Practice inspections;

- recognition of others' product approvals (or the data used for those approvals);
- development of harmonized auditing and vigilance reporting rules;
- use of non-governmental accredited expert third party bodies for inspections and approvals, where possible.

Similarly, many economies require purchases of medical technologies to take place through centralized and/or government-administered insurance reimbursement systems. China is still in the process of reforming and developing its reimbursement system. To ensure timely patient access to advanced medical technologies supplied by foreign as well as domestic sources, member economies should agree to adopt these guiding principles regarding the reimbursement of medical technologies:

- establish clear and transparent rules for decisionmaking;
- develop reasonable timeframes for decisionmaking;
- institute data requirements that are sensitive to the medical innovation process;
- ensure balanced opportunity for the primary suppliers and developers of technology to participate in decisionmaking, e.g., national treatment;
- establish meaningful appeals processes.

Challenges and Opportunities in China

The Chinese market presents excellent opportunities for the U.S. medical technology sector. China has already become an important market for our industry. While reliable statistics are not yet available, AdvaMed estimates that the Chinese market for medical technology is at least $3 billion and growing rapidly. It is on pace to surpass some of the key European markets for medical technology in a few short years. As global leaders, U.S. medical technology firms already account for a significant portion of sales in China, and the position of these firms underscores the importance of ongoing efforts with the U.S. Government to open the Chinese market further.

At the same time, AdvaMed members must overcome hurdles to realize further opportunities. AdvaMed and its member companies have identified a number of priority issues we are seeking to address in China. AdvaMed looks forward to working with the government of China, the U.S. Congress and the U.S. Administration to address the following barriers

- redundancy in the regulatory process;
- unnecessary regulatory burdens on diagnostic products; and
- difficulties with the centralized tendering system.

For the medical technology industry, the Bush Administration's efforts with China under the U.S.—China Joint Commission on Commerce and Trade (JCCT) are critical for allowing U.S. medical technology firms broader access to the burgeoning Chinese health care market. The JCCT has been a valuable forum for the open discussion of specific regulations affecting medical devices, including between the U.S. FDA and the Chinese State Food and Drug Administration (SFDA). This forum allows us to gain a better understanding of the status of China's regulatory process—including some of its regulations we believe to be duplicative and unnecessary for patients' health, and its unique treatment of certain diagnostic products as pharmaceuticals instead of devices. We would like to see this forum enhanced to include discussion of other issues.

In addition, we have appreciated the government of China's willingness to meet with us and representatives of our member companies on issues not covered under the JCCT. For example, we have benefited from China's explanation of its centralized tendering system, but difficulties remain. We hope to have additional exchanges with the Ministry of Health and other appropriate agencies to address a number of lingering questions and concerns.

The nascent U.S.—China Health Care Forum initiative, led by the U.S. Department of Commerce and supported by AdvaMed and other health care partners, holds great promise as another vehicle for addressing many of the trade-related and health policy-related barriers confronting U.S. medical technology firms in China. AdvaMed looks forward to participating in this forum at its inaugural meeting this July.

Conclusion

AdvaMed appreciates the shared commitment by the President and the Congress to expand international trade opportunities and encourage global trade liberalization. We look to the President and his Administration to aggressively combat barriers to trade throughout the globe, including China. The medical technology industry is committed to working with Congress and the Administration on upcoming trade policies and agreements to ensure patients throughout the world have access to medical products

Statement of Richard N. Holwill, Alticor, Inc.

INTRODUCTION

We would like to thank the Chairman and the Committee for this opportunity to participate in this review of U.S.-China Economic relations through a written submission. The topic, U.S.-China economic relations, deserves a thorough and dispassionate review. Yet, much of the rhetoric about this topic is based on incomplete information and is often driven by intense passions. We are submitting our views with the hope that they will provide the committee with a perspective of a company that has faced numerous difficult problems but has, nonetheless, succeeded in China.

Alticor, Inc., is a Michigan-based manufacturer of cosmetics, nutritional supplements, personal and home-care products that sells exclusively through the direct selling channel. Alticor's operating companies include Amway (China) Co., Ltd. (ACCL), with retail sales last year of more than $2 billion. These sales include as much as $800 million in U.S. exports that support thousands of jobs in Michigan and California.

We have strongly supported normalization of trade relations with China and full approval of China's accession into the World Trade Organization. We continue to believe that the WTO provides the rules-based framework needed for the full resolution of the challenges that exist in this relationship. We also believe that some of the proposals being discussed in Congress would grievously undercut the WTO system and, thereby, do more harm than good to U.S. commercial interests. In this paper, we will outline the problems as we see them and will articulate an appropriate response in each case.

Our goal in this paper is to explain that, even amid the most daunting problem area, there are success stories that will serve as models for long-term solutions that are consistent with the WTO rules. The fundamental point is quite simple: If we want China to participate in a rules-based trading system, we must work within those rules to solve problems that develop in the trading relationship. To do otherwise by taking unilateral actions against China or any other trading partner both makes us vulnerable and makes the system less effective.

INTELLECTUAL PROPERTY RIGHTS

Enormous problems are associated with the failure to enforce intellectual property rights. These include counterfeit products, illegally recorded media, misused and degraded trademarks and an overall degradation of brand value. We will not repeat the litany of abuses in this area, as we are certain that others have done so.

Instead, we wish to report to the Committee that Amway China has been extremely successful in protecting its intellectual property rights. Our executives recognized that provincial-level officials were responsible for enforcement of IPR. By courting local officials and by demonstrating that our tax payments contributed significantly to local development, we were able to engage these officials as stakeholders in our success. We further demonstrated that counterfeit products hurt the local tax base as well as our company.

As a direct consequence, ACCL has enjoyed excellent support from authorities, who last year seized millions of dollars worth of counterfeit Amway products and who closed businesses that sold such products or improperly used our trademarks. We believe that other companies can follow the model we have used and, thereby, find willing partners in provincial and local governments who will contribute to improved IPR enforcement.

Having said this, we must also note that some provinces and, in particular, at least one autonomous city government are reported to have been particularly uncooperative with others in the business community in general with regard to IPR protection. We believe that, U.S. government efforts in support of IPR protection will be more effective when officials work with the central government to target localities with the worst IPR enforcement records.

We would also ask that the U.S. government press the Chinese government to establish courts where civil complaints about IPR violations can be heard on an expedited basis. With such courts, companies can seek restraining orders or other forms of injunctive relief aimed at stopping the production of counterfeit products. The government should also create a mechanism to seek damages in cases where IPR violations are proven. We believe that the threat of effective civil action will greatly enhance government enforcement of intellectual property rights.

We urge Congress to provide full funding to the State and Commerce Departments and the U.S. Trade Representative so that they can assist U.S. companies in their effort to protect intellectual property rights, assist the Chinese government in developing better programs to enforce IPR rules and, if the pattern of IPR abuse is not broken, seek redress for damages through WTO procedures.

EXCHANGE RATES

We have watched with interest as many in the manufacturing community and in Congress have focused on China's exchange rate, which is pegged to the U.S. dollar, as the panacea for resolution of those problems that are apparent in the trading relationship with China. At a hearing last year, the President of Alticor, Doug DeVos, offered testimony challenging the conventional wisdom with regard to exchange rates. We said then, and iterate now, that allowing the Chinese renminbi to find its own value in a free market could be a disastrous experiment.

Our concern is driven by the fragility of the Chinese banking system. The legacy of politically driven loans to State Owned Enterprises (SOE's) has not yet been resolved. Because so few of these SOE's are solvent and paying on their loans, several of the major banks rely on Government support to maintain solvency. While China has the reserves to support banks for the time being, doing so indefinitely is a fundamentally unwise policy. Most investors understand this problem and, if given the chance to move assets to a more secure currency, may well do so. Were that to happen, the renminbi would fall in value relative to the U.S. dollar and, thereby, exacerbate not resolve the exchange rate problem.

We must also note that, heretofore, China's purchases of industrial goods and raw materials had left it either in a global trade deficit or with imports and exports nearly balanced. China recorded a trade surplus for the first time earlier this year. There is every reason to believe that this surplus will be systemic. As a consequence, China would be wise to take steps to revalue the renminbi using technical measures short of a full float.

We believe that a realistic valuation can be achieved by pegging the renminbi to a basket of currencies that is representative of trade volumes with its major trading partners, to include the Euro and Yen. The average price of the currencies and percentages in the basket will fluctuate in ways that reflect market forces without exposing the banking system to the disintermediation associated with a flight to value. This type of "technical" float has proven useful in other developing countries and should be tried before exposing the renminbi to market forces that consider factors other than trade flows in determining actual value.

We urge the Congress to reject appeals to a unilateral tariff based upon immediate demands that China allow the market to set the value of its currency. Such appeals are unwise and likely to be counterproductive. We would also encourage the Chinese government to look to alternate mechanisms in determining the value of the renminbi. Finding a safe alternative is as much in China's interest as it is ours. With a proper balance in currency values, China will avoid the trap of distorting its development by artificially subsidizing exports while penalizing imports that will keep the economy both viable and competitive.

CONCLUSION

Congress is correct in seeking to better understand the issues in the U.S.-China economic relationship. It would be wrong, however, to place the blame for the current trade imbalance solely on the policies and actions of the Chinese. While China must do more—particularly with regard to IPR protection and revaluing its currency—Congress should also examine U.S. policies that hinder the competitiveness of U.S. companies in world markets. A list of burdens on U.S. exporters includes:

- The high cost and inefficiency of the U.S. health care system.
- Double taxation on corporate dividends.
- Extra-territorial taxation.
- Excessive product liability damage awards.
- Regulatory requirements that impose costs without commensurate benefits.

Congress could do much to make U.S. companies competitive by identifying and revising U.S. policy issues that hinder business. Blaming China for policy failures in the United States accomplishes nothing at all. At the very least, Congress should avoid making matters worse by taking unilateral actions that are inconsistent with WTO rules, as would be the case with a unilateral tariff imposed on Chinese exports to the United States. Such a move would expose U.S. companies to WTO sanctioned retaliation and, thereby, destroy our growing exports to China, harm U.S. companies that now profit in China and, most severely, damage irreparably our commitment to a rules-based trading system. We are the ultimate beneficiaries of such a system. Congress should move to strengthen that system, not harm it with the imposition of unilateral sanctions on any country.

Statement of Nate Herman, American Apparel & Footwear Association, Arlington, Virgina

Thanks you for providing us this opportunity to submit a statement for the record in connection with this hearing.

The American Apparel & Footwear Association (AAFA) is the national trade association representing apparel and footwear companies, and their suppliers. AAFA members produce, market, distribute and sell clothing and shoes in virtually every country in the world, including China and the United States.

Our comments are structured to offer commentary on the role of China in the post textile and apparel quota world as well as the role of China as a potential consumer market for U.S. footwear and apparel companies. We will then make recommendations on U.S./China trade policy, particularly with respect to China's compliance of its World Trade Organization (WTO) obligations.

Role of China in the Post Quota World

On January 1, 2005, the United States and other WTO member countries discontinued the use of quotas to restrain imports of textile and apparel products from WTO and many non-WTO countries. The end of quotas has generated considerable anxiety among textile and apparel interests worldwide as the prevailing view, reinforced by a number of academic studies and some industry assessments, is that China will become a dominant player in the industry in the coming years. While many developing countries have traditionally viewed quotas as a policy tool to limit their exports to the United States, they have only recently begun to view them as a mechanism that prevented one country from gaining a single dominant share in the marketplace.

We have made no official assessment of how China will perform in the post has quota world. While statistics on some products freed from quotas in the past few years and other anecdotal evidence derived from other industries backs up the view that China will gain an enormous share of the U.S. import market, equally compelling facts show that China will have difficulty assuming this role. Many companies are reluctant to commit additional orders to China because they want to achieve diversity in their sourcing. Companies cite many reasons for retaining business in other countries, including proximity to markets, uncertainties in China, preferential trade arrangements, and pre-existing partnerships with factories.

Much attention has focused recently on the role that China safeguards—negotiated as part of China's accession package to the WTO—can play in the coming 4 years. The United States has already invoked the safeguard on four occasions and has recently self-initiated investigations in three more cases. With all the hype surrounding these cases, it is important to understand several issues relating to the safeguard tool.

First, although many in the textile industry support their aggressive use, safeguards on imports of textile articles from China are not likely to promote textile and apparel manufacturing in the United States. Imports already supply 96 percent of the U.S. apparel market, so quotas on imports from China will merely divert some Chinese made apparel imports to other countries, primarily those in Asia. Moreover, safeguards only restrict the cutting and sewing of Chinese made apparel, and not whether that apparel contains Chinese fabrics. The safeguards may succeed in shifting some apparel operations from China to other countries but those diverted garments may still contain Chinese textiles. At a minimum, safeguards on Chinese apparel do not promote the use of U.S. inputs.

This is a critical point to understand as there is considerable expectation that quotas on China will result in increased business in the United States. Up until the beginning of last month, the United States maintained quotas on hundreds of textile and apparel articles from dozens of countries. Many of these quotas were in place for several decades. During that time, apparel import penetration grew to high levels while U.S. textile and apparel employment fell steadily. If quotas on dozens of countries for 30 years did not help protect the U.S. textile and apparel industry, it is unlikely that quotas on a single country for only 4 years will now accomplish that goal.

Second, the safeguard tool is intended to be used when there is market disruption in the United States that has occurred because of Chinese imports. In other words, it is intended to stop market disruption when the source of that disruption can be traced directly back to China. It is not intended, as some argue, to address real or perceived concerns with the Chinese economy or to encourage Chinese adherence to its WTO obligations. In fact, use of the safeguards as an enforcement tool, without data to show an explicit Chinese role in U.S. market disruption, may cause the WTO to find that the U.S. is violating its own WTO obligations with respect to China.

Third, there is an unintended side effect of quota restraints on China that should be more fully understood by the Commission. Efforts to restrain imports from China, or encourage the Chinese government to impose additional taxes on their textile and apparel exports to the United States, do indeed result in an additional cost. That cost is either borne by the U.S. apparel company or passed on to the U.S. consumer. In either case, that cost represents a transfer of funds from U.S. citizens to the Chinese government. We fail to understand why a policy promoting such a financial transfer is in the best interest of the United States, especially when the quota restraints achieved do not promote U.S. jobs.

Role of China as Consumer Market

With a middle class of over 200 million people and growing, China represents the next great market for U.S.-made and U.S.-branded products. Many of our members, including such well-known household names as Reebok and New Balance, have already blazed the trail for American brands by aggressively pursuing the Chinese consumer. Even so, multiple obstacles abound that restrict the access of U.S. footwear and apparel brands to this lucrative and growing market.

While we applaud the huge strides China has already made in meeting its WTO obligations, China has fallen short in two important areas that directly affect both our footwear and apparel members.

First, China continues to delay the issuing of regulations providing foreign firms distribution rights in the Chinese marketplace. In addition, the regulations issued to date allowing foreign firms trading rights in China are vague in many key aspects. As a result, our members must comply with a myriad of often conflicting regulations that can vary from region to region and forces them to enlist a Chinese partner in order to sell their products in China. More importantly, without rules on distribution rights, our members are unable to sell their product in the Chinese market *even if the product is made in China in Chinese factories.* For example, with over 98 percent of the shoes sold in the United States being imported, U.S. footwear firms produce a significant percentage of shoes in China to serve not only the U.S. market but also many other countries around the world. Despite the fact China accounts for over half of the shoes produced worldwide, U.S. footwear firms currently cannot sell the shoes they make in China to the Chinese market. Under current rules, these firms are required to export the shoes out of China and then re-import them back into the country. Until China issues and then enforces a single and simple set of clear and transparent rules granting foreign firms distribution rights, U.S. footwear and apparel brands and the U.S. workers they employ in marketing, distribution, and research & development will continue to lose out on one of the biggest consumer markets in the world.

Second, the scourge of counterfeiting continues to run rampant in China, with knock-offs of well-known U.S. footwear and apparel brands sold in markets in virtually every Chinese city and town. Even if U.S. footwear and apparel firms are granted full distribution rights, they will have to compete against these inferior knock-offs that dramatically undercut U.S. brands. Not only are these products priced well-below actual market value, but the low-quality of the counterfeit products also tarnish the hard-earned reputation of U.S. brands.

Again, China has made significant progress in Intellectual Property Rights (IPR) enforcement. However, by all accounts, the most recent rules promulgated by China fall well short of what is needed to ensure that the intellectual property rights of U.S. footwear and apparel firms are protected. Among other problems, the new rules lack the criminal penalties needed to deter counterfeiting.

As you know, many of these same counterfeit products end up on the streets of U.S. cities, hurting U.S. footwear and apparel brands in their own home market. We believe concrete steps, such as those proposed in new bi-partisan legislation introduced at the beginning of this Congress, are needed to punish those in the United States that attempt to benefit from Chinese counterfeiting. The Stop Counterfeiting in Manufactured Goods Act, introduced by U.S. Representative Joe Knollenberg (R–MI), requires the mandatory destruction of equipment used to manufacture and package counterfeit goods. In addition, it addresses methods that counterfeiters have used to evade prosecution, such as the selling of patch sets or medallions that can later be attached to generic merchandise and given the appearance of a genuine product.As the Committee moves forward with its deliberations, we would make several policy recommendations.

First, to the extent that Congress wishes to discourage sourcing in China, there are several policy options that are far more effective than the imposition of additional quotas. Swift implementation of new trade agreements with Central America, such as the U.S./Central America Free-Dominican Republic Trade Agreement (CAFTA), would promote more imports from a region with a demonstrated capability and supply chain that favors U.S. textiles and yarns. This, in turn, would promote more U.S. textile jobs. Similarly, enactment of programs, such as that proposed in the Tariff Relief Assistance Development Act of 2005 (S. 191), which would eliminate tariffs on countries like Bangladesh, Cambodia, and Sri Lanka, would promote sourcing in poor, developing countries that are highly dependent upon textiles and apparel for employment and foreign exchange revenues.

Second, we encourage the Committee to focus on those areas of China's WTO commitments where more progress can be made and where there are demonstrated U.S. commercial interests at stake. From our perspective, we believe greater attention to intellectual property rights (in particular preventing counterfeiting of trademarks or trademarked goods), distribution rights, and market access can promote greater use of U.S. exports or U.S. branded products in China while reducing revenue loss to U.S. intellectual property holders.

We also support resolution of the currency issue, primarily to induce more certainty into the relationship. Some of our apparel members and many of our footwear members are very dependent on China, both to import inputs that are used for U.S. assembly as well as finished products that are sold throughout the United States. Sudden shifts in the currency value would disrupt supply chains in a way that would ultimately harm U.S. interests. Likewise, imposition of additional taxes on imports from China, such as recent Congressional proposals, only raise emotions and uncertainty without making a positive contribution to the bilateral economic policy debate.

Third, we believe the China safeguards should only be invoked where the data shows a precise cause and effect between U.S. market disruption and imports from China. We understand the EU is viewing these safeguards as a "last resort" and only when the "measures are fully justified." We would encourage a policy that is more in line with this thinking so that safeguard policy not act as a disruption to the broader commercial relationship. Above all, we believe safeguard policy should be part of a transparent process that leads to predictable, fact-based outcomes.

In conclusion, we are mindful that many in our industry, and many around the country, are concerned over the role that China will play in the coming years. At the same time, we know that many in our industry view China as an important strategic partner. While many disagree over whether China is more a challenge or an opportunity, most agree that the way forward involves a predictable and comprehensive approach that is based on rules and not political imperatives.

Thank you.

Statement of Robert Stallman, American Farm Bureau Federation

The American Farm Bureau Federation (AFBF) appreciates the interest of the House Committee on Ways & Means in the U.S./China economic relationship, and is pleased to submit the following comments for inclusion in the hearing record. As the nation's largest organization of farmers and ranchers, Farm Bureau members are directly affected by both farm product exports to China and farm product imports from China.

FBF has trade and economic concerns with China. Nevertheless, AFBF has also found the Chinese to generally be constructive trading partners. This is important because U.S. agriculture:

- is increasingly dependent on foreign trade for economic prosperity;
- looks to developing nation markets as the best opportunity for future export growth; and,
- particularly looks to growing markets in the Asia-Pacific region, especially China, as the area where growth in both income and population will offer the greatest opportunities for economic success.

Unlike many other U.S. economic sectors, the agricultural products sector enjoys a rapidly growing annual trade surplus with China of more than $4.7 billion,[1] an increase of 216 percent in 5 years. Since 1998, the U.S. has registered dramatic gains in exports (by value) of soybeans, cotton, wheat, hides and skins and consumer-oriented products such as dairy products and processed fruits and vegetables. In 2004 alone, the total value of U.S. agricultural exports to China grew over the previous year by more than 94 percent to $6.45 billion. China is now the fourth largest market for U.S. agricultural products, exceeded only by North America and Japan.

Since 2000, the value of agricultural imports from China has grown at a slower rate of 88 percent during the period, starting from a much smaller value base. China has made gains into the U.S. market for intermediate and consumer-oriented products such as feeds and fodder, fresh and processed fruits and vegetables including juices and miscellaneous high-value products.

To U.S. agriculture overall, China is a great economic opportunity. In some agricultural sub-sectors however, it is a substantial economic threat.

China is a dominant world producer of many agricultural products that have export potential, including corn, vegetables, fruits and nuts, soybean meal, pork, sugar and confections, food ingredients and rice. U.S. producers of horticulture and specialty crops are concerned about the direct negative impacts that Chinese fruits and vegetables are likely to have when they are approved for entry into the U.S. market. The direct negative impacts are expected to be both in the form of extreme price competitiveness (imported at price levels below the U.S. cost of production) and increased exposure to the introduction and subsequent control of new pests and diseases, which can be very costly.

Additional threats by China to U.S. agriculture result indirectly from increasing competition in third country markets in which China is or has established preferential or free trade agreements, especially with several important customers of U.S. agricultural products in the Asia-Pacific region, including Japan, Korea, Taiwan and the ASEAN countries. Recent reports indicate in fact, that traditional sales of U.S. corn to South Korea have declined as South Korean purchases of corn from China have substantially increased.

SPECIFIC ISSUES THAT NEED CLOSE ATTENTION

For U.S. agriculture, the economic issues with China are predominately trade oriented. China has made considerable progress in trade liberalization, including its WTO agriculture commitments. It still has some distance to go to be fully consistent with its WTO obligations but we recognize that it will take time. As long as good and meaningful progress is being made AFBF is satisfied to let that progress continue.

There are some economic issues that do need more immediate, more aggressive intervention because they are beginning to have meaningful, negative and often times unfair repercussions to the U.S. economy.

Monetary Policy

Several have made the point regarding China's peg of its currency to the U.S. dollar. AFBF feels strongly that China should become the full-fledged member of the global economy that they seek to be. However, part of the cost of that membership is exposing their currency to market forces. AFBF supports the Administration's efforts to send the strongest possible signals to China that it needs to take this step soon. This transition should be done in a reasonable manner, but it should be done nonetheless. The Chinese economy is strong enough and it certainly has the monetary reserves to make this transition. China should lay out a transparent process and initiate this transition soon.

If it is determined that China's management of its monetary policy has the effect of providing a WTO-inconsistent government subsidy that unfairly benefits Chinese product imports into the U.S. market, AFBF would support the imposition of import duties on Chinese products. AFBF policy is clearly opposed to the arbitrary imposition of import duties that are not based on the outcome of a competent, procedural and WTO-consistent examination of the issues.

Export Subsidies

The use of WTO-inconsistent export subsidies by Chinese officials continues and has been expanded by provincial governments. The practice of exempting corn, produced in China but destined for export markets, from the requirement to pay value-added tax (VAT), while applying the VAT to Chinese corn consumed domestically,

[1] U.S. Bureau of Census Trade Data / USDA–FAS BICO, CY2004

is clearly a subsidy to exported corn that competes against corn produced and exported by the United States, and the subsidy may be getting larger. The VAT rate on imported corn remains 13 percent but the base value on which the VAT is calculated is established by the government, not by the market. Because Chinese corn production in 2005 is forecast to be larger than total domestic demand, corn traders believe China is expected to increase the base value of corn from Y860 (U.S. $104) per ton to Y1100 (U.S.$133) per ton and then rebate the 13 percent VAT on the larger base value (approx. U.S.$3.77 more per ton).

The reduction of U.S. and other countries' corn sales to South Korea, while Chinese corn sales to that same country correspondingly increase, is good evidence that China has increased the use of export subsidies to sell its excess production in 2005.

Moreover, application of the VAT on corn imported by private firms, while at the same time exempting state enterprises from paying the VAT on imported corn, discriminates against the private enterprises and their suppliers.

Other Market Access Barriers

U.S. agricultural exports to China have increased substantially in part because China has reduced many barriers to its market including a reduction of tariff levels, bringing sanitary and phytosanitary procedures into greater consistency with its WTO obligations, and educating its officials about the procedures needed to be a member in good standing of the WTO.

That said, China still maintains non-tariff barriers that inhibit further imports of many U.S. agricultural products. The most obvious of these is the manner in which China imposes additional, seemingly arbitrary requirements on import shipments. The actions are applied without prior notice and lack geographic consistency, they fail to allow transition periods sufficient for trading partners to implement compliance measures and they result in expensive delays in the issuance of permits for quarantine inspections. The administration of AQSIQ (Administration of Quality Supervision, Inspection and Quaratine) Decree 73 on U.S. soybeans is but one instance where trade is easily restricted by the Chinese under the guise of phytosanitary protection.

Application of U.S. Import Relief Statutes to Non Market Economics (NME)

The failure of U.S. import relief statutes to aid the U.S. apple industry in competing with imports of apple juice concentrate from China is a major reason why such statutes must be amended to apply to non-market economies such as China. The effort by U.S. apple producers to reasonably compete in their domestic market, and in the process preserve their entire pricing structure, was defeated by a procedural matter even after the U.S. Department of Commerce and the International Trade Commission confirmed the existence of product dumping and material injury.

Rep. Philip English of Pennsylvania has introduced H.R. 1216, a bill to extend countervailing duty provisions of the Tariff Act 1930 to non-market economy countries. The ability of U.S. apple producers and processors to base their unfair trade complaint on the presence of a government subsidy could have been very helpful in being awarded relief, rather than grief. AFBF believes that public debate on the merits of H.R. 1216 is warranted and encourages the full Committee to hold hearings on the bill for the purpose of facilitating that debate.

Import Duty Bonding Privileges by New Shippers

Another issue of considerable concern to AFBF is the failure of U.S. law and administrative practice to prevent Chinese firms from escaping their obligation(s) to pay import duties on products that have been assigned such duties subsequent to antidumping investigations. Existing U.S. law and administrative practice of the U.S. Customs & Border Patrol allow importers to post bonds in lieu of cash deposits for duties that must be paid on imports while the Commerce Department conducts a New Shipper Review, which is required of new exporters to the United States if the products exported are subject to an antidumping order.

Too often, Chinese firms have evaded the proper payment of duties by posting a bond for the duties owed and shipping product to the U.S. subsequent to that bond. During this time, the Commerce Department is undertaking its aforementioned New Shipper Review. After the review is completed (up to 12 months after imports first appear on U.S. shores), the Commerce Department attempts to contact the new exporter to collect duties owed only to find that it has vanished. In its place is a new exporter that, because it is new, must itself go through the New Shipper Review process. In the meantime, efforts to collect duties owed from the bond posted by the previous but now vanished exporter are met with resistance, even litigation, by the issuing surety company. The result is that millions of dollars of import duties are not paid, Chinese exporters maintain their illegal competitive advantage over

U.S. companies, and U.S. firms lose faith and confidence in the ability of their government to protect the principles of “fair” trade.

Rep. Charles Pickering of Mississippi has introduced H.R. 1039 as a temporary remedy to this problem. AFBF supports the bill and urges the Committee and Congress to enact the bill into law as quickly as possible.

Thank you for the opportunity to provide comments to the Committee. Again, AFBF thanks the Committee for its interest in and leadership on this very important topic.

Statement of Donna Harman, American Forest & Paper Association

The American Forest & Paper Association (AF&PA) appreciates this opportunity to present the forest and paper products industry’s views regarding United States-China Economic Relations & China’s Role in the World Economy. AF&PA is the national trade association of the forest, pulp, paper, paperboard and wood products industry. The forest and paper products industry accounts for more than 7 percent of total U.S. manufacturing output and ranks among the top ten manufacturing employers in 42 states. The more than 200 companies and related associations AF&PA represents have a strong interest in making sure that commitments made by China are met from the outset to establish a solid basis for the continued growth of business and economic opportunities.

AF&PA was a strong supporter of Permanent Normal Trade Relations for China, and of China’s accession to the WTO. Our industry’s support was based on the prospect that China’s rapid economic growth would generate strong demand for U.S. exports of paper and wood products. At the same time, we recognized that the expectation of market opportunities could only be achieved if China implements commitments to open up its market and removes trade barriers—which were a condition of its accession to the WTO.

While China has made progress toward becoming a market economy, the Chinese government has been employing an array of industrial policy tools to grow its manufacturing capacity and become a top supplier of manufactured products to the world. In the forest products sector, this has resulted in the rapid expansion of China’s paper and wood production. Consequently, there has been a substantial drop in market opportunities for U.S. manufacturers and rapid growth in China’s exports of paper and wood products. This is particularly troubling since China doesn’t have the large fiber resource base needed for a competitive forest products industry, and is almost wholly dependent on imported fiber in the form of logs and other wood products, wood pulp and recovered paper.

FORESTS PRODUCTS TRADE WITH CHINA

U.S. exports to China of paper and paperboard reached $491 million in 2004, up from $328 million in 2001. While this is a healthy increase and reflects China’s rising paper and paperboard consumption and overall reduction in tariffs, the longer term prognosis is not positive as China’s production capacity is rising at a rapid pace and is displacing imports in key paper and paperboard grades. Over the same time period, U.S. paper and paperboard imports from China more than doubled, from $635 million to $1.3 billion last year.

To supply China’s massive paper and paperboard capacity growth, Chinese producers have had to turn to foreign supplies to meet their fiber needs. The results have been skyrocketing demand for imported wood pulp and recovered paper. In particular, the U.S. has become the main source of China’s recovered paper imports, affecting the U.S. market for certain recovered paper grades. U.S. recovered paper exports to China rose from just 1 million metric tons in 1998 to 5.9 million metric tons in 2004, representing 13 percent of total U.S. paper recovery.

China is a major market for U.S. wood products, particularly for hardwoods used domestically in architectural applications and flooring. U.S. hardwoods are also used for furniture, picture frames and other manufactured wood articles exported back to the U.S., and to Europe and other markets. As it currently stands, China is now the fourth largest importer of all wood products; the largest importer of logs and the world’s second largest plywood producer, behind the United States. U.S. wood product exports to China rose from $140 million in 2001 to $378 million in 2004. The U.S. is the fourth largest supplier of wood products to China, behind Russia, Malaysia and Indonesia.

SUBSIDIES

China's domestic forest products industry faces a large fiber supply gap due to insufficient domestic forest resources and strong growth in demand for wood, pulp and paper to fuel both the domestic market and exports. To assist the domestic industry, the Chinese government has implemented a number of policy measures aimed at better balancing China's fiber supply with domestic fiber demand over the long-term as well as reducing dependence on imported processed wood and paper products.

With a stated objective of encouraging domestic investment and expansion in value-added forest products processing industries, China has expanded its production capabilities in many valued-added paper and wood processing enterprises. Many of the measures used to achieve this rapid industry development include certain subsidy related measures that may be in violation of WTO rules. In particular:

- Using the tariff structure to encourage imports of raw materials versus finished products (tariffs on pulp, logs and lumber reduced to zero);
- Protecting domestic producers via various non-tariff and product standard barriers and anti-dumping investigations (newsprint-1998, coated art paper—2002, kraft linerboard-2004);
- Policy loans, subsides, and preferential tax polices for domestic enterprises to invest in forest resources, processing operations, and capacity expansions;
- Expanding border trade value-added tax (VAT) provisions to allow for large increases in low cost wood imports;
- Active government and banking sector involvement in financing, including subsidies and/or low interest loans and debt forgiveness or extension of repayment terms.

Last year, AF&PA completed the study *"China's Subsidization of its Forest Products Industry"*, which examines and documents the various financial, trade and policy measures that the Chinese government is using to build its pulp, paper and wood processing industries and supporting fiber resources. The study found that the Chinese government is employing an array of industrial policy tools—especially subsidies—to prop up state-owned enterprises, promote the introduction of new technology, and build new production capacity. Some key findings from the study:

- $1.67 billion in government financing and loan interest subsidies were granted for technology renovations of 21 state-owned papermills from 1998 to 2002.
- Policy banks such as the China Development Bank and the Agriculture Bank of China are providing companies in the forest products sector with low interest loans or loans with unusually long repayment terms.
- At the provincial and municipal levels, banks are engaged in non-standard lending and other practices to attract foreign investment, including debt forgiveness and debt-for-equity swaps, extended loan repayment terms and preferential loan interest rates.
- The Ministry of Finance has designated $1.73 billion for the development of fast-growth-high-yield plantations by 2015.

AF&PA has consulted with USTR and the Department of Commerce on these findings. Last fall, the U.S. submitted a series of questions to China in the WTO regarding China's subsidy practices, including subsidies to the forest products sector. The Chinese government committed to respond to the U.S. questions regarding its subsidy practices by the end of 2005.

While USTR has expressed concerns over China's subsidies practices in the WTO, U.S. industries have not been able to resort to the use of countervailing duty (CVD) law to such subsidy practices. Since 1984, the U.S. Commerce Department has not applied CVD law to non—market economies (NMEs) such as China, even though the WTO does not prohibit the application of CVD law to NMEs. AF&PA, and a large group of U.S. industries, supports H.R. 1216 and S. 593 to clarify the intent of Congress by expressly providing for the application of CVD provisions to China and other NMEs.

CURRENCY MANIPULATION

Under its WTO accession agreement, China committed to open up its market across the board by reducing tariffs and other impediments to trade. However, China effectively has nullified this commitment by engaging in protracted large-scale buildup of foreign exchange in order to keep its currency, the Yuan, at a fixed exchange rate of 8.28 Yuan to the U.S. Dollar for the past 10 years. This exchange rate level is significantly weaker than the Yuan would be otherwise based on international market forces alone. Many economists estimate that China's currency is undervalued by some 40 percent. As a result, U.S. exporters of forest and paper products, as well as other U.S. exporters, have been at a significant competitive disadvantage when doing business in the Chinese market or when competing in the U.S. or third country markets against Chinese products.

The effect of the significant undervaluation of the Yuan has impacted more than just the trade balance. China's accumulation of dollar reserves means that for every dollar the Central Bank of China purchases it is creating 8.28 new Yuan. As a result, China's money supply is growing at a rapid pace, providing a large source of cheap funds for investment in massive manufacturing capacity including in the paper and wood sectors.

Government manipulation of exchange rates for the purpose of gaining a competitive advantage for local industry can substantially offset the balance of benefits U.S. trade negotiators achieve in any trade agreement. The General Agreement on Tariffs and Trade (GATT) Article XV, now incorporated within the WTO, addresses Exchange Arrangements and stipulates that members should not take exchange rate actions which "frustrate the intent of the provisions of this Agreement", namely, negotiated reduction of tariffs and other barriers to trade. For this reason, AF&PA urges the Administration to initiate formal negotiations on an expedited basis for the purpose of ending China's currency manipulation.

ANTIDUMPING PROCEEDINGS

China has used antidumping investigations to protect inefficient producers and to reduce import competition for new manufacturing capacity. On March 31, 2004, China initiated an antidumping investigation against U.S. unbleached kraft linerboard—the raw material used in the manufacture of corrugated shipping containers. If China proceeds to impose antidumping duties on U.S. kraft linerboard, it would severely impact more than $115 million in U.S. exports to that country.

This is the third Chinese antidumping investigation against U.S. paper products in the past 6 years and follows a pattern where such investigations are launched against imports of paper products that are experiencing significant growth in domestic manufacturing capacity. Indeed, in this case there is no evidence that the domestic Chinese linerboard producers identified in the petition are in any way injured. Based on publicly available information, all the identified producers are profitable, have ready access to capital, are expanding rapidly, and increasing market share. It would be especially egregious should China stop imports of U.S. kraft linerboard that is primarily used to package China's massive exports to the United States that have resulted in the U.S. bilateral trade deficit with China which exceeded a record $160 billion last year.

While a preliminary determination is still pending more than 1 year after the initiation of the investigation, AF&PA would like to highlight two particular issues:

- Errors in the Scope of the Investigation: The specific Harmonized System (HS) codes identified in the official scope of the investigation conflict with the written description of the product subject to the investigation in several significant respects. Specifically, the scope of the investigation identifies several HS categories that describe products that are not within the scope of the investigation and excludes the proper HS category for kraft linerboard. AF&PA is concerned that these errors will result in the use of inaccurate import data by the Chinese authorities and also could result in duties being imposed on products not subject to the investigation. China's Ministry of Commerce (MOFCOM) must correct the HS codes that are inconsistent with the written description of the scope of the investigation and adjust the statistical data used in the investigation accordingly.
- Inadequate Access to Information: The Investigation Bureau of Industry Injury (IBII) did not make available to the U.S. industry copies of the questionnaire responses of the Chinese industry for more than a month after the due date for questionnaire responses. This lack of timely access to information is impairing the ability of the U.S. industry to present fully its arguments against imposition of antidumping duties and is inconsistent with China's obligations under the WTO Antidumping Agreement. That Agreement specifically requires that "evidence presented in writing by one interested party shall be available promptly to other interested parties participating in the investigation" (Art. 6.1.2) and "the authorities shall whenever practicable provide timely opportunities for all interested parties to see all information that is relevant to the presentation of their cases" (Art. 6.4).

ILLEGAL LOGGING/SMUGGLING

Of growing concern is the amount of illegally harvested timber that may be entering the China market. International environmental agencies have documented significant discrepancies between China's import statistics and the export statistics of some of China's wood trading partners, particularly in border areas with Myanmar and Russia. Illegal logging affects not just the health of the forest in particularly sensitive regions, but also undermines public acceptance of commerce in legally harvested and traded forest products. U.S. trade opportunities in China are directly affected by the abundance of inexpensive, illegally harvested timber. Points raised in a study recently commissioned by AF&PA, *Illegal Logging and Global Wood Markets: The Competitive Impact on the U.S. Wood Products Industry (November 2004)* include:

- China is a price sensitive wood market where an exploding demand is fueling wood imports, much from countries without strong environmental or forest management controls.
- Despite a logging ban and other cutting restrictions which have led to a significant decline in Chinese timber harvests, unauthorized timber harvesting continues to be a problem.
- It is estimated that 40% of Russian log imports entering China are suspicious (potentially illegal) because of excess cutting, harvesting without authorization or as undocumented/unreported exports. Imported Russian lumber is also suspicious (manufactured from illegal logs).
- The impact of illegal wood in China extends to Chinese exports, for example plywood or wooden furniture, made with illegal tropical hardwoods from Africa and SE Asia.

Compounding the problem is that illegally logged wood is frequently smuggled into mainland China in an effort to avoid the 17% VAT, or is sent to a third country where it is processed and then re-exported to China. The smuggling activity is putting U.S. exporters at a competitive price disadvantage. Progress is being made in shutting down smuggling operations, but concern still exists over the presence of illegally logged wood in the marketplace.

CONCLUSION

AF&PA agrees with the Administration that China has made important strides in meeting its WTO obligations. However, the benefits of the economic relationship with China have been largely one sided, with China continuing to maintain a range of industrial policies that significantly reduce export opportunities for U.S. industry and give Chinese producers an unfair advantage in the U.S. and third country markets. The Administration needs to address the critical issues of subsidies, currency manipulation, and illegal logging in both bilateral negotiations with China and in the WTO, as appropriate. AF&PA believes the Congress can take action in the short-term by passing H.R. 1216 and S. 593 to clarify the intent of Congress by expressly providing for the application of CVD provisions to China and other NMEs. In addition, we urge the Congress to consider other WTO compliant measures that would to encourage swift action on the part of the Chinese government to revalue their currency.

AF&PA appreciates this opportunity to provide comments on this issue. Please do not hesitate to contact us for further information regarding this submission.

Statement of Shane Downey, American Foundry Society

The American Foundry Society ("AFS") submits these comments for the record of the April 14, 2005 hearing. The AFS regrets that time limitations did not permit the Committee to hear from AFS witnesses in person, but hopes that these written comments will help the Committee's understanding of serious problems faced by the U.S. foundry industry because of China's trade and economic policies.

Overview of the U.S. Foundry Industry

Foundry products encompass all cast products that are formed by pouring molten metal into molds or dies and allowing the metal to solidify. The terms "castings" and "foundry products" are used interchangeably. The products manufactured by foundries are typically divided into several categories, based on the type of metal that is cast (*i.e.*, iron, steel, aluminum, copper, and other non-ferrous metals). Most foundries work only with one type of metal.

Castings are used in a wide variety of applications, the three larges of which are automotive; machinery and equipment; and other transportation equipment. Other applications include piping systems (pipe, valves, fittings) and construction and municipal applications.

The foundry industry is critical to the manufacturing sector. Indeed, about 90 percent of all U.S.-manufactured goods contain some type of cast product.

The future of the U.S. foundry industry, however, is being severely threatened by low-priced imports, primarily imports from China. Imports have become a large and growing share of the U.S. market for foundry products. Increasing imports have displaced U.S. sales by domestic foundries in two key ways: first, imports of foundry products take sales directly from the domestic industry, as purchasers such as automotive original equipment manufacturers ("OEMs") have increased their foreign sourcing of foundry-made parts. Second, further-manufactured good or finished goods that contain foreign-made castings (such as imports of finished construction equipment) are increasingly being imported. Thus, imports directly take sales away from domestic foundries and indirectly supplant domestic castings in finished products; both have caused a reduction in demand for foundry products within the United States market.

A few statistics highlight the foundry industry's decline. In 1984, the U.S. industry was comprised of 3,400 foundries; in 2004, there were just 2,380—a loss of more than one thousand businesses, and a percentage contraction of almost 30 percent. Over 50 foundries have been lost every year for the past 20 years.

These closures have a devastating impact on communities across this country. Traditionally, and corresponding to the great diversity of products made by this industry, the U.S. foundry products industry has been made up of a large number of relatively small companies: 80 percent of U.S. foundries have fewer than 100 employees. With foundry companies being located in every state of the Union, plant closures have been felt across the United States.

China's Policies and How They Affect U.S.-China Trade

Of all current sources of castings imports, China is by far of the greatest concern to U.S. foundries. Not only is there a huge and virtually limitless capacity in China for castings products, with prices that undercut all other foreign sources as well as U.S. prices, but China appears to provide a number of subsidy programs that are contingent upon exports. Other Chinese subsidy programs are contingent on the use of domestic over imported goods in the manufacturing process.

The Office of the U.S. Trade Representative's 2005 report on trade barriers, an excerpt of which is attached here, provides more detail on the suspected subsidies and also expresses frustration from lack of transparency about Chinese programs and China's continued failure to make any of the subsidy notifications that have been required of China since it became a member of the World Trade Organization 3 years ago. (Only in November 2004 did China indicate that it would submit a subsidies notification during 2005.)

It is ironic, moreover, that Chinese foundries enjoy unimpeded access to the U.S. market while U.S. foundries trying to do business in China are faced with substantial barriers. For example, a U.S. bronze foundry company, Bronze Craft, has been trying to establish a foundry in China to serve the Chinese market. It has been informed by its broker that if it plans to manufacture and sell its products in China it will have a 17 percent tax levied on its products—but if it were to manufacture in China and export its products, it would be given a preferential tax deferral of 17 percent. This is, sadly, a fairly common example of what U.S.-China trade is like today: American manufacturers are welcome to set up plants in China, provide jobs to Chinese workers and purchase Chinese inputs to make those goods, but can't expect to sell there. The only economic incentive for setting up a plant in China is to send the goods back to markets like ours.

What Can be Done to Help the U.S. Foundry Industry

The U.S. foundry industry is facing a bleak future, but if Congress and the Administration act soon, this industry may be able to survive.

When China joined the WTO, it agreed to certain conditions that were designed to protect U.S. industries against surges of imports that were injuring them. The safeguard mechanism was codified in section 421 of the Trade Agreements Act 1974, as amended. Although the Administration has said that it is committed "to maintaining the integrity of section 421 as a viable and useful trade mechanism",[1] the President's actions, unfortunately, directly contradict this. Not one of the section 421 cases that has gone to the President with recommendations for relief from the U.S. International Trade Commission has resulted in the President giving any relief. Given the results of the 421 cases to date, it is not likely that any industry or U.S. producer will seek a remedy under section 421; and even if one were willing

[1] Testimony of Deputy United States Trade Representative Peter F. Allgeier before the House Appropriations Committee on Commerce, Justice, State, and the Judiciary and Related Agencies (May 22, 2003).

to commit to the significant resources needed to pursue a 421 remedy, this Administration's record to date gives little hope of a successful result.

As mentioned, the President has not provided relief in any section 421 case to date, and we believe this is because there are several problems with the Administration's approach to the statute. To give U.S. manufacturers a fair shot at getting the relief they deserve, we ask that the Committee consider the following changes to section 421:

The President amd/or Office of the U.S. Trade Representative should be prohibited from revisiting facts found, or conclusions drawn by the fact-finder in section 421 investigations (*i.e.,* the ITC). The ITC receives reams of briefs and data (including confidential submissions) and holds public hearings in which all parties can be questioned under oath and respond to all arguments raised. The Commission issues a report and opinion that addresses each of the issues raised by the contending parties. Recognizing that the Commission would engage in a fair and exhaustive process, Congress indicated in the legislative history to section 421 that the ITC findings be given great weight by the President. Unfortunately, the interagency process that has been established under section 421 has resulted in staff essentially reviewing and revisiting factual determinations made by the ITC. Indeed, it appears that the interagency staff acts like an appellate body, second-guessing the determinations of the six presidentially appointed members of the Commission. AFS does not think that this is what Congress intended, or is the best process otherwise.

This approach certainly violates the congressional intent that the ITC's findings be given great weight by the President: the legislative history to section 421 explains that Congress created a presumption in favor of the President giving relief when the ITC made an affirmative finding of market disruption. Moreover, Congress said that presumption could be overcome only if the President finds that providing relief would have an adverse impact on the United States economy "clearly greater than the benefits of such action, or, in extraordinary cases, that such action would cause serious harm to the national security of the United States." H.R. Rep. No. 106–632 at 18 (2000), *reprinted in* 2000 U.S.C.C.A.N. 727, 737. This standard makes sense: the President is to accept the ITC's determination *unless* there are broad domestic or international reasons not to do so. Disagreement with a factual determination does not rise to this standard.

The President should be prohibited from using certain justifications to deny relief. For example, one of the reasons given by the President in denying relief to U.S. industries under section 421 has been that the proposed relief would be ineffective, given the presence of third-country imports in the United States that could increase following a decline in Chinese imports. This justification should not be permissible for denying relief for at least two reasons. First, relief under section 421 does not necessarily have to cause a decline in imports from China: it could have the effect of encouraging a rise in prices to a reasonable level at which U.S. goods could compete. And, because Chinese imports tend to be the lowest-priced goods in the market among all imports, an increase in the prices of Chinese goods often leads to an increase in other imports' prices, so it is also unlikely that third-country imports will displace Chinese imports. Second, it would be a rare instance, if ever, in which imports from other countries are not in the U.S. market at the same time as Chinese imports are in the market, so using this as a reason to deny relief ensures that there will never be a case in which the President would afford relief.

The President should also not be allowed to deny relief through the use of piecemeal aspects of the ITC's record. The President has, for example, said that relief was not justified because the ITC's econometric model known as "COMPAS" did not support it. The COMPAS model, first, is controversial because it can have greatly varying (and unreliable) results depending upon the nature of the databases to which it is applied, and its utility has, thus, not been proven across the wide variety of industries and cases in which it has been applied. Second, even when working with optimum data conditions, COMPAS addresses only the first year of potential relief under section 421. Because it will always take a certain amount of time for any program of relief to begin to work and more time for relief to become effective, any assessment of whether relief should be given based only on the first year following implementation would always or virtually always lead to a negative result. Not only should COMPAS model results not be allowed to deny relief, but the President should not be allowed to pick and choose from the ITC's record those parts he chooses to justify his decision. Congress intended for the President to consider the ITC's findings as a whole, not individual aspects that may suit a different outcome.

China and the United States each agreed to the section 421 safeguard mechanism as part of China's accession to the WTO. U.S. industry needs a workable, effective mechanism, not one that appears never to be used to give relief when needed. As the Committee considers our trade with China, AFS urges you to modify—and make usable—the section 421 process.

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quasi-governmental industry associations formed to take the place of the ministries that governed production during the earlier central planning era. Foreign investors report that the industry associations are using the power to issue export licenses to force companies to participate in association-supported activities. For example, the steel producers' industry association will not issue an export license to any company that does not contribute to its antidumping defense funds., as the January 1, 2005 deadline for removal of global textile quotas drew near, China announced plans to impose export duties on certain In categories of textile and apparel products. Details of this plan are still unclear but appear to represent an effort by China to manage the export growth of these products in response to concerns from China's trading partners.

Export Subsidies

China officially abolished subsidies in the form of direct budgetary outlays for exports of industrial goods on January 1, 1991. China agreed to eliminate all subsidies prohibited under Article 3 of the WTO Agreement on Subsidies and Countervailing Measures, including all forms of export subsidies on industrial and agricultural goods, upon its accession to the WTO in December 2001.

A general lack of transparency makes it difficult to identify and quantify possible export subsidies provided by the Chinese government. China's subsidy programs are often the result of internal administrative measures and are not publicized. Many of the subsidies take the form of income tax reductions or exemptions that are *de-jure* or *de facto* contingent on export performance. They can also take a variety of other forms, including mechanisms such as credit allocations, low-interest loans, debt forgiveness and reduction of freight charges. U.S. industry has alleged that subsidization is a key reason that Chinese exports are undercutting prices in the United States and gaining market share. Of particular concern are China's practices in the textiles industry as well as in the steel, petrochemical, high technology, forestry and paper products, machinery and copper and other non-ferrous metals industries.

U.S. subsidy experts are currently seeking more information about several Chinese programs and policies that may confer export subsidies. Their efforts have been frustrated in part because China has failed to make any of its required subsidy notifications since becoming a member of the WTO three years ago. At a meeting of the WTO's Council for Trade in Goods in November 2004, China committed to submit its long-overdue subsidies notification in 2005.

Since shortly after China acceded to the WTO, U.S. corn exporters have been concerned that China provides export subsidies on corn. In 2002 and 2003, it appeared that significant quantities of corn had been exported from China, including corn from Chinese government stocks, at prices that may have been 15 to 20 percent below domestic prices in China. As a result, U.S. corn exporters were losing market share for corn in their traditional Asian markets, such as South Korea and Malaysia, while China was exporting record amounts of corn. In 2004, however, trade analysts began to conclude that, because of several economic factors, including changes in the relationship between domestic prices and world prices, China is now trending toward becoming a net importer of corn.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

While China has made significant progress in its efforts to make its framework of laws, regulations and implementing rules WTO-consistent, serious problems remain, particularly with China's enforcement of intellectual property rights. Throughout 2004, the United States placed the highest priority on the need for improvements in China's enforcement efforts, as counterfeiting and piracy in China are at epidemic levels and cause serious economic harm to U.S. businesses in virtually every sector of the economy. In April 2004, in response to concerns raised by the United States, China's Vice Premier Wu Yi presented an "action plan" to address the IPR problem in China. Intended to "substantially reduce IPR infringement," this action plan calls for improved legal measures to facilitate increased criminal prosecution of IPR violations, increased enforcement activities and a national education campaign. The United States is monitoring implementation of this action plan closely and will conduct an out-of-cycle review in early 2005 under the Special 301 provisions of U.S. trade law to assess China's implementation of its IPR commitments. The United States will take whatever action is necessary at the conclusion of the out-of-cycle review to ensure that China develops and implements an effective system for IPR enforcement, as required by the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement). Supplementing these efforts is the Strategy Targeting Organized Piracy (STOP!), a U.S. Government-wide initiative begun in October 2004 to empower U.S. businesses to secure and enforce their intellectual property rights in overseas markets, to stop fakes at the U.S. borders, to expose international counterfeiters and pirates, to keep global supply chains free of infringing goods, to dismantle criminal enterprises that steal U.S. intellectual property and to reach out to like-minded U.S. trading partners in order to build an international coalition to stop counterfeiting and piracy worldwide.

Legal Framework

In anticipation of its accession to the WTO, China began modifying the full range of IPR laws, regulations and implementing rules, including those relating to patents, trademarks and copyrights, in an effort to comply with the TRIPS Agreement. By the end of 2001, China had completed amendments to its patent law, trademark law and copyright law, along with regulations for the patent law and regulations addressing computer software protection and the protection of layout designs of integrated circuits. After it acceded to the WTO, China issued regulations for the trademark law and the copyright law. China also issued various sets of implementing rules and judicial interpretations in the patent, trademark and copyright areas. Overall, the legal changes made by China represent major improvements that have moved China generally in line with international norms in most key areas, although more work needs to be done, particularly with regard to administrative and criminal enforcement. In addition, new legislation may be required in certain "cutting edge" areas.

Statement of John Nolan, American Iron and Steel Institute, China Currency Coalition, and Steel Manufacturers Association

My name is John Nolan, and I am Vice President and Manager of Sales and Marketing for Steel Dynamics, Inc. (SDI), a producer of a broad array of high-quality, carbon flat-rolled, structural, and bar steels. SDI was founded in 1993 as a new, independently financed, American steel company with several mini-mills and steel-processing operations located in Indiana, and our total annual capacity now exceeds 4 million tons. I am submitting this written statement on behalf of the American Iron and Steel Institute (AISI), the China Currency Coalition (CCC), and the Steel Manufacturers Association (SMA), all organizations to which SDI belongs.

There can be no reasonable doubt that China presents an enormous challenge for the United States. The single greatest commercial disadvantage that the U.S. faces is China's manipulation of its currency. The undervaluation of the yuan is estimated to be about 40 percent and acts both as a subsidy for Chinese exports to the United States and third countries and as a hidden duty on U.S. products that would be imported into China. From our perspective, the situation is not unlike being in a 100-yard dash and starting at least 40 yards behind your chief competition, not a good position in which to be.

Last week, as you know, Chairman Hunter and Congressman Ryan introduced H.R. 1498, the Chinese Currency Act of 2005, a bipartisan effort to address in a constructive manner an extremely serious threat. The AISI, CCC, and SMA all wholeheartedly support this legislation, which is a thoughtful attempt to hold China to account for its currency manipulation in a way that is consistent with the agreements of the World Trade Organization (WTO).

It is vitally important that China's undervaluation of the yuan be seen as the violation that it is. China must not be allowed to ignore its international legal obligations at the WTO. Exchange-rate issues become trade issues as a practical matter and are recognized as such under Article XV of the General Agreement on Tariffs and Trade. Consequently, they should no longer be considered to be solely within the purview of the Treasury Department and monetary policy. When currency manipulation acts as a prohibited export subsidy and facilitates imports from China, the result is market disruption in the United States.

The Ryan-Hunter bill rightly recognizes this distinction and would amend the U.S. countervailing duty statute and the China-specific, market-disruption statute to enable U.S. industries and workers to pursue relief under either or both laws against subsidized, injurious imports into the United States from China. Also importantly, in a case in which market disruptions were found, the Ryan-Hunter bill would prohibit the Secretary of Defense from procuring Chinese-origin products if the Secretary determined that the U.S.-made products like the imports from China were critical to the U.S. defense industrial base. The President could waive this prohibition on a case-by-case basis only if he decided waivers were in the national security interests of the United States.

Along these same lines, we also enthusiastically support H.R. 1216, introduced by Congressman Phil English and others, which would clarify that the U.S. countervailing duty statute applies to imports from nonmarket-economy (NME) countries. These WTO-consistent bills are a valuable part of the broader effort to check China's unlawful subsidization.

Finally on this subject, I want to convey a sense of urgency. Valuable time is being lost, and the figures on China's enormous foreign-currency reserves, bilateral trade surplus with the United States, and global trade surplus continue to rise alarmingly and at an unsustainable pace from the vantages of the United States and China itself in the final analysis. Even so, the Treasury Department in recent years has refused in its semi-annual reports to find any currency manipulation and undervaluation by China of the yuan. This reluctance is unsettling and confusing. During the period 1992–1994, the Treasury Department in five semi-annual reports made affirmative findings of currency manipulation by China on the strength of data far below the levels of today. A chart showing these contrasts is attached. More than negotiation with China is needed to avoid serious adverse consequences for the economic and security interests of the United States.

The United States needs to communicate a clear, unified, consistent, and apolitical position to the Chinese on the important business issue of their currency manipulation. This position needs to address the yuan's undervaluation for the prohibited export subsidy that it is; it needs to address the impact of the yuan's undervaluation on U.S. manufacturers; and it needs to address the dangers of China's currency manipulation to the Chinese economy going forward.

While China's manipulation of its currency is of paramount concern, not surprisingly, we have a number of concerns regarding important *non-currency matters*, and it is essential to get these right as well.

WTO Compliance Problems

Ensuring that China fully implements and abides by its WTO commitments—and that U.S. industries have ready and meaningful access to WTO-sanctioned trade remedies—is a top priority to industries in the United States.

With regard to China's compliance record, we have growing concerns about the pace and thoroughness of China's efforts to comply with its WTO obligations. Particularly worrisome is that China:

- Imposes WTO-inconsistent restrictions on the exportation of key raw materials;
- Provides significant subsidies beyond its currency manipulation to its manufacturing and other industries;
- Fails to meet key implementation milestones (e.g., on trading and distribution rights);
- Continues to pressure the U.S. and others to end nonmarket-economy treatment in antidumping (AD) cases, in spite of China's failure to eliminate its non-market practices;
- Continues to pressure foreign countries to eliminate China-specific "safeguard" provisions early (e.g., section 421 in the U.S.), despite numerous findings of disruptive trade, and threatens to take countermeasures; and
- Manipulates its value-added tax system to benefit Chinese companies.

Chinese Government Subsidies

In China, key national, provincial and local governmental goals are to promote investment, exports and employment. Governmental policies are used to "direct" or "manage" corporate decisionmaking in manufacturing and other industries. For example, at industrial parks throughout China, a wide variety of tax-related investment incentives are advertised to encourage direct foreign investment, with exemptions and reduced rates often linked to "technologically advanced" enterprises and to export levels (that is WTO-illegal).

We believe it is well past time to do an in-depth analysis of the entire government-industry relationship in China. It should, at a minimum, explore such factors as: government ownership; privatization and private ownership; land ownership and control; price coordination; other administrative guidance; banking and finance; utility rates; infrastructure development; taxation; restraints on imports; restrictions on exports; research and development; worker training and retraining; and rationalization and the closure of uneconomic enterprises.

China's Unacceptable Position in the OECD Steel Subsidies Agreement (SSA) Negotiations

China is already the world's largest producer and consumer of steel by far (with nearly 30 percent of total world steel production and consumption). Its actions are having a growing impact in a number of areas of direct importance to the global steel industry—including trade in raw materials and activity in other manufacturing sectors.

The positions that the government of China has taken in the SSA negotiations are revealing of larger aims. China would like to use these negotiations (whose initial goal was to enhance subsidy disciplines in the global steel sector) to obtain relief from its WTO accession obligations. The three steel industries of North America have spoken with one strong, united view on China's goals in the SSA negotiations. They oppose:

- Granting China market-economy status in steel antidumping cases;
- Guaranteeing that there will be no use of the "special safeguard" mechanism against Chinese steel products; and
- According China status as a "developing country" and giving it preferential treatment of any kind in the SSA.

At a time when China is running enormous trade surpluses with the United States and North America:

1. We must retain an unchallenged right to use the special safeguard mechanism if there are surges of imports from China of steel or any other product;
2. We must retain an unchallenged right to apply NME methodology in AD cases involving imports from China until steel and other key sectors of the economy in China are no longer under governmental regulation or control; and
3. China should comply fully with its WTO commitments and eliminate all of its direct and indirect subsidies to steel.

Need to Get Our Own House In Order

We need to continue to make ourselves much more competitive through a comprehensive and proactive approach that might be called "trade policy plus." With regard to domestic policy, we need to do all we can to help:

- Make steel producers and our customers in the U.S. and North America more competitive;
- Look at our own natural advantages; and
- Reform tax, litigation, regulatory, health care and energy policies.

The goal must be to make it more attractive to invest in manufacturing—and infrastructure—in the NAFTA region. China is in the process of building a first-class, nation-wide infrastructure. As it does, it will drive down production costs for manufacturing and other industries even more.

Historical Comparison of Determinations by the U.S. Department of the Treasury Regarding the People's Republic of China and Currency Manipulation
Values in Billions of U.S. Dollars

Date of Determinations	**1992 - 1994**	**1995 - 2004**
Semiannual Treasury Determinations	**Affirmative Determinations: Currency Manipulation Found**	**Negative Determinations: No Currency Manipulation Found**
Foreign Exchange Reserves	$19.4 - $51.6	$73.6 - $609.9
Capital Controls Employed	* Dual Exchange Rate System * Regulated Currency Swap Markets * Foreign Exchange Allocations	* Forced Repatriation of Profits * Households' Access to Foreign Exchange Curtailed * Open Market Operations to "Sterilize" Excess Yuan * Increased Banking Sector Reserve Requirements * Foreign Exchange Surrender Requirements * Restrictions on Foreign Exchange Holdings
China's Global Trade Surplus	-$3.6 - $14.7	$18.1 - $256.2
China's Bilateral Trade Surplus With the U.S.	$18.2 - $29.4	$33.8 - $163.6

Sources: Foreign Exchange Reserves and Global Trade Surplus Data (1992-1994): IMF International Financial Statistics; data on China's Bilateral Trade Surplus with the United States from Official Statistics of the U.S. Department of Commerce; data on China's Global Trade Surplus (2004) estimated by the China Currency Coalition based upon data from China's major trading partners through Global Trade Information Services (all data are on an annual basis for ease of comparison).

Statement of David L. Karmol, American National Standards Institute

Introduction

The standardization policies and practices of the People's Republic of China (*hereinafter referred to as either* "PRC" *or* "China") have significant ramifications for American firms that wish to export to the PRC market or who wish to source manufacturing in China. As described in this testimony, recent events indicate that stakeholders in the PRC may have been considering the use of standards as trade barriers as a strategy to shelter certain of China's growing industries.

It is well established in the community of nations that standards should meet societal and market needs and should not be developed to act as barriers to trade. In approving the World Trade Organization (WTO) Technical Barriers to Trade Agreement, WTO members established globally accepted principles as a framework to promote cooperation and discourage the use of standards as trade barriers.

During 2004, the PRC government completed its own investigation of the nation's standards system, identifying problems and suggesting solutions. The issuance of these strategy reports and the seemingly positive content identifying internal changes to be made to the PRC standardization system has been applauded by the American National Standards Institute (ANSI), administrator and coordinator of the United States' private sector-led and public sector-supported voluntary consensus standardization system.

ANSI has offered its support in carrying out the goals to reform the PRC standards system and will encourage support of a process that is driven by marketplace demand where standards are developed in r esponse to specific concerns and needs expressed by industry, government, and consumers.

Policy Considerations

To assist in the mitigation of concerns about the Chinese standardization policy, ANSI offers the following policy considerations for review and deliberation by the Ways and Means Committee of the United States House of Representatives and for consideration by stakeholders in the PRC:

The global economy will be best served if the PRC joins with the United States and other nations in embracing the globally accepted principles of standardization endorsed by the WTO (see Annex A). In particular, support should be given to open and inclusive participation in standardization activities; balancing the interests of all stakeholder groups so that the outcomes are representative and broadly supported; and maximizing the participation of, and value to, both intellectual property rights (IPR) holders and implementers.

Voluntary consensus standards enable industry growth, promote vendor differentiation and allow for adaptation to meet unique consumer and stakeholder needs. To the extent that the PRC adopts existing and globally recognized voluntary standards—rather than developing unique standards for use only in China—the nation and its growing export market will benefit.

The inclusion of intellectual property, under reasonable and non-discriminatory (RAND) terms and conditions, in voluntary consensus standards provides benefit to the contributor of that intellectual property via licenses and/or recognition and to implementers of the standard via the reduced need to support multiple specifications. Companies in China are encouraged to consider offering intellectual property for inclusion in globally recognized standards.

The global landscape is rich with entities, systems and processes that support regional and international standardization activities. These include treaty organizations where governments are members; non-treaty organizations whose membership is comprised of national representatives; professional and technical organizations whose membership is on an individual or organizational basis; and through consortia whose membership is typically company and industry based.

The PRC will benefit by broadening its definition of "international standard" to include documents that have been either developed or ratified by any consensus-based organization pursuant to transparent policies that are reasonable and non-discriminatory. China's current definition is limiting in that it applies only to standards that have been approved by the International Organization for Standardization (ISO), International Electrotechnical Commission (IEC), and the International Telecommunication Union (ITU).

As a means of fostering both competition and innovation, governments in all nations should allow stakeholders, particularly companies, to choose among the different voluntary standards that may be applicable.

The above policy considerations are aligned with high-level strategies developed by the U.S. Department of Commerce following the issuance in May 2004 of "*Standards and Competitiveness—Coordinating for Results,*" a report by then Commerce

Secretary Donald Evans acknowledging the growing awareness of standards as a key trade issue for U.S. exporters to PRC.

These considerations are also aligned with the latest edition of the draft *United States Standards Strategy*,[1] a guidance document developed during 2004 and 2005 by members of the U.S. standardization community, including representatives of industry,[2]government, consumers, academia and more. The Strategy's purpose is to establish a framework that can be used by all stakeholders to advance U.S. viewpoints on global trade issues—such as those arising with China and other trading partners; key national priorities such as homeland security and emerging technologies such as nanotechnology; consumer health and safety; and more. A key aspect of the Strategy is reference to the requirements of the WTO's Technical Barriers to Trade as related to standards practices.

The current draft version of the *U.S. Standards Strategy* can be found on ANSI's website at. The draft is expected to be finalized by mid-year 2005.

Call for Congressional Recognition and Endorsement

Congressional recognition and endorsement of the *U.S. Standards Strategy* will provide valuable support to the private sector as it engages with the PRC and the various governmental and private standards organizations in China. We encourage the Ways and Means Committee to offer a resolution or other legislative vehicle to enable the Congress to formally endorse the *U.S. Standards Strategy*.

Background on the U.S. Standardization System and the Role of the American National Standards Institute (ANSI)

The U.S. private sector-led, voluntary standardization system has been in existence for more than 100 years. It is a highly decentralized system and naturally partitioned into industrial sectors that are supported by numerous independent, private sector standards development organizations (SDOs). It is a system that is demand-driven by the marketplace with standards typically developed in response to specific concerns and needs expressed by industry, government, and consumers.

Since 1918, this system has been administered and coordinated by the American National Standards Institute (ANSI) with the cooperation of the private sector and the Federal, state and local governments. ANSI does not develop standards. Rather, it functions as a central clearinghouse and coordinating body for its member organizations. The Institute is a unique partnership of industry, professional, technical, trade, labor, academic and consumer organizations, as well as government agencies. These members of the ANSI federation actually develop standards or otherwise participate in their development, contributing their time and expertise in order to make the system work.

ANSI ensures the integrity of the U.S. standards system by:

- establishing a set of due process-based "essential requirements" that SDOs may follow in order to manage the consensus standards development process in a fair and open manner,
- accrediting SDOs who adhere to these requirements,
- approving candidate standards from ANSI-accredited SDOs as American National Standards (ANS), and
- conducting regular audits of the ANS activities of ANSI-accredited SDOs to ensure ongoing compliance with ANSI's essential requirements.

ANSI has accredited hundreds of SDOs across a range of industry sectors. These industries include (but certainly are not limited to) telecommunications, medical devices, heavy equipment, fire protection, information technology, petroleum, banking and household appliances. There are now approximately 10,000 ANSI-approved ANS that address topics as diverse as dimensions, ratings, terminology and symbols, test methods, interoperability criteria, product specifications, and performance and safety requirements. These standards development efforts serve the public interest and are being applied to new critical areas such as the environment, healthcare, homeland security and nanotechnology.

The Institute's approval of a candidate standard as an ANS verifies that the principles of openness and due process have been followed and that a consensus of all interested parties has been reached. Due process requires that all proposed ANS be circulated to the public at large for comment, that an attempt be made to resolve

[1] The *United States Standards Strategy* (draft second edition) is an update of the *National Standards Strategy for the United States* (first edition—August 2000).

[2] Representatives of the National Association of Manufacturers (NAM) have been actively involved in the process of updating the *U.S. Standards Strategy*; William Primosch, NAM's senior director of international business policy, headed the working group drafting the international section of the Strategy.

all comments, and that there is a right of appeal. In addition, ANSI considers any evidence that a proposed ANS is contrary to the public interest, contains unfair provisions or is unsuitable for national use. This basic formula has been the hallmark of the ANS process for decades, and it has garnered worldwide respect and acceptance.

One of the best indicators of confidence in the U.S. voluntary consensus standardization system (as exemplified by the ANS process) is Congress's 1996 passage of the National Technology Transfer and Advancement Act (NTTAA). This law (P.L. 104–113) requires Federal agencies to use voluntary consensus standards for regulatory purposes wherever feasible, and to procure equipment and services in accordance with such standards. It also requires agencies to increase their participation in voluntary consensus standards activities and directs the Commerce Department's National Institute of Standards and Technology (NIST) to coordinate Federal, state and local voluntary standards and related conformity assessment activities.

ANSI also promotes the use of U.S. standards internationally. The Institute serves as the U.S. national body representative in two major, non-treaty international standards organizations: the International Organization for Standardization (ISO) and, through the United States National Committee, the International Electrotechnical Commission (IEC). ANSI and the USNC play a leadership role in ISO and IEC, respectively, on both policy and technical matters.

Part of ANSI's role as the U.S. member of ISO includes accrediting U.S. Technical Advisory Groups (U.S. TAGs) which develop and transmit, via ANSI, U.S. consensus positions on the activities and ballots of ISO technical Committees and Subcommittees. Similarly, the USNC approves TAGs for IEC activities. In many instances, voluntary standards developed by U.S. SDOs are taken forward, through ANSI or the USNC, where they are approved in whole or in part by the ISO and/or IEC as International Standards. ANSI also encourages the adoption of international standards as national standards where they meet the needs of the user community.

In addition, ANSI advocates U.S. positions in various regional standards organizations and regularly meets with representatives from standards bodies in other nations. Thus, ANSI plays an important role in facilitating the development of global standards that support global commerce and which prevent regions from using local standards that favor local industries as trade barriers.

Conformity assessment is the term used to describe steps taken by both manufacturers and independent third-parties to determine fulfillment of standards requirements. ANSI's role in the conformity assessment arena includes accreditation of organizations that certify that products and personnel meet recognized standards. The ANSI–American Society for Quality National Accreditation Board (ANAB) serves as the U.S. accreditation body for management systems certification, primarily in areas such as quality (ISO 9000) and/or the environment (ISO 14000). ANSI also is involved in several international and regional organizations to promote multilateral recognition of conformity assessments across borders to preclude redundant and costly barriers to trade.

In summary, through its various roles and responsibilities, ANSI advances its mission to "enhance both the global competitiveness of U.S. business and the U.S. quality of life by promoting and facilitating voluntary consensus standards and conformity assessment systems and safeguarding their integrity."

Standards and Trade With China

The role of the PRC as the world's largest contract manufacturer makes it critical that China be persuaded to continue its participation in international standards forums, rather than develop its unique national standards. This is especially important in those instances where the intellectual property rights that are often incorporated into standards are not made available on the basis of reasonable and nondiscriminatory terms.

As the U.S. member body of ISO, and via the U.S. National Committee, of IEC, ANSI serves as the national standards body counterpart to the PRC and can help influence Chinese stakeholders to participate in the fair and open standardization process that has as its goal the development of a single set of globally recognized and accepted standards.

As noted in the Introduction of this testimony, however, events of the past few years indicate that stakeholders within the PRC may have been considering the establishment of trade barriers as a strategy to shelter the nation's growing industries. One well-publicized example is related to the PRC's domestic high-technology industry and the issue of a Wireless Local Area Network (WLAN) Authentication and Privacy Infrastructure (WAPI) and Wireless Fidelity (Wi-Fi) chips, the devices that allow computers to access the Internet through local wireless networks.

On May 12, 2003, the PRC government mandated that a new WLAN WAPI security standard take effect in June 2004. The new standard was developed independently by the PRC Broadband Wireless IP Standard (BWIPS) Group with little or no communication with other standards organizations and no foreign participation. Upon implementation of the PRC government directive, foreign importers to China would have been mandated to comply with a requirement to form joint ventures with one of 24 PRC companies that had been given proprietary technical information required for implementation of the WAPI standard.

The U.S. government and industry pointed out that there is already an internationally accepted standard for such technology (IEEE 802.11). On March 2, 2004, in a joint letter signed by U.S. Secretary of State Colin Powell, U.S. Commerce Secretary Don Evans and U.S. Trade Representative Robert Zoellick to Zeng Peiyan, Vice Premier of the People's Republic of China, the Bush Administration urged PRC to drop WAPI. Following high-level meetings in Washington, D.C., the PRC government announced that it would (a) suspend implementation of the WAPI standard, (b) work to revise the WAPI standard, taking into account comments received from PRC and foreign firms, and (c) participate in international standards bodies on WAPI and wireless encryption for computer networks.

In recent months, ANSI has worked through international forums, its ISO membership, and in concert with the China desk at the Department of Commerce's International Trade Administration to invite representatives of the PRC standards organizations to a meeting to discuss a long-term resolution of the WAPI issue, including fair consideration of the PRC proposal in the appropriate international forum. ANSI believes that respectful and open engagement with the various PRC standards groups is the best way to resolve such issues going forward.

While WAPI is important for many reasons, the PRC is also developing several other important (but locally divergent) standards in areas as diverse as the Internet Protocol, 3G wireless communications (such as TD SCDMA [3] and SCDMA [4]), audio-video capture and playback (AVS), document and data protection, the small intelligent grouping and resource sharing (IGRS) for terminal device collaboration radio devices being developed for inventory management (RFID), and others. It is the pervasive nature of these activities, and the related treatment of intellectual property, that is of significant concern to PRC's trading partners.

Subsequent to the initial WAPI controversy, the PRC government issued a report identifying concerns in the PRC standards system and suggesting solutions. The study was a cooperative effort between the Chinese Ministry of Science and Technology (MoST), the Chinese General Administration for Quality Supervision, Inspection and Quarantine (AQSIQ), and the Standardization Administration of China (SAC). The report itself was drafted by the China national Institute of Standardization (CNIS), an agency within the AQSIQ, which met with an ANSI delegation in Washington, D.C. in December 2003.

The report suggested:

- changing the existing four levels of: National, Vertical, Local, and Enterprise standards to the three levels of: National, Association, and Enterprise standards;
- changing the two categories of standards: Mandatory and Recommended standards into only voluntary standards; voluntary standards becoming mandatory only via references or citations in government regulations;
- changing the standards development accreditation scheme: Currently, national, vertical and local standards are subject to government approval. The suggestion is to change this system so that: governmentally accredited bodies will approve national standards and associations will approve association standards;
- that enterprises should be free to determine their own standards usage without the governmental registration required today;
- that standards should be adopted voluntarily by the users of standards.

The issuance of the SAC strategy reports, and the seemingly positive content identifying internal changes to be made to the PRC standardization system, prompted ANSI to send a letter to the Administrator of SAC, Li Zhonghai, in October 2004. This letter congratulated SAC on the undertaking of this study and applauded the recommendations put forward in the report.

To further its outreach efforts, in mid-January 2005 ANSI's president and chief executive officer Dr. Mark. W. Hurwitz, traveled to China to meet with Adminis-

[3] Time Division Synchronous Code Division Multiple Access (TD–SCDMA) is a mobile telephone standard for wireless network operators who want to move from a second generation (2G) wireless network to a third-generation (3G) one.

[4] Synchronous Code Division Multiple Access

trator Li and representatives of CNIS, the administration of Certification and Accreditation of China (CNCA), the Standards Press of China (SPC) and the U.S. Foreign Commercial Service in Beijing. During these discussions, ANSI agreed to serve as the distributor of Chinese national standards in the U.S. and SAC agreed to become a distributor of American National Standards, as well as certain other standards developed by U.S.-based standards-setting bodies, in China. This arrangement will facilitate access to the national standards of each nation and is seen as crucial to the promotion of cross-border trade.

ANSI has also taken steps to mitigate the difficulty of obtaining entry visas for Chinese technical experts who are attempting to attend meetings of international standards Committees in the United States. Among the actions taken was publication of a guidelines document that provides information for Chinese technical experts and for the administrators and officers of the technical Committee meetings that are hosting those meetings; ANSI is engaged in ongoing discussions of this topic with the U.S. Department of State and other relevant agencies.

Dr. Hurwitz also explored with SAC the prospect of increasing U.S. and other foreign access to participation on standards-setting Committees in the PRC. Current and proposed future options were discussed, with a strong indication being given to ANSI by SAC that China will be moving away from its past practices of favoring government-held seats on its national standardization Committees and placing restrictions and/or limits on open participation on these Committees.

Finally, during his visit Dr. Hurwitz was introduced to a new initiative within PRC to develop a Chinese Standards Strategy. The Strategy's goals include efforts to develop, within 15 years, "independently self-proprietary technical standards through effective measures, so as to improve international competitiveness of China's technical standards and therefore increase the international market share of Chinese products."

Its Guiding Principles bear in mind the goals of "new-stage industrialization and comfortably off society," focus on improvement of technical standard adaptability and competitiveness, couple standard independence/innovation with international norms, integrate governmental instruction and market orientation with enterprise as the major player, and meet the strategic requirements of technological innovation as well as industrial and trade development on technical standards.

In the near term, Chinese strategic goals to be achieved by 2010 include the formation of a rather complete national technical standard system, putting the overall technological level of Chinese standards on a par with that of international standards for key areas. By 2020, the PRC intends to upgrade its international standards involvement to an advanced level, putting China high on the rank of international standardization contributors.

Statement of James Thomas, ASTM International, West Conshohocken, Pennsylvania

ASTM International is pleased to take this opportunity to comment on United States-China economic relations and China's role in the world economy. As the largest U.S. domiciled international standards developing organization, we are particularly interested in commenting on China's progress and the U.S. response in the implementation of China's World Trade Organization (WTO) accession commitments to remove non-tariff barriers to trade such as standards and technical regulations. Standards are vital to everyday commerce and trade as they effectively provide for a level playing field and ensure that two parties involved in a contract or two nations involved in trade are able to communicate clearly, in a common language.

ASTM International's Role in International Trade

ASTM International facilitates the development of technical standards for about 90 industrial sectors including steel, copper, plastics, building construction, roads, petroleum, textiles, adhesives, medical devices, sports equipment, air quality, water quality, consumer product safety, nuclear energy, industrial chemicals, and so forth. With 30,000 individual technical experts from 118 countries—including China—participating in the drafting of ASTM standards, ASTM International is truly a global forum for the development of consensus standards. ASTM standards and technical documents serve as the basis for manufacturing, management, procurement, codes, and regulations worldwide.

ASTM International Agreements with Chinese Standards Bodies

ASTM International has a long history of participation in Chinese standardization activities and many deep and mutually productive relationships. Activities include the recent signing of an agreement with the Standardization Administration of the People's Republic of China, and agreements with other standards organizations including the Chinese National Institute of Standardization and the Shanghai Institute of Standardization.

Through our agreements with China's leading standards bodies, ASTM International provides access to all ASTM standards; jointly sponsors standards and training programs; provides participating membership to Chinese representatives on ASTM technical committees; and provides internship programs for Chinese experts to come to ASTM International's Global Headquarters in Pennsylvania for extended study of the ASTM International standards development process. In return, the Chinese standards bodies promote the acceptance and use of ASTM standards in China; utilize the resources of ASTM International to develop Chinese National Standards and reference ASTM standards where applicable in Chinese National Standards (China currently uses over 500 ASTM standards as the basis of their national standards); and facilitate connections between Chinese technical experts and ASTM International technical committees to ensure that the standards meet the needs of Chinese industry.

ASTM International's Presence in China

ASTM International is one of four U.S.-based international standards development organizations that have jointly established the Consortium for Standards and Conformity Assessment (CSCA) and that has opened a new China office to establish a much-needed presence in China for U.S.-based standards and conformity assessment organizations. Located in Beijing, the office will help to build cooperative and enduring relationships with Chinese governmental and industry standards associations. It will also help promote the acceptance and use of ASTM International standards and of other U.S.-domiciled standards developing organizations in China. Part of the funding for the office was awarded through the U.S. Commerce Department's Market Development Cooperator Program. The other members of the consortium are the American Petroleum Institute, ASME International (formerly known as the American Society of Mechanical Engineers), and CSA America.

China's Obligations Under the WTO TBT Agreement

With China's accession to the WTO comes an obligation for China to comply with the World Trade Organization's Technical Barriers to Trade (TBT) Agreement. The WTO TBT Agreement has established certain rules and procedures that pertain to the development, adoption and application of mandatory technical regulations, voluntary product standards, and the procedures used to determine compliance with those standards and regulations. Under the WTO TBT Agreement, international standards are recognized based on the transparency, openness and impartiality in their development process rather than the label they bear or their source.

While ASTM standards are accepted and used throughout the world as the basis for contracts, codes, and regulations, access to global markets increasingly depends on standards being set by other countries and international organizations. Some nations' have government policies or laws that prohibit the use of de facto international standards, including those developed by ASTM International. Of particular concern, the implementation document (Document #10) of China's Law of Standards states in chapter 1, section 3;

"International Standards are the standards issued by the International Standard Organization (ISO), International Electrotechnical Commission (IEC), International Telecommunication Union (ITU) and other international organizations recognized and publicized by ISO."

China's definition of "international standards" appears to be inconsistent with the definitions and principles of the WTO TBT Agreement and harmful to the best interests of ASTM International. This definition can also be disadvantageous to the efforts of many businesses to compete in China's emerging marketplace.

Through the CSCA office and other contacts, ASTM International will continue to engage in an open dialog with Chinese governmental and enterprise representatives so they might better understand the multiple paths to international standardization and conformity assessment. While we are encouraged by efforts to date, continued attention from the U.S. government officials and Congress would be welcomed to ensure that a market-oriented, enterprise-centered standards development system develops in China that is consistent with the WTO TBT Agreement obligations. The U.S. government should communicate a clear and concise statement of U.S. trade policy as it relates to the WTO TBT Agreement and its obligations to accept and use "international standards" based on the transparency, openness and impartiality in their development process rather than the label they bear or their source.

Because voluntary consensus standards developed under the auspices of ASTM International incorporate various aspects of current market practice—for example safety, quality, efficiency, or the implementation of new materials—China will benefit from the application of these standards in improving the quality of its goods, advancing the health and safety of its people and environment, and enhancing its competitiveness in a global marketplace.

Launches Aggressive Standards Strategy

Recognizing that standards will continue to be a key success factor in the expansion of its economy and manufacturing base, and because of its accession to the WTO, China launched two research programs in September 2002. The programs, on the technical standards development strategy in China and the establishment of a national technical standards system, established strategic goals to be accomplished in three phases by 2050.

- By 2010, form a new voluntary technical standards system and enhance the market adaptability of technical standards;
- By 2020, perfect the technical standards system and raise the level of Chinese technical standards development; and
- By 2050, ensure that Chinese technical standards hold a pre-eminent and prominent international status.

This strategy has created a demand for the development of technical standards across a wide range of industry sectors.

Conclusion

In conclusion, the standards of ASTM International are widely applied in various industries in China. With China's accession to the WTO comes an obligation for China to comply with the WTO TBT Agreement. We expect that with China's entry into the WTO and the expansion of international communication and international trade, the standards of ASTM international will most likely increase in popularity as more and more enterprises will adopt them. While we are pleased with our agreements and relationships with the Chinese standards community, we welcome the interest and attention from Congress and would benefit from a clear and concise statement of U.S. trade policy as it relates to the WTO TBT Agreement and its obligations to accept and use "international standards" based on the transparency, openness and impartiality in their development process rather than the label they bear or their source.

Thank you for the opportunity to comment and please feel free to contact ASTM International's office in Washington, D.C., at (202) 223–8505, or our Global Headquarters in Pennsylvania at (610) 832–9687, if we can provide additional information.

Statement of Robert Vastine, Coalition of Service Industries

The Coalition of Services Industries (CSI) appreciates this opportunity to convey to the Ways and Means Committee the U.S. service industry's concerns about China's implementation of WTO accession commitments.

The U.S. has a positive balance in its cross-border services trade with China, and has experienced dramatic growth in its services exports in the last decade. In 1992, U.S. services exports to China were $1.57 billion, with a surplus of $52 million. In 2003, U.S. services exports to China increased to $6 billion, with a positive balance of $2 billion. Our largest exports to China are in travel, transportation, education, financial, business and professional services.

Services sales by U.S. affiliates in China have grown from $320 million in 1994 to $3.4 billion in 2002. By contrast, China's sales through affiliates in the U.S. increased from $45 million in 1994 to $125 million in 2002.

China's WTO accession in 2001 was a significant step in advancing services trade liberalization and promoting sectoral reforms through ambitious and comprehensive WTO obligations. These obligations demonstrated the Chinese government's intention to modernize and integrate economically with the rest of the world. However, the true value of China's commitments is to be measured by the degree to which they are implemented.

Although China has made efforts to bring its legislation into WTO compliance, significant sectoral and cross-sectoral implementation issues persist.

Cross-Sectoral Issues

Excessive Capitalization Requirements

We acknowledge China's efforts to reduce required capitalization levels in insurance in response to the U.S. industry study "A Recommendation for Revisions to the Capitalization Requirement Rules for Life Insurance Companies Operating in China." However, more progress is needed since the capitalization requirements remain high given assumed risks and international practices.

Chinese regulators have also imposed high capital requirements that bar market access in other key services sectors, including asset management, telecommunications, freight forwarding and logistics. CSI members believe such restrictions hurt the interests of U.S. companies and impede the expansion of China's economy. High capitalization requirements are not an effective way to ensure financial solvency. They prevent the efficient use of scarce capital, thus hindering the sound development of China's economy.

Emergency Safeguard Authority

China has made important legislative changes intended to implement its WTO commitments, including the Foreign Trade Law that came into force on July 1, 2004. However, we are concerned that Article 45 of the Law permits the use of emergency safeguard measures (ESMs) against services imports. ESMs for services are not provided in China's terms of accession, and we strongly oppose any efforts to employ a services safeguard mechanism.

Transparency

According to the General Accounting Office report "U.S. Companies' Views on China's Implementation of Its Commitments," of March 24, 2004, U.S. companies consider China's commitments in transparency of laws, regulations, and practices among the most important. Despite China's extensive transparency commitments, U.S. companies have been denied the right to comment on new regulations, or have been unable to do so because comment periods have been too short. Rather than specifying all criteria that foreign firms must satisfy, China's rules sometimes provide regulators with broad discretion which results in varying rules and decisions. Chinese laws, regulations, and administrative practices frequently change without warning, and may not be applied uniformly, especially at the local level.

Government Procurement

China should eliminate significant market access barriers in its software procurement. Unfortunately, China has recently enacted a procurement law that requires that the Chinese government purchase domestic goods and services with limited exceptions. This law has the potential to exclude U.S. goods and services providers from the significant public sector market.

China's draft "Implementation Measures for government Procurement of Software" is the first of a series of sectoral rules to implement the new government procurement law. These regulations will create a discriminatory procurement regime that will severely restrict or exclude most non-Chinese companies from selling software products and services to the Chinese government, China's largest buyer. These regulations represent a step back, and go far beyond U.S. procurement practices. China's proposed rules will clearly discourage development of a strong Chinese software sector by isolating it within a protected market.

The government procurement law and the Implementing Measures move in the opposite direction from China's unfulfilled WTO accession obligation to start negotiations for membership in the GPA. The Chinese government should adopt an open, inclusive, non-discriminatory and transparent procurement regime by commencing negotiations to accede to the GPA and suspending adoption of the Implementation Measures and other discriminatory procurement rules.

Intellectual Property Rights Protection

China's piracy and counterfeiting at the wholesale and retail levels, end user piracy, and Internet piracy remain rampant due to lenient penalties, uncoordinated enforcement among local, provincial and national authorities, and the lack of transparency in administrative and criminal enforcement. The piracy rate for optical media products and software is reported to be in excess of 90 percent. Although recent copyright amendments and regulations made progress toward bringing Chinese law into compliance with TRIPS, the law still provides inadequate criminal liability for copyright offenses, e.g. corporate end user and Internet piracy, unclear protection for temporary copies, and overly broad exceptions to protection of computer software. Overall, the issue of IPR protection is marked by a readiness of the central government to address the problem, while implementation at local levels remains unsatisfactory.

IPR Enforcement Regime

Chinese agencies should better coordinate to improve enforcement of administrative and criminal measures. There has been some success in bringing civil actions, however China's criminal law has rarely been used to prosecute piracy because of the high thresholds for criminal liability. Administrative enforcement is slow, cumbersome, and rarely results in deterrent fines. Although Chinese authorities have undertaken administrative enforcement actions against pirates, the government's refusal to share information about the activities of CD plants and about the ultimate outcomes of its actions makes it difficult to assess China's efforts. Copyright authorities are typically understaffed, and lack skills and resources, as well as a mandate to take strong administrative measures.

Civil copyright enforcement is also hampered by the courts' unwillingness to grant provisional remedies on an *ex parte* basis, even though the amended law now authorizes such remedies.

Criminal prosecution of copyright piracy remains restricted by the Chinese criminal code which requires a demonstration that piracy is occurring for the purpose of making a profit. This is very difficult to demonstrate, particularly if it happens online. Therefore, China should closely adhere to TRIPS which requires criminalization of "copyright piracy on a commercial scale"—not just piracy for profit.

Unfortunately, the recently amended Supreme Court's Judicial Interpretations (JIs) have failed to establish an acceptable framework for criminal prosecutions and deterrent penalties for IPR violations. The new JIs make only minimal decreases in the monetary thresholds, and leave damages to be calculated at pirate prices. The new threshold may be effective only if it brings more criminal cases against pirate manufacturers and distributors.

Under the new rules, online infringements that meet the thresholds are criminalized, but the ability to use these rules in practice has yet to be tested. Although the rules criminalize importing and exporting of pirate products, criminal penalties are very low, since liability results from China's rules covering "accomplices." End user software piracy does not appear to be criminalized, and the rules are weak with respect to repeat offenders.

The local copyright authorities and the local administration should cooperate to ensure adequate administrative enforcement against all types of copyright offenses, including unauthorized use of software by companies. Chinese authorities at the national and provincial levels should also conduct aggressive investigations to trace the source of pirate optical disc production, impose criminal sanctions on pirate producers and distributors, and institute a zero tolerance policy for the sale of infringing materials. Chinese customs must be directed to refer large-scale pirate seizures for criminal prosecution. China's Internet piracy should be addressed through appropriate legislation and strict enforcement. At the JCCT meeting in 2004, China agreed to join the WIPO "Internet" Treaties, and we look forward to swift implementation of this commitment.

To ensure that improvements in China's enforcement regime yield meaningful gains for U.S. right holders, the industry suggests that the U.S. government establish evaluation criteria that provide an objective and verifiable mechanism to measure progress in China's IPR regime. These criteria should assess (i) criminal, civil and administrative enforcement against all forms of piracy and counterfeiting; (ii) end user compliance with IPR laws; and (iii) government-sponsored public education and awareness programs about the importance of IPR laws. These IPR initiatives, however, will do little to increase market access for U.S. IPR products if China persists in maintaining trade and investment barriers.

Market Access for IPR Products

Foreign investors' greater participation in local media companies can help solve China's piracy problem. Current rules make it difficult for U.S. companies to enter the Chinese market to supply legitimate products, thereby ceding the market to counterfeit producers. Therefore, we encourage China to increase the 49% cap on foreign ownership of distribution and video replication companies.

The Chinese government should secure freedom of establishment for foreign investment companies, including pay-television broadcasters. We believe that companies should be able to choose the form of commercial presence that best suits their operations and business objectives.

China should increase revenue sharing beyond 20 films, eliminate the import monopoly and the distribution duopoly; eliminate or reduce the "black-out" periods for foreign film screening; and reduce taxes and fees. Prime-time broadcast restrictions for foreign programming of pay and non-pay television broadcasters should also be reduced.

An improved regulatory and licensing regime is essential in combating IP piracy. China's censorship clearance procedures for optical media should be streamlined. These procedures give another advantage to pirate producers by severely hindering timely distribution of legitimate CD, VCD, and DVD products in China. Restrictive licensing policies on retail outlets also inhibit the industry's ability to provide consumers with timely access to legitimate products. Retail chain stores should be granted a national license to distribute CDs and other media products, instead of requiring separate licenses in each jurisdiction. China should also clarify the authority for the issuance of retailers' AV licenses in home video.

China remains a large producer and distributor of high-quality counterfeit software and IT-related products for local and foreign markets. Corporate end user software piracy and unauthorized loading of software on computers before they are sold are also significant issues for CSI members. Actual increases in China's purchases of legitimate U.S. IPR products are an important tool to measure progress in improving market access through IPR protection.

Technology Standard Setting Issues

China's movement toward adopting unique national technology standards instead of available international standards threatens to become a significant barrier to foreign competition, and to undermine China's ability to export its own products.

CSI greatly appreciates the Administration's efforts to address the issue of standard setting for China's wireless local area network (WLAN) encryption. However, the scope of the problem is much broader, since China is developing unique national technology standards across a wide range of products.

Voluntary, industry-led, consensus based, and non-discriminatory standards are essential to promote interoperability, competition and innovation. As a general matter, technology standards should not be mandated by governments. Standards, and the technologies they embody, should be allowed to compete in the marketplace.

As a general matter, CSI members are concerned about the issues of protection for foreign patents, the inability of foreign companies to be voting members of the standards development groups, and attempts to severely limit compensation for intellectual property rights as the new standards are being developed.

We encourage China to participate in international standard setting bodies and to align its standards development with international practice. It is also important to protect intellectual property rights embodied in standards through China's adoption of rules consistent with international practice. Intellectual property is increasingly important to technology leadership, so it is in both Chinese and U.S. interests to establish clear rules for standards.

Sectoral Issues

Insurance

Since the amendment of China's Insurance Law in 2003 by the National People's Congress, China's Insurance Regulatory Commission (CIRC) has issued several important implementing regulations.These regulations have relaxed China's initial capitalization and licensing requirements in insurance. Nevertheless, significant market access and national treatment impediments for foreign insurers remain.

Branching

Following the establishment of an initial branch in a province, insurers seek greater clarity regarding procedures and approvals for establishing subsequent branches, sub-branches, and related entities in the same province.

Foreign invested insurance companies should enjoy national treatment, and be able to apply for any number of branch approvals simultaneously at any given time, as well as receive new product licenses without delay. Provisions covering branching in the Administrative Regulations and the Foreign-Invested Implementing Rules are silent on the number of branches a company may apply for at one time, and whether branch approvals will be granted consecutively or concurrently. A number of Chinese companies have received branch approvals on a concurrent basis, even when first establishing their businesses in China. In contrast, no foreign insurance company has received branch approvals on a concurrent basis, including when first establishing their business.

National Treatment for Capitalization Requirements

After being presented with the U.S. industry study "A Recommendation for Revisions to the Capitalization Requirement Rules—" in 2003, CIRC has substantially lowered its capitalization requirements to RMB 200 million for initial establishment and RMB20 million for each additional branch. However, the new capitalization levels are too prescriptive, and are still much higher than international norms with respect to specific business models and assumed risks. According to the industry study, China's new capitalization requirements in insurance remain higher than in eleven important Asian markets, and much higher than in the United States and the European Union.

China needs to confirm the scope of the initial establishment fee of RMB200 million, and ensure that this includes the right to establish sub-branches without limitation on numbers. China's prudential reasoning behind the branching capitalization requirements of RMB20 million for each additional branch should also be addressed.

Overseas Utilization of Foreign Exchange Funds

With respect to CIRC's "Provisional Measures on the Administration of the Overseas Utilization of Insurance Foreign Exchange Funds" released on August 9, 2004, we are concerned that the threshold for utilization is unjustifiably high. Paragraphs 4 and 5 of the article entitled "Insurance fund move precludes qualified domestic institutional investors (QDII)" states that only the largest companies, which excludes foreign participating companies, are authorized to access overseas fund/equities. These provisions have significant national treatment implications, and should be expanded to allow utilization by foreign participating companies.

Group Life "Master Contract Coverage"

On December 11, 2004, the CIRC announced that China's commitments to provide market access in group, health, pension, and annuity insurance had been fulfilled by the deadline set in the WTO. However, CIRC is yet to issue implementing guidelines that identify entities covered under group life "master contract coverage," and specify qualifying criteria for insurers interested in providing this coverage.

Transparency

China should give insurance entities a reasonable period to review and comment on proposed new measures. We are pleased that CIRC offered the opportunity for public comment on its "Trial Implementing Rules for the Administration of Foreign-Invested Insurance Companies" and "The Administrative Regulations on Insurance Companies" both issued in 2003, and the Insurance Law issued in the end of last year. However, the opportunity to comment on important sectoral regulations is still rare. Therefore, we encourage the CIRC to allow all interested parties to participate in the entire rule-making process through submission of data, written or oral statements, and arguments, in advance of the issuance and implementation of all regulations.

We also welcome the fact that CIRC's "trial implementation" regulations are open to revision as needed. The U.S. insurance industry fully supports China's efforts to develop and refine its insurance regulatory system. We remain committed to engaging in positive dialog with Chinese regulators, and encourage them to consult with U.S. and other international experts as they continue to develop the Chinese regulatory system.

Improving the transparency of the rulemaking process as well as maintaining equal application of licensing and solvency rules to foreign and domestic companies is especially important as new regulations are being released. Some new regulations appear to have unreasonable provisions that will put many new entrants at a competitive disadvantage in the marketplace. Specifically, recent regulations allow companies with licenses for more than 8 years to invest in a much broader range of assets than companies entering the market since China joined the WTO. Such arbitrary provisions are inconsistent with China's national treatment commitment and have no prudential rationale. We urge a transparent discussion of their prudential justification.

Acquired Rights

CSI members seek confirmation that existing direct branches and other insurance company operations may continue, but are not required, to operate under the same conditions and authorities accorded at the time of establishment, whether or not the said condition and/or authority complies with new rules, including operations, financial structure, capital and mode of establishment. China should exempt existing companies from compliance with new rules if such companies choose to maintain their existing status, which should be protected as an acquired right. A company that chooses to maintain its existing status should not be penalized by additional, alternative restrictions on its ability to operate and expand business in China.

Any company should be permitted to expand its business into new cities/provinces and into new product lines, including group business, consistent with China's insurance commitments. Restrictions, not based on international norms on the ability to operate and expand business, are counterproductive both for the companies and for the Chinese economy, and should not be applied to new foreign companies, either.

CSI and the U.S. insurance industry strongly support the dialog between CIRC and U.S. insurers under the auspices of USTR and the U.S. Embassy in Beijing, as an important forum to raise sectoral issues. Following the second session in April 2005, we see a template for the dialog and sincerely hope that the proposed November 2005 meeting will occur as discussed with CIRC and USTR on April 8th. We hope CIRC will also include relevant Chinese government officials in the discussion on issues of asset management and taxation, as well as invite other global companies to the program.

Banking

On June 26, 2004, China's *Administrative Measures on Foreign Debt of Foreign Banks in China,* which restrict the foreign-currency lending of foreign bank branches and their offshore funding, went into force. These measures will work to the significant detriment of Chinese businesses and borrowers, including Chinese financial institutions, which rely on international banks for an increasing proportion of their financing needs. Under these rules, corporate clients' foreign-currency denominated loans may not be converted into renminbi. This will discourage renminbi expenses by foreign investors whose presence is otherwise actively sought in the Chinese economy. Foreign banks will also be unable to grant Standby Letters of Credit in foreign currency to Chinese banks in order to allow corporate clients to borrow renminbi loans from these banks.

The measures also introduce a quota which limits foreign-currency refinancing of foreign banks in China from their head office and offices in third countries. These restrictions are especially damaging, since China's domestic inter-bank market for foreign currency is almost non-existent and foreign bank branches are heavily dependent on funding from their head offices or offices in third countries.

Although identical restrictions are applied to domestic banks, their negative effect on foreign banks will be much larger. Foreign banks have little access to the renminbi market, and their clients are more internationally oriented, with a greater need for flexible foreign exchange transactions.

Securities and Asset Management

On December 21, 2001, the China Securities Regulatory Commission (CSRC) issued the Joint Venture Rules for asset management companies, which do not provide a defined set of criteria for approval, and give the CSRC broad discretion to impose additional qualification requirements. The rules also stipulate that foreign firms must have at least RMB 300 million (U.S.$36 million) to qualify as a joint venture partner, an amount significantly higher than in any other national jurisdiction. Given that asset management firms do not need capital reserves to protect investors, this requirement poses a market access barrier.

CSRC does not appear to abide by its own regulations which require giving notice of the status of a joint venture application within 30 days. We also understand CSRC may be changing its regulations regarding joint venture establishment requirements, and would appreciate the opportunity to comment on those changes.

CSI members urge China to go beyond its WTO commitments and allow a foreign firm to choose its form and equity participation levels and compete on the same basis as domestic firms. We also ask that China permit foreign firms to set up securities companies through vehicles of their choice, with power to engage in a full range of securities activities, including underwriting and secondary trading of government and corporate debt and A-shares. Foreign securities firms should be allowed to trade renminbi and renminbi-linked products with Chinese entities, as well as create and distribute derivatives.

We are pleased that China took steps to open the A-share market to foreign investors by adopting rules on qualified foreign institutional investors (QFIIs). However, many institutional investors are unable to take advantage of the rules because the following aspects of the new rules limit their practicality:

- The rules restrict the percentage of an issuer's securities that may be held by any single QFII and all QFIIs in the aggregate.
- The rules require each QFII to commit total investment of at least U.S.$50 million to a special QFII account.
- Certain elements of the QFII licensing process lack transparency. For example, the licensing rules include a provision that allows the CSRC and SAFE to give

priority consideration in granting licenses to "pension, insurance or mutual funds that have a good investment record in other markets."

- Investment quotas must be fully funded within 3 months, and the unused portion of quotas will expire. This period should be increased to at least a year.
- The invested amount must remain in the QFII account for at least a year for open-end funds and 3 years for closed-end funds, and any remittances from the account must be approved in advance by the State Administration of Foreign Currency Control (SAFE).[1]

We understand that the CSRC is reviewing the lock up periods for investment for a possible change in the requirement. We would welcome such an amendment to the QFII rules, which would encourage further investment by QFIIs.

Private Pension

CSI members welcome the Chinese government's publication of key enterprise annuity regulations in May 2004. We believe tax favored, employer-sponsored supplementary private pension plans, managed by professional financial services firms—insurers, pension and retirement savings companies, banks, securities and mutual fund companies—is an important element to help China adequately address its growing aging challenges. However, we encourage Chinese authorities to make the following improvements:

- The Chinese government should flesh out the details of existing regulations, including information on licensing procedures and licensing authorities for private pension companies. It is essential to establish simple and transparent licensing procedures.
- Tax regulations should enable employers to make tax-deductible contributions to their employees' pension plans. The rules should also enable tax deferral for individuals contributing to their defined contribution pension accounts, similar to the U.S. 401(k) plans.
- Chinese authorities should also ensure strict sectoral supervision and allow market driven fees on private pension businesses, without fee caps.

Express Delivery

Draft revisions to China's Postal Law violate its accession commitments in market access and national treatment. The draft raises the following key issues:

- *Market Access for Foreign Providers.* The draft legislation provides China Post with an absolute monopoly for all shipments weighing less than 350 grams. Regarding shipments over 350 grams, there is a provision prohibiting delivery of "addressed letters, printed matters and parcels" by foreign invested enterprises unless in the form of express delivery services. We believe that the enlarged scope of this monopoly is a flagrant violation of the horizontal rollback provision in China's WTO commitments.

The draft also stipulates that when the State Council's rules with respect to the international express industry contradict the legislation, the Council's rules will prevail. However, there are inconsistencies in those provisions, and we are concerned that the State Council can change its regulations at any time.

- *Universal Service Charge on Express Industry Revenues.* The draft legislation creates a new, unspecified charge on express industry revenues. The size of this fee and the basis on which it will be charged remain to be outlined in regulations. We understand that this fee is intended to support China Post's universal service obligation to deliver mail to remote regions. However, it is not the obligation of the express industry to fund China Post's responsibility to provide universal postal service, which is distinct from express delivery.
- *Regulator'sIndependence.* The draft legislation fails to provide for the establishment of an independent regulator. Having a postal agency as regulator puts U.S. companies at a serious competitive disadvantage and raises significant market access concerns.
- *Licensing Procedures.* The draft legislation establishes a new, unworkable licensing regime with new authorities of supervision, inspection, and punishment granted to the postal regulator. Express delivery companies and their existing subsidiaries, that have already been issued licenses under existing regulations, as well as all future subsidiaries should not be required to re-apply and/or apply as appropriate for the licenses with the new regulatory authority.

[1] The lock up rules pose regulatory compliance issues for mutual funds, which are required to meet redemptions at all times. As a result, most U.S. mutual funds obtain exposure to China not under the QFII rules, but by investing in Chinese securities available in Hong Kong.

Freight Forwarding and Logistics Services

MOFCOM revised the international freight forwarding (IFF) rules on December 11, 2002 to permit majority foreign ownership of IFF ventures. However, the revised rules do not provide a schedule for establishing wholly foreign-owned IFF enterprises. We would like to ensure that China will allow wholly foreign-owned freight forwarding subsidiaries according to its schedule of commitments, by December 2005, and that interested foreign companies will be able to provide their comments before such rules become law. CSI members are also concerned about the continuing uncertainty regarding the specific procedures for wholly foreign-owned enterprises in land transportation to begin operation.

On July 26, 2002 MOFTEC issued the “Notice on Relevant Issues Regarding the Experimental Establishment of Foreign-Invested Logistics Companies” which allowed foreign providers to conduct the full range of logistics services in eight provinces and cities. However, IFF companies are being permitted only to engage in local delivery within the city or province in which they are licensed to operate, but not between the specified areas.

The licensing process in logistics and freight forwarding remains non-transparent, costly, and time consuming. Logistics companies applying to provide multi-modal services face the arduous task of acquiring and interpreting information about requirements that vary depending on the national authority and the province in which they file the application. Freight forwarding enterprises should be extended national treatment, and should be able to obtain a national operating license.

CSI members also urge China to extend national treatment for equity capital to U.S. providers of freight forwarding and logistics services. The minimum registered capital in freight forwarding equals U.S.$1 million, plus U.S.$120,000 for each additional branch, which is twice as high as the requirement for domestic companies. To provide third party logistics services, foreign companies must meet a U.S.$5 million capital requirement.

Telecommunications

Despite China’s commitment to provide a *reasonable* period for public comment, changes to the 2003 Catalogue of Telecommunication Services were published by the Ministry of Information Industry (MII) only 1 week before their implementation. The very short period of one week between publication and implementation made meaningful comment impossible. The resultant telecommunications service classification regulations redefine basic and value added services so as to protect the state-owned incumbent providers. For example, they limit IP-virtual private networks (IP–VPNs) to “domestic” services, and delete “resale” services. A basic services license, available to foreign invested joint ventures only since December 2004, is subject to a RMB 2 billion (U.S.$250 million) capitalization requirement, which is 100 times higher than for value added service licensees.

We urge Chinese authorities to classify value-added and basic services in a manner that encourages competition and limits pre-qualification capitalization requirements to those directly related to specific risks of a new venture. A narrowly tailored performance bond would be more appropriate to address any reasonable risk concerns.

CSI members believe that the MII cannot be considered as an independent telecom regulator because it continues to support state enterprises. The regulator has persisted in issuing rules distinctly favorable to state owned enterprises without inviting public comment, contrary to China’s obligations.

We are pleased that China is currently circulating a long awaited telecom bill among its government offices. We hope this bill will address outstanding sectoral issues, and be available for public comment well before it comes into effect.

Digital Products Customs Valuation

China made WTO commitments with respect to customs valuation to apply digital products tariffs based on the value of the underlying carrier medium rather than on the imputed value of the content (i.e. on the basis of projected royalties). In June 2003, however, China issued regulations which do the exact opposite. Chinese authorities should reverse these regulations and ensure that customs valuation for all forms of digital products (including, software, movies and music) is based on the value of the underlying carrier medium.

We appreciate the continuing efforts by the USTR, the Department of Commerce, and other governmental agencies to obtain China’s full implementation of its WTO accession obligations. We hope that this year the consultative process with the Chinese government can bring more progress in these and other sectors of interest to the U.S. services industry.

CSI members believe that China's full compliance with its accession commitments and further services trade liberalization will accelerate its development as a mature global trade leader, and help solve existing trade imbalances with the U.S.. China's initial services offer at the Doha Round and its intention to submit a revised offer are welcome steps toward this goal.

CSI members hope that China will join the U.S. efforts to energize WTO services negotiations. China's active and constructive participation in the Doha Round services negotiations is essential. The Doha Round presents a great opportunity for China to exercise its influence with developing countries by helping convince them of the benefits of adopting services trade and investment liberalization as China has.

Computing Technology Industry Association
Washington, DC 20005
April 27, 2005

House Ways & Means Committee
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC

Dear Members of the House Ways & Means Committee:

The Computing Technology Industry Association (CompTIA) is pleased to submit comments to the Committee to be included in the record for the Hearing on the United States-China Economic Relations and China's Role in the World Economy held on April 14, 2005.

CompTIA is the world's largest information and communications technology trade association with over 20,000 members in 102 countries. CompTIA's members consist of software developers, hardware manufacturers, application service providers, Internet service firms, distributors, retailers, resellers, training, service, and telecommunications companies. The Association's members collectively employ thousands of people and produce billions of dollars worth of goods and services each year. CompTIA operates in both in the U.S. and in China with offices located in Hong Kong.

CompTIA's core mission includes the promotion of policies that enhance growth and competition within the computing industry and the facilitation of the development of vendor-neutral standards in e-commerce, customer service, workforce development and ICT work force certification.

Recently, China promulgated draft "Implementation Measures for government Procurement of Software". These Implementation Measures would severely restrict market access by non-Chinese companies. Moreover, it is our understanding that the draft Implementation Measures represent the first of what is likely to be a series of sect oral rules promulgated by the Chinese government to implement its new procurement law.

We believe that the domestic procurement preference set forth in the Implementation Measures contradicts the general trend in international trade and procurement law toward open, transparent, technology neutral and non-discriminatory access to global markets. In addition, the draft Implementation Measures run counter to the spirit of China's commitments that it made when it acceded to the WTO Agreement and assumed observer status with respect to the WTO government Procurement Agreement (GPA).

More specifically, we believe that the requirements set forth in the draft Implementation Measures are overly restrictive and inconsistent with international practice. No other major economy has proposed similar measures to develop their software sector in this way. These measures create a serious risk that China's software industry will become further isolated from the global marketplace. This result has harmful implications for both the U.S. and Chinese economies.

The Chinese government's most recent move to close is software procurement market to foreign providers signals a troubling departure from its WTO commitments and from internationally accepted free trade norms. We urge the U.S. Government to continue to press for further liberalization of China's trade policies in a manner that benefits both the U.S and Chinese economies.

We appreciate the opportunity to provide these comments and look forward to working with Committee on an issue of great importance to the technology community— improving China's commitment to fair and open trade.

Respectfully,

Roger Cochetti
Group Director, U.S. Public Policy

Statement of J.P. Gorgue, ContiGroup Companies, Inc., New York, New York

Thank you, Mr. Chairman, for the opportunity to bring to this Committee's attention a matter that I believe is a very important example to the future of the trade relationship between the United States and China. This hearing is focused on United States-China Economic Relations and China's role in the World Economy. However, there is an essential issue that must be addressed, the administration and enforcement of arbitral and legal judgments. Simply put, China cannot reach its economic potential with the United States until it consistently applies the rule of law and due process of law to foreign companies and investors doing business in China.

ContiGroup Companies, Inc. (ContiGroup) would like to take this opportunity to address a specific trade issue with China that we have first-hand knowledge about. Our issue is an example where the United States must encourage China to abide by their law and enforce arbitration awards against a Chinese counterparty under the 1958 New York Convention. China is a party to that Convention.

Mr. Chairman, allow me to provide you and the Committee with a little background about ContiGroup Companies, Inc. ContiGroup Companies, formally known as Continental Grain Co. is a recognized leader in integrated poultry and pork production and cattle feeding, with nearly two hundred years of experience in agribusiness and global trade.

The Co.'s principal businesses are Wayne Farms LLC, ContiBeef LLC, and Premium Standard Farms. The Co. also has significant business interests in Latin America and China. In all, ContiGroup serves customers around the world through facilities and affiliates in ten countries.

One of the world's largest agribusiness companies, the ContiGroup Companies:

- Employs more than 15,000 people worldwide and has offices and facilities in 10 countries
- Operates 13 state-of-the-art poultry plants across the southeastern United States
- Supplies fresh and further-processed poultry to restaurant chains, frozen food makers, and other retail companies throughout the world
- Runs one of the world's largest cattle feeding operations, with six major feedlots in Colorado, Kansas, Oklahoma and Texas
- Raises and markets more than 1 million head of beef cattle per year
- Ranks as the second-largest integrated pork producer in the U.S. through its joint venture with Premium Standard Farms
- Is a major producer of animal feed, wheat flour, pork, and poultry in Latin America and the Far East

As you can see, Mr. Chairman, ContiGroup Companies has a substantial role in the U.S. agricultural and related business. Currently, the U.S. enjoys an agricultural trade surplus with China.

In many respects China is a developing country, yet, it has become a dominant producer and a world-class exporter of many agricultural products. To U.S. agriculture, including the ContiGroup, China remains a great opportunity while at the same time it's a substantial threat. As in our case where the Chinese court refuses to adhere to the rule of law and enforce an arbitral award against a Chinese company.

Mr. Chairman, allow me to provide the Committee with the facts of the ContiGroup case that brings me here today.

Continental Enterprises Limited (a subsidiary of ContiGroup Companies) entered into a contract on July 2, 1997 to sell 300,000 metric tonnes of Brazilian and/or Argentine Soybean meal to the Shandong Zhucheng Foreign Trade Group Co. The shipment was to be in parcels of 50,000 metric tonnes each month in May to August 1998 with 100,000 metric tonnes to be shipped in September 1998.

The agreed price was U.S. $231 per metric tonne C&FFO with payment to be made by irrevocable sight documentary credit. All other terms of the contract were as per GAFTA Contract No 100. It was expressly agreed that any dispute arising under the contract was to be referred to arbitration in accordance with the Rules of GAFTA Contract No 125 and with any arbitration to be held in Hong Kong. The Contract was to be governed by English Law. By Addenda dated 9 March 1998 and 21 May 1998 additional amendments were made to the shipment period, contract price and credit terms.

The first shipment was made in July 1998. By reason of the failure of the Buyers to open a Letter of Credit in relation to the next shipment they were placed in default under the contract. The Buyers failed to open subsequent letters of Credit in relation to the subsequent shipments and were placed in default in relation to each shipment.

On November 27, 1998 notice of arbitration in relation to all claims arising under the above contract (and Addenda). The Arbitration proceedings were actively pursued by both parties. On November 9, 2000, the GAFTA Tribunal handed down a first tier Award against Shandong Zhucheng Foreign Trade Co. That Award was the subject of an Appeal. By an Award dated May 9, 2002, the GAFTA Appeal Board gave its Award against Shandong Zhucheng Foreign Trade Co.

The law of the People's Republic of China on Civil Procedure (1991) provides that if a party to an Arbitration Award fails to comply with the terms of the award then the other party may apply for enforcement to the court in the place where the party against whom the enforcement is sought has his domicile or where his property is located. At which time Chinese law also provides that the court has 60 days to grant or deny recognition and enforcement. In our case, this has not been done. This is important because Continental Enterprises Limited made application, dated **October 23, 2002,** to the Intermediate People's Court in Qingdao, China for the recognition and enforcement of the Appeal Award. No decision has been rendered, after two and half years.

The matter came for a first hearing before the court on December 10, 2002. On December 19, 2002, Continental Enterprises Limited were informed that the Shandong Higher People's Court had ordered the transfer of the case to them. On February 18, 2003, a hearing took place before the Shandong Higher People's Court. On July 16, 2003, Continental Enterprises Limited were informed through their Chinese lawyer that the matter was then before the Supreme Court in Beijing.

After considerable further delay and in January 2004 the Shandong Higher People's Court ordered further clarification to be given as to why the seat of the arbitration was in London and the physical place of arbitration was in Hong Kong. The GAFTA secretariat responded to that request for information in March 2004. Further requests by Continental Enterprises Limited for a hearing or for further information concerning the status of the long outstanding application have been refused by the Court.

Yet, as of today, six and-a-half years later, we are still trying to enforce payment of this $14,000,000 arbitration award.

It is essential, Mr. Chairman, that companies be able to enforce legal contracts, and when necessary, legal judgments. This is one example of where the Chinese fail to meet their trade obligations. Simply put Mr. Chairman and Members of the Committee, China is not following their own rules of law and denying justice.

By not taking necessary rule of law remedial actions, the Chinese government and courts promote Chinese companies to break the law. Federal agencies which administer trade remedy and compliance laws in the U.S. must have the authority and be able to enforce the rule of law so that U.S. industries and businesses are protected against unfair trading practices. This is especially true when administering trade remedy laws in defense of unfair trading practices undertaken by countries such as China.

Thank you for the opportunity to present our views. I look forward to answering any questions that you and members of the Committee may have.

Kellwood Co.
Chesterfield, Missouri 63017
April 25, 2005

Committee on Ways and Means
1102 LHOB
Washington, DC 20515

I am asking you to support the U.S. apparel industry and the U.S. consumer by denying any attempts to impose unreasonable and ill-advised restrictions on Chinese textile and apparel products. **Re-imposing quotas on China will save not a single U.S. textile or apparel production employee's job.**

The ***10-year phase out*** of textile and apparel quotas under GATT finally reached an end on January 1. The apparel industry can, for the first time in over 40 years, manage our business with efficiencies and best practices that other industries have always had available to them; no longer subject to a patchwork of limits that restrict who we could work with, in which country and how much it would cost. As a major supplier of apparel to middle-income customers across the country, these changes mean we can concentrate on providing quality, cost-effective apparel to the U.S. consumer.

During the 12-month period leading up to this final phase-out of the quotas, a confusing array of rules and restrictions that were part of U.S. quota management, expired. Without the ability to utilize these rules, U.S. apparel importers changed sourcing patterns during the last quarter of 2004 and, to avoid potential embargoes, delayed shipping goods until after the first of the year. These changes lead to the large volume of imports in January and February.

In addition, since China was one of the last countries to be added to the quota regime, they had an unusually small allotment in proportion to their production capabilities. Because of this they were held to less than 5% of the U.S. apparel import market while subject to quotas. Taking this into consideration, large ***percentage*** increases are to be expected following the phase-out.

Statistics published by the Department of Commerce bear out expectations for a sharp increase of imports from China during the month of January—the only month for which data is yet available. However, the numbers are not reported within a practical perspective. Consider, instead of isolated percentages selected out of context, the following information for the 12-month period ending January 31, 2005, directly from the DOC report:

- U.S. apparel imports from ALL sources were up 8.47%.
- Overall imports from China were up 47.05%—increasing China's total market share to 22%, only a 6% ***market share*** increase.
- Imports from Hong Kong, Taiwan and Korea were down 29% to 8% of the total U.S. imports.
- Imports from South Asia and ASEAN countries maintained their 32% market share.
- Imports from the CBI countries held at 16% of market share.

Thus, China's increases for the most part reflect held-back shipments from 2004 and a restructuring of production between Hong Kong and China. Will China continue to expand their market share? Yes. Did any of this growth affect apparel production in the United States? No. This, and future growth, will not come from the minimal apparel production that remains in the U.S., but from a shifting of production elsewhere in the world—a phenomenon that has been playing out for years.

The apparel industry chases changing consumer tastes for styles and fabrics that require a flexible and ever-changing sourcing model. There are quality, logistics and social/political considerations that will prevent any single country from becoming a sole source. China will be a major source, due to their dedication to installing state-of-the-art facilities and their ready and able labor force. However the realignment in global production shakes out, U.S. apparel jobs will not be affected, since the great majority of production jobs migrated off-shore in the past 10 years ***while quotas were firmly in place.***

Kellwood Company, a $2.4 billion U.S. marketer and merchandiser of wearing apparel, is a prime example of the changing face of the apparel worker in the U.S. Although we no longer maintain sewing facilities in the U.S., we have a U.S. work force of approximately 5000 employees in over 14 states in industry-careers that are unaffected by trade benefits to other countries. Continuing to keep our company strong through allowing us to source apparel *at the right place, the right time and the right price* is vital to our customers, our employees and our stockholders. Our brands offer fashion and value to the American consumer through a multitude of retail channels, including department, mass, specialty, mail order and discount stores, with sportswear, activewear, sleepwear, lingerie, infant and childrenswear, designer labels, urban trends, wovens and knits; made possible by our global sourcing capabilities.

Any threat to what remains of U.S. apparel production—and more extensively to textile and fiber production—posed by the elimination of quotas will not be affected by new restrictions that hurt U.S. business and consumers. The best way to help these remaining U.S. industries is to help their largest market—the CAFTA countries. Without tariff assistance, the ability of neighbors in the CAFTA countries to compete with any of the Asian production centers is severely handicapped. Efforts to bring about passage of CAFTA would be far more valuable to the U.S. textile industry than imposing delaying restrictions on China. We therefore encourage you to vote for this necessary, positive trade package as the best way to keep a hemispheric balance in global trade.

Sincerely,

Wendy Wieland Martin

Kondor Waffenamt
Apple Valley, California 92308
April 22, 2005

Committee on Ways and Means
1102 LHOB
Washington, DC 20515

Mr. Chairman and Members of the Committee:

My name is Richard Radcliffe. I am a retired Captain in the United States Air Force and I wish to express my views regarding trade with the People's Republic of China (PRC).

I believe that the PRC is using trade as a form of economic warfare against the United States. The desired outcome of this war is first to enable the PRC to make Taiwan part of the PRC by coercion if possible or by military conquest if necessary. To this end the PRC must reduce the capability of the United States to economically support the military forces necessary to defend Taiwan. The second desired outcome is to render the United states incapable of challenging the PRC's supremacy in Eastern and Central Asia.

I believe that the current currency imbalance is a means of draining sufficient dollars from the world economy that the PRC can control the value of the dollar by buying or selling U. S. Treasury instruments. The supply of dollars held by the PRC also allows them to apply economic leverage to American industries that they consider to be strategically important to them or to us. The PRC uses these dollars and proposed orders from technically advanced American manufacturers such as Boeing to coerce technology transfers as part of sales. Such transfers of technologies in the fields of navigation, autopilot and other types of dual-use aviation technology allow the PRC to advance the quality of their military aviation by incorporating clones of the systems they receive in their aircraft.

In addition, aircraft purchased as proposed civilian transports may be converted into things like command and control aircraft, aerial tankers, strategic and tactical airlift aircraft and electronic warfare aircraft. Once the PRC possesses the aircraft we lose control over what that aircraft actually does.

Additionally, the PRC has used contracts to launch satellites as a means of acquiring dual-use technology to improve its strategic and tactical missile forces. There are now public estimates that over 700 tactical missiles are aimed at Taiwan. The Taiwan Relations Act provides that the United States will defend Taiwan against any attempt by the PRC to unilaterally incorporate Taiwan into the PRC. Each time that we sell advanced technology products to the PRC and provide the technology transfer we are enhancing the ability of the PRC to forcibly incorporate Taiwan into the PRC and adding to the dangers that Americans will face if sent to the defense of Taiwan.

I believe that the PRC also uses trade to cripple domestic industries in the United States and make us more dependent upon the PRC for certain goods. The textile industry is but one example that was cited before the Committee. Steel is another example. Both of these industries are essential to America. Which industry will be next?

I believe that the Committee on Ways and Means must lead the fight to provide American industry with a level playing field in trade when dealing with the PRC. I also believe that we must reduce the ability of the PRC to apply economic pressure to certain American industries and companies using its extensive dollar holdings. I believe that the Committee on Ways and Means should produce a bill that levies a countervailing duty on all goods imported from the PRC. This duty should be equal to the difference in value between the official value of the Renminbi and its value presuming it was a free-floating currency. For example, the stated value of the Renminbi is currently a little over eight to the dollar. However, if the Treasury Department in conjunction with the Federal Reserve were to estimate that the actual value of the Renminbi were to be four to the dollar, a duty would be assessed on imports from the PRC of 100 percent.

I am not suggesting this countervailing duty merely as a means of providing equity to American manufactures but also as a measure in the national defense. The PRC continues to buildup its military. There is no doubt in my mind that shortly the PRC will attempt to present the United States with a *fait* acompli with regards to Taiwan. In addition, the PRC continues to provide the bulk of economic support to the Democratic People's Republic of Korea (North Korea). This economic support allows the DPRK to apply its scarce resources to the construction, deployment and in some cases export of Weapons of Mass Destruction and their delivery systems.

I believe that one of the reasons that the PRC provides this support is to force the United States at some time in the future to make a choice between defending the Republic of Korea against an invasion or the threat of an invasion from the North and defending Taiwan against an invasion from the PRC. The recent civil disobedience in China relative to Japan and the textbook issue I believe has more to do with the Joint Communique from the "2+2" talks where Japan stated that Taiwan was of strategic interest to Japan. This an indication of how serious the PRC is about the incorporation of Taiwan into the PRC by any means necessary.

Therefore, anything that we can do to reduce the economic power of the PRC over the economy of the United States is in our National interests and must be pursued. This must include such countervailing duties and other measures as necessary to protect strategic American industries and prevent "dollar blackmail" of our technologically advanced industries.

Additionally, I believe that the responsibility for licensing the export of advanced technologies should be removed from the Department of Commerce and placed within the Department of Defense. The Congress addressed technology transfers in a special report to the Speaker a few years ago. While this topic may not be under the purview of the Committee on Ways and Means, members of that Committee are influential members of Congress and other committees. I would ask the members of the Committee to use their influence in the House to see that such action is taken.

Thank you for the opportunity to address the Committee.

Richard Radcliffe
Captain
United States Air Force (Retired)

Statement of Cass M. Johnson, National Council of Textile Organizations

Our statement today specifically addresses the threat from China and how the removal of quotas on imports from China is likely to the impact the U.S. textile and apparel sector. It contains recommendations for steps the U.S. government and U.S. Congress should take to address the threat that China poses specifically to the U.S. textile sector, as well to U.S. manufacturing in general.

The National Council of Textile Organizations (NCTO) represents the entire spectrum of the textile sector, including fiber, yarn, fabric, and supplier industries. The U.S. textile industry is one of the most highly automated and advanced textile sectors in the world. Over the last 10 years, the U.S. textile industry has invested almost $35 billion in upgrading its plants and equipment. The U.S. textile sector—from fibers to apparel—employs nearly one million workers in the United States.

BACKGROUND

As you know, the Uruguay round Agreement on Textiles and Clothing (ATC) required that existing quotas on textiles and apparel be phased out on January 1, 2005. Recognizing China's ability to overwhelm world trade in this sector once quotas were removed, the World Trade Organization (WTO) included a special China textile safeguard in China's WTO accession agreement. China agreed to the textile safeguard provision, and in return the WTO allowed China to be integrated into the ATC and the quota phase-out immediately upon admission to the organization. This special textile safeguard provision is available to all WTO members and has been utilized by numerous countries which are also concerned about China's ability to overwhelm their markets.

On October 27, the U.S. industry began filing safegaurd petitions with the U.S. government covering a variety of textile and apparel products. An importing group, the U.S. Association of Importers of Textile and Apparel filed a case with the Court of International Trade asking that the cases be suspended while the government's safeguard procedures were reviewed by the Court. On December 27th, the Court issued a preliminary injunction. Six weeks later, the U.S. government appealed the injunction to the Federal District Court of Appeals. The case is scheduled to be heard in May.

On January 1st, 2005, quotas were lifted on imports of textiles and apparel from China as well as other countries. On April 1st, the U.S. government released preliminary data on imports from China showing that imports surged during the first three months of the year, with over 400 million garments exported from China. Chinese export increases were as high as 1,500 percent in some of the most sensitive textile and apparel categories.

On April 4th, the U.S. Government self-initiated investigations into surging imports from China of cotton trousers, knit shirts and underwear. ON April 7th, the U.S. industry filed six additional petitions asking for safeguards to be applied against a range of textile and apparel categories and urged the U.S. government to expedite its decisionmaking process.

SUMMARY OF DATA ON THE CHINA THREAT

The enormous surge in imports of textiles and apparel from China during the first quarter of the year demonstrates that the longstanding concerns of the U.S. textile industry—as well as most of the world's textile and apparel producers [1]—of a Chinese tidal wave were well founded.

In January through March of 2005, China exported more than 400 million garments to the United States, an all time record for any country. Imports increased by more $1.3 billion in just 2 months time and some particularly sensitive products, such as cotton trousers, saw import increases of as much as 1,500 percent. Exports of cotton trousers increased from 5 million in Jan-March 2004 to 81 million in January-March 2005. Cotton knit shirts, another sensitive category, saw increases of almost 1,300 percent, from 6 million shirts in first quarter 2004 to 86 million in first quarter 2005.

In categories removed from quota, China's prices in January dropped an average of 22 percent compared to prices 1 year ago, with the average Chinese price in January 2005 of $1.25 per square meter compared to $1.61 per square meter in January 2004. Highly sensitive categories saw much deeper price cuts, with prices for Chinese cotton trousers falling 54%, from $10.56 a trouser to $4.75 a trouser. In fact, if China repeats its behavior in 2002, when 25 apparel categories saw their quotas removed, the U.S. can expect overall prices for apparel to drop by more than 50 percent.

Under normal market conditions, China could never offer these kinds of price reductions; it is only because of direct government subsidies, currency manipulation, rebates, and tax breaks, that Chinese firms can undercut every other producer in the market. If a U.S. firm behaved in such a manner, it would immediately be the subject of numerous federal investigations where enormous penalties and prison sentences would be imposed on those found guilty of such practices. Numerous studies, recent trade data and insights from importers and sourcing agents on the impact of the quota phase-out all lead to a simple conclusion: if the U.S. government does not act and act quickly to re-impose quotas from China, the U.S. textile and apparel sector—along with much of the world's textile and apparel production—will quickly be over-run and destroyed by China.

As China's own reports make clear, for the last 15 years, the Chinese government has been aggressively implementing an ambitious plan to make their textile and apparel sector the dominant player in world trade. In pursuit of this goal, the Chinese government has poured tens of billions of dollars into its textile and apparel sector in the form of free capital, direct and indirect subsidies and a host of other "incentives" to create an environment where no one, including the lowest cost-producing countries in the world, can compete with them in world markets.

In this effort, China has largely succeeded. As U.N. trade figures clearly demonstrate, there is essentially no doubt that China is substantially underpricing its textile and apparel exports compared with every other producer in the world. The United Nations COMTRADE database [2] shows that China charges on average 58 percent less for apparel products than the rest of the world.

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[1] The Global Alliance of Fair Trade in Textiles and Clothing (GAFTT) (www.fairtextiletrade.org) is comprised of almost 100 trade associations from over 50 countries around the world. GAFTT formed in 2004 to counter China's attempts to gain hegemony over world textile and apparel trade. GAFTT members represent over $150 billion in textile and apparel trade worldwide.

[2] The United Nations COMTRADE database collects export and import trade data from government around the world: http://unstats.un.org/unsd/comtrade.

In every case where China has gone head to head with other producers, China has won by an enormous margin. Typically, China has ended up with a 75 percent share of the market with the next largest supplier getting 5 percent. The trade figures show that whenever China enters the picture, the free market fundamentals that should drive trade and competition get thrown out the window. Literally, no country is spared. It has not mattered whether you have the benefits of lower labor costs (Bangladesh, Indonesia), duty-free access to a particular market (the Caribbean Basin, Sub-Saharan Africa) or proximity to the U.S. market (U.S. producers, Mexico and the Caribbean). These factors simply do not make a difference when China is part of the equation.

The reason for this is the pervasive intervention of the Chinese government throughout its textile and apparel sector. Because the Chinese government essentially finances the sector—through currency manipulation, central bank loans, subsidies to state-owned enterprises, exports subsidies, tax incentives, reduced electrical costs (among many others)— Chinese exporters are free to drop prices to whatever levels are necessary to get the sale.

This means that as hard as U.S. textile mills or Bangladeshi knitters or Turkish yarn spinners or Mexican trouser makers or African shirt manufacturers invest in their businesses, when put head to head with China, they will lose the sale. This fact has proven out time and again in world markets where quotas have not been in place. In Japan, for instance, China has taken an 83 percent of the Japanese apparel market. The next largest supplier is Italy with 5 percent.

Producers around the world have tried to compete. U.S. textile mills have one of the highest capital reinvestment rates of any industrial sector. Since the quota phase-out was agreed to in 1994, U.S. Government statistics show that U.S. textile mills have invested more than $34 billion in new plants and equipment. As a result, U.S. textile output per worker has increased by 37 percent over the last 10 years, from $44.50 per worker hour to $63.54 per worker hour.

In other words, the U.S. industry has done what it was supposed to do in order to prepare for the quota phase-out. It has re-invested in its plants and equipment and become even more productive than ever before. In fact, productivity increases in the U.S. textile sector are among the highest of any industrial sectors over the last ten years.

But the textile industry, or any industry, cannot compete against entire governments. We cannot compete against a Chinese government that gives its exporters a 40 percent price advantage because of a rigged currency. We cannot compete against Chinese government banks that provide essentially free cash for plants and equipment. We cannot compete against state-owned textile mills that get billions of dollars in government handouts each year and never have to show a profit.

And, as mentioned earlier, we are not alone. All across the globe, textile and apparel sectors that provide millions of jobs, mostly in developing and least developed countries, are at risk. A clear recognition of this is that 28 countries stood up at the WTO's Council on Trade in Goods last October and demanded that the WTO take up the issue. Another is the creation of an international coalition of textile and apparel groups—the Global Alliance for Fair Trade in Textiles—which was formed just last March and now includes 96 textile and apparel trade groups from 54 countries representing $150 billion a year in textile and apparel trade. At GAFTT's most recent meeting in Washington, the group called for immediate use of the China textile safeguard in order to prevent China's takeover of world trade in these sectors.

When the Chinese government breaks the rules, our government can and should act on behalf of U.S. industry and U.S. workers. The safeguard measures in the WTO Agreement are directed specifically toward China because negotiators realized that China in particular did not play by the rules and, as a result, it posed a real threat to textile and apparel sectors around the world.

Recommended Course of Action

First, the U.S. Government must expedite the safeguard actions which it has self-initiated as well as the decisionmaking process for safeguard petitions filed by the U.S. industry and also modify its safeguard procedures in order to make them effective.

Specifically, the government must revise its procedures in order to speed up the decisionmaking process. Currently, the process requires up to 4 months to conclude and can be instituted only and entire first quarters worth of data have been reported upon. In real terms, this means the industry must wait until July or August to get a safeguard that will then only be imposed for the remainder of the calendar year. A safeguard that only lasts 5 months is no safeguard.

China has clearly demonstrated an ability to take advantage of the procedures as currently written. Import increases from China were the highest in the apparel categories that were clearly targeted by the industry for safeguard actions. This included a 1,500-percent increase in cotton trousers and a nearly 1,300-percent increase in cotton knit shirts.

Instead, the government must revise its procedures to clearly allow for "threat" cases to be brought and for expedited consideration of both U.S. Government-initiated and U.S. industry petitions.

Second, the U.S. Government must push for a permanent safeguard mechanism in the Doha Round of trade talks. A serious flaw in the existing safeguard is that it is currently scheduled to expire in 2008—regardless of whether China ends the unfair trade practices that make the safeguard necessary in the first place. A permanent safeguard must be part of the Doha Round of trade talks.

Third, the U.S. Government must begin to aggressively counter China's unfair trade practices. The government must impose punitive sanctions against China's imports if China does not move quickly to float its currency. It must initiate WTO subsidy cases against China's use of government banks to finance its export machine. It must crack down on continuing massive transshipment and illegal smuggling of Chinese textile and apparel products. It must reverse the Commerce Department position against allowing industry to attack China's subsidy schemes using countervailing duty laws.

Fourth, the U.S. Congress must take in the lead in demonstrating to China that there are costs to its mercantilist trade policies and its refusal to act as a responsible player in the world trade arena. The Congress should quickly pass the Ryan-Hunter China CVD bill and the Schumer-Myrick China currency bills. These bills send the strongest message to China that its anti-free market behavior has real costs and that the U.S. Congress will not allow more U.S. jobs to be sacrificed because of China unfair trade practices.

DETAILED REVIEW of CHINA THREAT

The next sections of this statement will present data evaluating the threat that China poses: 1) the size of China's textile and apparel sector; 2) the government support that China gives to this sector, and 3) China's ability to underprice and overwhelm its competitors, including the U.S. textile industry.

Size and capacity of China's textile and apparel sector.

It is no exaggeration to say that China's textile and apparel sector exists on a scale unimagined in other countries. This sector alone employs tens of millions of worker and supports, directly or indirectly, as many as ninety million workers.[3] Entire cities in China are dedicated to the production of specific types of textile or apparel products. And the textile and apparel sector, targeted by the Chinese government as a "pillar of the economy", is China's largest earner of foreign exchange of any sector, garnering $65 billion in foreign exchange earnings in 2003.

Today, according to Chinese government reports, China produces more than 20 billion garments a year, enabling China "to offer four pieces of clothing to every person on earth."[4] Its production base has increased by 50 percent in just the last 4 years. And the Chinese government reports investments of $21 billion in its textile and apparel sector in just the last 3 years.

The International Trade Commission reports that, in 2001, "China alone accounted for 29 percent (34.7 billion pounds) of the world's total textile fiber production." Keep in mind that China reports that its textile and apparel output has increased by between 40 and 50 percent since that time.[5]

Other Chinese government statistics show that last year there were 3,784 textile plants under construction in China, with $180 billion in outstanding planned investment and $78 billion poured into new production in 2003.[6]

In order to fill these plants with machinery, China has been on a buying spree during the past four years, in some cases consuming up to two-thirds of world production of textile machinery (i.e. broadwoven fabric looms).

[3] *China: Stick to WTO Rules, Commerce Minister Urges,* just-style.com, September 20, 2004.

[4] XINHUA news agency (April 14, 2003) "China's garment industry makes important strides".

[5] *Id. See,* ITC discussion of Yarn and Fabric production Capacity, pp. 1–19—1–22 of the ITC Report.

[6] *China Surge Big Topic at Cotton Meet,* Women's Wear Daily, March 3, 2004.

Recent information on China's garment industry indicates that China has maintained its enormous pace of expansion through September 2004. Already the world's largest exporter of textiles and apparel, China is reporting a 27-percent increase in production thus far this year.[7]

A new survey of China's apparel manufacturers by Global Sources, a large broker for many of China's exports, found that 89 percent of them were planning to expand output after the global end of apparel quotas. Half of the 215 companies surveyed planned to increase production capacity by 20 to 50 percent, and several other companies indicated intentions to expand capacity by more than 50 percent.[8] The survey found manufacturers were either building new factories or moving to new factories and extending existing factory space or upgrading equipment. All of them said they would be hiring more staff.

China's government support of its textile and apparel industry.

As the U.S. China Commission and other independent bodies have already noted, the Chinese government engages in a variety of unfair and anti-competitive trade practices that make it difficult, if not impossible, for either U.S. manufacturers or other manufacturers, to compete.

In textiles and apparel, government involvement is pervasive in China. China has declared textiles and apparel to be a "pillar industry of the nation" and China's textile and apparel output is actively managed through Five-Year Plans going back almost 50 years, and the Tenth Five-Year Plan concludes in 2005.[9] In its most recent 5-year plan, China establishes government objectives for virtually every segment of the industry.[10]

According to the most recent Textile Five-Year Plan, 46 percent of textile assets are state-owned, and 31 percent of all state-owned enterprises are operated at a loss.

For its part, the U.S. government has long acknowledged that China does not play fair in textiles and apparel. In a recent WTO submission, the U.S. Government noted that China provides assistance to its textile sector in numerous ways, including "the manufacturing of raw materials, the financing of mill establishments and the purchase and selling of raw materials."[11]

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[7] Chinese Textile and Apparel— Updated Figures through Sept. 04.

	Amount	Increase over YTD September 2003
Textile and Apparel production	1,081 billion Yuan	27%
Exports of textiles and apparel	$83.17 billion	20%
—Garments	$44.69 billion	19%
—Textiles	$26.01 billion	27%

Source: CNTC

[8] *U.S. Weighs Import Limits on China,* The New York Times, September 11, 2004.

[9] "Industry Overview: The Tenth Five-Year Plan of the Textile Industry and its Development", BizChina, 11/18/2004.

[10] The Tenth Five-Year Plan contains objectives for all aspects of the textile and apparel sector. These include:

1. Annual growth rate;
2. Industrial value growth rate;
3. Growth rate for foreign exchange to be earned;
4. Proportionate growth for different textile and apparel sectors;
5. Labor productivity growth;
6. Energy consumption;
7. Water consumption;
8. Renovation and upgrade of the cotton spinning sector;
9. Renovation and upgrade of the wool yarn and weaving sector;
10. Renovation and upgrade of the silk and linen sector;
11. Renovation and upgrade of the knitted textile sector;
12. Renovation and upgrade of the chemical fibers sector;
13. Renovation and upgrade of the industrial textile sector;
14. Renovation and upgrade of the industrial textile machinery sector;
15. Renovation and upgrade of the dyeing and finishing sector;
16. Renovation and upgrade of the apparel sector, including the expansion of exports and development of branded and children's apparel.

[11] Ibid.

China's other unfair trade practices affecting textiles and apparel include currency manipulation, forgiveness of loans from state-owned banks, favorable bank terms for "honourable enterprises" which target export industries, export-contingent tax incentives for foreign-invested enterprises (FIEs), income tax refunds for foreign investors in export-oriented businesses, income tax reductions equal to 50 percent for FIE's in export-oriented businesses, VAT refunds for imported capital equipment used for export-oriented businesses, grants by individual provinces for export-oriented industries and continued subsidies for state-owned enterprises which are running at a loss[12] and subsidies for coal and oil supplied to Special Industrial Sectors (such as textiles and apparel).

China's ability to underprice and overwhelm its competitors, including the U.S. textile industry.

The threat that China poses to U.S. textile and apparel companies and their workers can be assessed in a number of ways. These include a review of: A) China's prior behavior in textile and apparel categories removed from quota control in 2002; B) China's penetration of textile markets outside of the United States; C) China's pricing on the worldwide market for textile and apparel products; D) analyses and studies by international groups on China's domination in a post-quota world; E) statements by importers and retailers about their sourcing intentions once quotas are removed.

It is significant that all of these perspectives come to the same conclusion—China will dominate trade in textiles and apparel in a quota-free world. Estimates for the size of that domination begin at around 50 percent and increase upward to between 70 and 75 percent. Correspondingly, the impact on the U.S. textile and apparel sector from such a scenario is severe, with U.S. production plunging by two-thirds and job losses of 500,000 workers or more. The United States is not the only victim—job losses worldwide may be a large as 30 million with developing and least-developed countries bearing most of the cost.

China's prior behavior in textile and apparel categories removed from quota control in 2002.

In 2002, as part of the phase-out of worldwide quotas, a relatively small number of textile and apparel categories were removed from quota control. The bulk of textile and apparel categories—80 percent of trade—remained under quota restraint until January 1, 2005.

In particular, 25 apparel categories and 115 home furnishing and made-up[13] tariff lines saw quota protection removed. This early quota phase-out provides a preview of how the rest of the world—including U.S. textile and apparel manufacturers—might fare now that all quotas have been removed.

The result in 2002 was a quick and devastating flood of apparel imports from China in quota-free products. In less than 3 years, China's exports took a 73 percent share of the U.S. apparel market in the quota-free categories, with exports from China rising more than 1,100 percent. On the home furnishing and made-up product lines, China took a 60 percent share of the U.S. market as exports from China increased more than 900 percent. China's share in these textile and apparel products is continuing to increase today.

In volume terms, China's export increases were unprecedented, with China's total increases into the U.S. market in just 3 years totaling nearly 4 billion square meters.[14] In comparison, China's increase in this relatively small number of categories was as large as the entire exports of the second largest supplier to the U.S. market, Mexico, which shipped 4.1 billion square meters in 2004. China's increase was larger than the total textile and apparel export from every other country in the world.

The flood of apparel exports from China was driven by a sudden, drastic decline in China's prices for these goods once quotas were removed. In apparel categories, China dropped prices by an average of 53 percent while for "made up" products, Chinese price declines averaged almost 60 percent.

[12] China committed to end these subsidies as part of its accession agreement and reported that all had been terminated as of 2002. However, recent Chinese government reports indicate that these subsidies are still in place and that money-losing enterprises continue to be supported. This includes a report that 47 percent of state-owned enterprises in the textile sector are running at a loss.

[13] Includes curtains, napery, tenting, bags, sailcloth, cordage, ropes, twine and bags, among other items.

[14] China increased its exports of apparel products by 1.3 billion square meters and its exports of home furnishing products by 2.6 billion square meters.

As China's exports soared, every other major supplier saw its market share drop sharply, falling by half or two-thirds. Countries such as Mexico, Honduras and Lesotho with free trade area and tariff preference benefits saw their exports in these products fall as dramatically as non-preference countries. This clearly demonstrates that China will take markets regardless of whether countries are beneficiaries of duty-free access to the U.S. market.

China's penetration of textile and apparel markets outside of the United States.

With quotas in place, China's penetration of the U.S. (and European) markets remained relatively low. In U.S. textile and apparel categories which had quotas in place prior to January 1, 2005, China's market share was generally below 10 percent.

However, United Nations trade figures show that in countries where China has not been restrained, China achieved a virtual monopoly of textile and apparel trade. Of particular interest to U.S. textile and apparel manufacturers is Japan and Australia. These are highly developed countries with strong consumer markets similar to those in the United States. The U.N. COMTRADE database shows China's share of these markets at 83 percent with China's textile and apparel exports totaling $16.5 billion in 2003. The next largest supplier is Italy with a 5 percent market share and $1 billion in exports. Following Italy is Korea with a 1.5 percent market share.

U.N. figures show that China has repeated this domination around the world. China's market share outside the United States and the European Union averages 63 percent with China's exports totaling $37 billion and the 100 plus countries making up the rest of the world exporting only $23 billion. The next largest competitor to China in this quota-free environment is Italy with a 6 percent share. The United States ranks third with a 3 percent market share.

China's pricing in the worldwide market for textile and apparel products.

The following excerpts from a December 2003 study by the Jassin-O'Rourke Group [15] details how China is able to sell goods at prices often below the cost of the production:

To date, major countries such as China . . . generally take[s] little or no profit on exported products, in order to generate hard currency and maintain capacity utilization levels; actual import statistics (average price per garment) for core products, compared to typical garment cost analysis, provide further validation of this, and in fact, suggest that some product is sold well below possible cost.

Additionally, a vast majority of China's apparel manufacturers are financed by government banks, and fail to repay loans; it is a widespread and typical practice to "forgive" outstanding debts of apparel firms. *Such practice contributes to China's apparel export pricing strategies that effectively encourage sale of products at whatever value is necessary to capture and/or maintain business; in our experience, such pricing is clearly below possible manufacturing costs for given garments*. These hidden subsidies can have a significant impact on the profitability or competing opportunities of the exporting companies.

Exporters in China appear to agree that they lack a reputation for fair pricing. The China Textile News Co. warns that "malicious price competition" in order to earn foreign currency could invite retaliation by trading partners.

"Major textile companies and organizations said a mechanism to control export prices should be set up to prevent malicious prices competition after quotas are removed in 2005. . . . Export prices of clothing have dropped by about 30 percent since 5 years ago. Price of shuttle-woven garment fell by 27 percent and those of knitwear by 33 percent, according to Xu Xiaochuan from the Sichuan Xinlixin Textile Company.

A senior official from the China Chamber of Commerce of Import and Export for Textiles echoed Xu, saying malicious price competition should be stopped because it merely invited international criticism and trade protectionism that would target the whole industry. . . . **To push exports up and pull in more foreign currency, many domestic companies run down their export business with**

[15] "Merits of A Free Trade Area Of The Americas", December 2003. The Jassin-O'Rourke Group has been providing consulting advice in textile and apparel sourcing to leading retailers, manufacturers and sources for more than twenty years.

fierce price cutting as they get more freedom with the gradual lifting of quotas.[16]

United Nations database tends to verify the Jassin-O'Rourke conclusions and China's own acknowledgement of their pricing strategies. COMTRADE shows that China charged, on average, 58 percent less for exports of trousers, shirts and underwear than did all other suppliers. These trouser, shirt and underwear product groupings represent the bulk of apparel production worldwide.

According to U.N. data, China's prices averaged $1.84 per garment compared to an average "rest of world" price of $4.42 per garment. China's disparity with U.S. producer prices was even greater, with China's prices averaging 76 percent lower than U.S. producer prices ($1.84 per garment vs. $7.63 per garment).

The U.N. data also showed that China's market share for these product categories in non-quota countries averaged 58 percent, with China's share in Japan and Australia averaging 88 percent. China's worldwide market share has been increasing rapidly over the past 5 years as China has ramped up production and increased exports by 76 percent.

The actual size of China's worldwide exports of these products is simply astounding. According to the U.N., China exported 2.9 billion shirts, 2.5 billion trousers and 3.6 billion pieces of underwear in 2003, the latest year that information is available.

Economic analyses and studies by institutional groups on China's domination in a post-quota world.

Virtually every study produced by private consulting groups, governments and international agencies has concluded that once quotas were removed China will rapidly increase its share of world trade in apparel, and the U.S. market will be the largest recipient of these exports. These studies include:

Goldman Sachs: "China's Textile/Apparel Manufacturing: The big bang in 2005," June 2004.

Goldman Sachs concludes that "without quotas, China's exports are set to expand immediately" and that "China has the ability to grow its textile and apparel exports rapidly once trade barriers are removed."

The Sachs study cites China's domination of similar sectors "such as footwear or toys or sporting goods—equally labor-intensive and low-value added" with China's market shares of 66 and 67 percent as an example of the kind of market control China can assert. The study also cites the development of a "complete food chain in textile and apparel manufacturing" in China and the likelihood that "once quotas are removed, wholesalers and retailers are likely to immediately consolidate their orders."

The study also concludes that safeguard measures *based on market disruption* are not likely to be successful because of China's ability to rapidly capture market share. Sachs says that such safeguards may be approved but because "there is likely a lead time for China's exports to prove to be market disruptive, and by which time, China's exports in these product may already be very substantial".

World Trade Organization, Hilegunn Nordds: "The Global Textile and Clothing Industry post the Agreement on Textiles and Clothing," 2004

Nordds concludes "the predicted changes (from quota elimination) are a substantial increase in market shares for China and India, while previously unrestricted (no quota or non-binding quotas) countries will lose market share as well as *local producers in North America* and the European Union." [emphasis supplied]

Using a GTAP general equilibrium model, Nordds predicts that China (including Hong Kong) "triples its share" and takes a 56 percent share of the U.S. import market for apparel while the Mexico and the rest of Latin American loses 70 percent, with the Mexican share falling to 3 percent (from 10 percent) and the South and Central American share falling to 5 percent (from 16 percent).

United States International Trade Commission, publication 3671: "Assessment of the Competitiveness of Certain Foreign Suppliers to the U.S. Market"

The United States International Trade Commission study of the impact of the quota phase-out concluded that "China is expected to become the 'supplier of choice' for most importers because of its large ability to make almost any type of textile and apparel product at any quality at a competitive price." The Commission cited importers who said "there is no garment that they would not make in China."

The Commission reviewed a number of recent studies concerning the quota phase-out, all of which predicted a large increase in Asian market share (China share was not generally extrapolated). One study by Avisse and Fouquin (2001)

[16] *Textiles Warn of Price War Damage,* China Textile Network Co., 8/23/04.

extrapolates China's apparel exports, predicting that it would jump 87 percent once quotas are removed.

The World Bank, Elena Ianchovichina and Will Martin: "Trade Liberalization in China's Accession to the World Trade Organization," 2001.

The World Bank study concludes that China will gain a 47 percent share of the world's export market in apparel once quotas are removed. While the study does not break out the U.S. import market, most studies and commentators agree that the U.S. import market is more susceptible to import penetration by China than others because of its "big box" retail concentration, intense price competition and long standing ties that U.S. importers and retailers have already developed with China.

Statements by importers and retailers about their sourcing intentions once quotas are removed.

Executives that make the sourcing decisions regarding textile and apparel products have been virtually unanimous that imports from China into the U.S. market will dramatically increase once quotas are removed.

Of these statements perhaps most significant was a confidential survey earlier this year of top U.S. executives for major importing and retailing firms who predicted that China would dominate trade in apparel once quotas were removed. The poll, which was conducted in January at the Cotton Sourcing Summit in Miami, asked what percentage of the U.S. apparel market China would take once quotas were removed. 87 percent of the respondents said China's share would exceed 50 percent and half of those predicted that China would gain between 75 and 90 percent.

Regarding major suppliers, 96 textile and apparel trade associations from 54 countries around the world have joined together in the Global Alliance for Fair Trade in Textiles (GAFTT) to raise concerns about China's ability to disrupt markets around the world once quotas are lifted. Citing member concerns, GAFTT recently stated: "Since China joined the WTO at the end of 2001, it has engaged in a premeditated and systematic effort to monopolize world trade in textiles and clothing by undercutting free market prices through a complex scheme of industrial subsidization and currency manipulation".

Regarding sourcing agents, one leading sourcing executive recently sketched his scenario for the end of quotas and China's likely response. In a Women's Wear Daily article, Robert Zane, of Liz Claiborne, described why China would move to quickly flood the U.S. market. Zane, who is senior vice president of sourcing, distribution and logistics at New York-based Liz Claiborne Inc., said the likelihood of safeguards will probably prompt a flood of Chinese goods into the U.S. market starting in January.

Just last week, Mr Zane expanded on his remarks by noting that, "In 1983, when quotas on Chinese shoes were lifted, China made less than 4 percent of the world's shoes. By 2003, its factories had captured more than 80 percent of that business, according to the American Apparel and Footwear Association." "Why should apparel be any different?" Liz Claiborne's Mr. Zane asked.[17]

In a complaint filed in the U.S. Court of International Trade on December 1, 2004,[18] the United States Association of Importers of Textiles and Apparel[19] (the "USA–ITA") stated to the Court that even allowing CITA to accept this petition for investigation harmed and aggrieved its members[20] because of the lead time necessary to enter into contracts to purchase textiles and apparel from China, which it indicated could be anywhere from 120 to 160 days.[21]

[17] New York Times, April 21, 2005

[18] *U.S. Association of Importers of Textiles and Apparel v. United States,* et al., Complaint filed in the U.S. Court of International Trade, Court No. 04–00598, dated December 1, 2004.

[19] "USA–ITA is a person who has been "adversely affected or aggrieved by agency action within the meaning of section 702 of title 5." 28 U.S.C. § 2631(i). USA–ITA members purchase and import into the United States textile and apparel products, and have entered or intend to enter into contractual relationships for the purchase and import of such products," supra note 21 at paragraph 6.

[20] "USA–ITA is a non-profit industry association representing the interests of the textile and apparel importers before Congress, the executive branch, the judiciary, the business community, and the public." *U.S.* Association of Importers of Textiles and Apparel v. United States, *supra* note 21, paragraph 5.

[21] "The nature of the business is such that importers typically need lead times of 120 to 160 days to place and receive orders," *supra* note 21, paragraph 41.

The USA–ITA indicated that its members had entered into contractual relationships concerning the subject products and "are now forced to modify their current sourcing plans—*i.e.* move such orders outside China. . . ."[22]

The USA–ITA also stated to the Court that its "members purchase and import into the United States textile and apparel products, and have entered into or intend to enter into contractual relationships for the purchase and import of such products. These products include goods that are the subjects of domestic petitions—filed October 13, 2004. . . ."[23] The original safeguard request concerning the subject products was filed October 13, 2004.

The USA–ITA goes further and indicates that its members had already placed orders for January delivery from China as it indicates that apparel ordered now would be for delivery in the third quarter of 2005. USA–ITA also clearly indicated its belief that imports from China of the subject products would grow dramatically as it argued to the Court that "quotas covering such products may be filled and closed by the third quarter of 2005."[24] USA–ITA believes that any safeguard limits imposed on the subject products would be filled by the third quarter of 2005, *even though those limits would necessarily be 7.5 percent greater than imports in 2004*. USA–ITA, therefore, essentially admitted to the Court of International Trade that it is convinced imports of the subject products will increase significantly once quotas are removed.

Other leading retail, importing and sourcing executives have regularly expressed their own expectations regarding how China will quickly move to dominate the U.S. market:

Bloomberg News 8/4/04—Bruce Rockowitz, an executive director at Hong Kong-based Li & Fung, which sources clothing worldwide for retailers including American Eagle Outfitters and Abercrombie and Fitch, estimates that 70 to 80 percent of all clothing production will move to China after January 1. Mr Rockowitz said that the Li & Fung has seen a sharp rise in U.S. orders for Chinese clothing. "The surge probably reflects fears that the U.S. will impose anti-surge quotas on Chinese clothing," stated Rockowitz.

Financial Times 7/20/04—Bob Zane, head of global sourcing and manufacturing for Liz Claiborne, told the Financial Times that he expects Liz Claiborne to halve the number of countries from which it sources clothes in the next three to 4 years. In the process, China's share of company direct overseas sourcing will go from about 15 percent to about half, a ratio that Zane expects other big U.S. purchasers will match. He sees China becoming "the factory of the world."

Textile Asia, June 2004—Alex To Man-yau, head of Chinese operations for Hong Kong trade facilitator, Trade Easy, said: "We are seeing a lot of inquiries and orders for Chinese garments from the U.S., Europe and Canada." Mr. To said that the average value of orders placed through his firm for Chinese garments by U.S., Canadian and European buyers has increased fivefold this year over last year."

Textile Asia, July 2004—Steven Feninger, Chief Executive of Linmark Group, a trading firm, said: "Garment orders are rushing to the Mainland from Southeast Asia and Central America in anticipation of the lifting of global textile quotas next January. The scale of the move to China is going to affect national economies." Linmark notes that "once textile quotas are eliminated under World Trade Organization rules, buyers are expected to shift en masse to cheaper Chinese goods." Linmark estimated "that the proportion of its sourcing from Mainland, Hong Kong and Taiwan will rise to 70 percent in 2 years."

Statement of John Meakem, National Electrical Manufacturers Association, Rosslyn, Virginia

NEMA is the largest trade association representing the interests of U.S. electrical equipment manufacturers, whose worldwide annual sales exceed $120 billion. The 380 member companies of NEMA manufacture products used in the generation, transmission, distribution, control, and use of electricity. These products are used in utility, industrial, commercial, institutional and residential installations. The Association's Medical Products Division represents manufacturers of medical diag-

[22] *U.S. Association of Importers of Textiles and Apparel v. United States,* supra, note 21, paragraph 42.

[23] *U.S. Association of Importers of Textiles and Apparel v. United States,* supra note 21, paragraph 6.

[24] *U.S. Association of Importers of Textiles and Apparel v. United States,* supra note 21, paragraph 41.

nostic imaging equipment including MRI, CT, x-ray, ultrasound and nuclear products.

With the valuable assistance of the Commerce Department's Market Development Cooperator Program, last year we opened a Beijing office that is helping our companies with all aspects of their China engagement. Our office has also been working constructively with Chinese counterparts on matters such as energy efficiency, standards development and anti-counterfeiting. Just now in February we conducted an important intellectual protection event in Beijing and signed a memorandum of understanding with the Standards Administration of China. In May we are sponsoring a major energy efficiency conference being put on in Hong Kong by the U.S. Foreign Commercial Service. In short, our China Initiative is off to an excellent start.

China is the single biggest factor influencing our members' business these days. It has quickly become their number three and fastest growing trading partner and export market (after Mexico and Brazil). There is enormous demand in China for the products that the members of NEMA manufacture——from power generating equipment to medical technology. Direct investment there by NEMA members continues to grow, both to serve the Chinese market and to send back• low-cost *components and commodity products that allow our members to stay competitive.*

Yet at the same time China is a two-edged sword that poses challenges and concerns for our industry, among them:

- *Counterfeiting:* the U.S. electrical industry continues to have fundamental, ongoing concerns about Intellectual Property protections in the People's Republic. While we recognize that the National Government in Beijing has made moves to address the counterfeiting problem, NEMA member companies are still all too often victimized by repeated, vast trademark infringement and piracy. The PRC needs to keep on strengthening its anti-counterfeiting measures and enforcement, particularly at the regional and municipal levels.
- *The China Compulsory Certification (CCC) Mark:* While some NEMA members have been able to obtain this new mark, the process is expensive, customs enforcement is inconsistent, and in some instances it remains unclear as to whether the mark is actually required. Further, despite the "national treatment" now afforded to non-Chinese products, for many electrical items the CCC only accepts goods built to either Chinese national (GB) standards or standards developed and published by the International Electrotechnical Commission (IEC) and International Standards Organization (ISO). (The latter still frequently does not include products built to U.S. requirements.) It should also not be necessary to obtain exemptions for non-CCC inputs coming in to China that will soon thereafter be leaving again as part of finished goods; plus, both the process for obtaining exemptions and the actual length of exemptions granted appear to be inconsistent in practice.
- *Potentially "Subsidized" Product Coming Into the U.S.:* Some of our members have noted competition from extremely low-priced Chinese electrical imports. Since the goods in question are frequently not labor-intensively produced, these member companies are concerned that the Chinese government may be subsidizing the purchase of raw materials and/or providing them below cost via state-owned enterprises. China has made WTO accession commitments regarding state-trading enterprises and subsidies; we trust the USG will join us in encouraging China to meet and keep those commitments, which include eliminating specific export subsidies and providing full information on the pricing mechanisms of its state trading enterprises for exported goods.
- Environmental Regulations: We are concerned that China may follow Europe in imposing unjustified restrictions on the ability of manufacturers to use materials in products and unnecessary burdens on manufacturers in the name of environmental protection.

Our industry welcomes competition from China, provided its companies play by the rules and Beijing fully complies with its WTO requirements. This said, we in the U.S. must realize that we cannot always blame the Chinese for problems of our own making. On the one hand, we can manufacture products better here that anyone—the productivity gains in U.S. manufacturing in recent years have been phenomenal. Yet on the other the cumulative, redundant, regulatory and legal burden *that has been* heaped upon manufacturers has become a major problem. The current Administration has thankfully won us some relief on this front, but there is still much that can done here at home to boost our own competitiveness.

Again, we thank the Committee for conducting this hearing and considering our remarks.

National Retail Federation
Washington, DC 20004
April 14, 2005

Hon. Bill Thomas
Chairman
U.S. House of Representatives
Committee on Ways and Means
Washington, DC 20515

Dear Chairman Thomas:

On behalf of the U.S. retail industry, the National Retail Federation (NRF) submits this written statement in reference to the hearing held on United States-China Economic Relations and China's Role in the World Economy before the U.S. House of Representatives Committee on Ways and Means on April 14, 2005.

The **National Retail Federation** is the world's largest retail trade association, with membership that comprises all retail formats and channels of distribution including department, specialty, discount, catalog, Internet and independent stores as well as the industry's key trading partners of retail goods and services. NRF represents an industry with more than 1.5 million U.S. retail establishments, more than 23 million employees—about one in five American workers—and 2004 sales of $4.1 trillion. As the industry umbrella group, NRF also represents more than 100 state, national and international retail associations.

INTRODUCTION

For most Americans, the most visible sign of the rapid growth in trade between the United States and China is when they visit their local stores. It is readily apparent to any shopper that China has become a large supplier of a wide range of consumer products sold in the United States, including clothing, shoes, toys, consumer electronics, housewares, furniture, and so forth. Some view this situation with alarm and point to the amount of Chinese goods in American stores as evidence of the demise in American manufacturing and loss of manufacturing jobs. Some even blame what they see as "greedy" retailers for this situation, and accuse retailers of being only interested in exploiting coolie labor in China to get the lowest priced goods at the expense of U.S. manufacturers and workers.

This disturbingly widespread view demonstrates a fundamental lack of understanding about the retail industry and, more generally about how the U.S. and global economies work. Trade in textiles and apparel has become a central issue in this debate as China has become a major supplier of clothing to the U.S. market. Therefore, NRF's comments will focus on these products in attempting to explain why retailers import from China, what impact that activity has had on the U.S. textile industry, and what are appropriate policy options for those inclined to think that Congress must intervene in this situation in some way.

WHY DO AMERICAN APPAREL RETAILERS IMPORT FROM CHINA?

Like any other business in the United States, retailers face the daily challenge of creating value for their customers and shareholders. Retailers must also grow their sales and their businesses in an industry marked by cutthroat competition, an average profit margin of 2 percent, and downward pressure on prices as U.S. consumers spend less discretionary income on clothing.

To meet these challenges, retailers must offer customers a fresh selection of products—goods they want to buy at prices they are willing and able to pay. Retailers seek out the best sources for products that meet those requirements. Sometimes that source is a U.S. producer. But often the best source is a foreign supplier because some products are only available from foreign sources, and other products are not available from U.S. producers in the quantities, timeframe, or at the quality and price available from foreign suppliers.

In deciding where to source the goods they sell, the key consideration for most retailers is not price, but rather finding suppliers that provide superior customer service, and retailers are willing to pay a premium for it. Under the current, just-in-time, "full-package" production and supply system, superior customer service means textile and apparel suppliers must make the retailer's needs the top priority, provide consistently high quality, speed-to-market and on-time delivery, and assist the retailer along every step in product development, from concept to market.

While there are U.S. textile companies providing good customer service, decades of protectionism through quotas and other barriers limiting foreign competition have had an unfortunate impact on the business ethic of many in the textile industry. Retailers frequently complain that too many U.S. textile companies treat them—

their customers—as “the enemy,” and view their business relationship with the retailer as an entitlement, rather than something that they must earn.

Meanwhile, Chinese suppliers, often owned by Hong Kong and Taiwanese companies with decades of experience competing for business in the U.S. market, have learned that the formula for success is treating the customer as “number one.” China also has other key advantages over even lower-cost countries—a work force that sets the standard for skill and productivity, modern factories and infrastructure built by massive foreign investment, easy access to raw materials through integrated textile and apparel production, competitive prices, consistently high quality, innovation, flexibility in executing orders, and “speed to market” (i.e., the ability to get goods to the customer quickly).

Although many in the U.S. textile industry blame Chinese “cheating” and “unfair” prices for lost jobs and bankruptcies, suppliers who are unable, or unwilling to serve their customers’ needs will lose out to their competition regardless of price or how much new technology they may have invested in.

IS CHINA DESTROYING THE U.S. TEXTILE INDUSTRY?

Many textile companies, their Washington lobbyists, and UNITE–HERE contend that imports from China are devastating the U.S. textile industry. But is this view really accurate?

Due to changes in the U.S. economy, imports as a whole have grown steadily over the past 40 years so that, by value, over 70 percent of all clothing sold in the United States is now sewn outside the United States. Import penetration is even higher when calculated by volume—over 90 percent. Accordingly, any increase in imports from China will largely come at the expense of other foreign suppliers, not U.S. production, and will not change the total import level.

While China’s share of global production is growing, a look at import mix and the apparel market shows that China is not the core problem the U.S. textile industry claims it is:

- Total U.S. apparel imports have risen only marginally over the past 4 years from $69 billion in 2000 to $76 billion in 2004 reflecting slight sales growth in the U.S. market (2.5% per year average);
- China accounts for at most 10% of the total U.S. market for apparel by value;
- Events in the apparel market have no impact on 83 percent of U.S. textile industry shipments, which are non-apparel related products;
- China accounts for only 1% of the U.S. market for textile products (yarns and fabrics)—Canada, Mexico, the EU, and Korea account for 63%;
- China accounts for only 10% of the total U.S. market for made-ups;
- Imports account for only 3.7% of the total U.S. market for carpets and rugs and 13.5% of the total U.S. market for curtains and linens;
- China is a growing export market for the U.S. textile industry—in 2003, 8% of the total value of textile and apparel products imported from China contained U.S. content (cotton $737m; MMF $130m, yarn $55m, fabric $31m).

In addition, for retailers the risks of putting all their orders in China are becoming too high for the following reasons:

- U.S. manufacturers will continue to file trade cases targeting Chinese goods;
- With most imports from China coming through the West Coast, particularly LA/ Long Beach, growing port congestion and labor strife in 2002 that resulted in a shutdown of the West Coast ports created were wake-up calls for retailers;
- During the SARS scare in 2003, retailers were unable to send their sourcing and design staffs to China for over a month;
- China is experiencing a serious energy crisis, which is causing blackouts and factory closures;
- Due to the huge influx of foreign direct investment, labor costs along coastal China are rising;
- In response, the Chinese government is pushing investment inland, which has a backward infrastructure, creating higher costs and potential delays in shipments.

As a result, retail orders in China have increased only 12 to 20 percent, and retailers are actively seeking alternative places to source product in places like India, Pakistan, and Central America.

WHAT IS REALLY GOING ON WITH THE U.S. TEXTILE INDUSTRY?

With jobs declining steadily (1.1% annual average) since 1948, regardless of profitability, textile employment is a poor indicator of the overall health of the sector.

As in manufacturing as a whole, most textile job losses are due to improvements in technology and productivity, not trade, as the industry has become capitol intensive.

This change is evident in a modern textile mill—instead of the factories of forty years ago, crowded with mill workers, there are cavernous rooms with automated spinning, weaving, and knitting machines making miles of yarn and fabric, all run by computer.

Textile bankruptcies are also not indicative of an industry that is on the verge of extinction, but rather one that is restructuring, rationalizing, and reducing capacity (plant closings, layoffs), to improve productivity, competitiveness, and profitability.

The majority of mills, those making home furnishings, floor coverings, automotive and industrial products and other non-apparel products, is profitable ($1.3b in 2003).

A minority of mills, those making yarn, thread and fabric for apparel production, is facing serious problems that have existed long before China came on the scene:

Private-ownership with limited access to capital;

High, unsustainable debt loads (*e.g.,* Pillowtex);

Comparatively inefficient and behind in the use of new technologies;

Productivity further hampered by U.S. quotas and high tariffs that limit use of a broader selection of competitively priced foreign yarns;

Resulting in a lack of flexibility, willingness and ability to provide short runs to designer specs for their retail and apparel customers;

Failure to adapt to fundamental changes in the U.S. apparel industry (evolution to global marketing and branding companies; "full package" production; specialty and niche production in the U.S.-commodity production overseas); and

Failure to prepare for end of quota—most textile companies polled in a UNC study had done nothing during the 10 years leading up to the end of quotas.

Evidence demonstrates underlying strengths in the U.S. textile industry:

Has attracted investment from Warren Buffet (Fruit of the Loom, Shaw Industries), Wilbur Ross (Burlington, Cone Mills) and Koch Industries (Invista);

While textiles and apparel are declining in terms of employment and share of GDP, many individual companies are stronger and more profitable as a result of restructuring (e.g., Cone & Burlington combined into International Textile Group);

Spurred by import competition, successful, entrepreneurial companies (e.g., Milliken) are adapting by getting out of the production of low cost, commodity yarns and fabrics and into specialized high-performance yarns and fabrics;

This change is creating more highly skilled, better-paying and highly trained jobs—marketers, designers, chemists and lab technicians, engineers—rather than low-skilled workers making commodity apparel yarns and fabrics;

U.S. exports of fabric and yarn to Chinese clothing factories have jumped 150 percent from $83 million in 2002 to a quarter of a billion dollars in 2003, and China is becoming an important export market for U.S. cotton.

WHAT ARE APPROPRIATE POLICY OPTIONS?

Even though the World Bank estimates that the increase in trade following China's accession to the World Trade Organization has added $75 billion to global income, some still believe trade with China is bad for the U.S. economy, security, and jobs. Under the guise of "fair trade" and leveling the proverbial playing field, some Washington policy makers believe that limiting imports from China is necessary to protect U.S. manufacturers and jobs and correct the bilateral trade deficit. However, this approach raises the fundamental question whether it is a wise or effective strategy in dealing with issues on China.

Over the past twenty-5 years, the United States has achieved an extraordinarily high level of import penetration for clothing—over 70% by value, 90% by volume—and shed a million textile and apparel jobs, notwithstanding the fact that textiles and apparel have been and remain the most protected sectors in U.S. manufacturing. Therefore, if the objective is to protect textile jobs, history proves that limiting imports, from China or any other country, through quotas, increased duties, or other trade barriers is a manifest failure. The reason is simply because job losses have been and will continue to be driven by factors other than trade.

Moreover, decades of protectionism have also been a dismal failure as a means to make the U.S. textile industry more competitive. Instead, protectionism has hindered innovation, advances in productivity, and delayed needed restructuring in the industry, while imposing a huge cost on American consumers, taxpayers, and the economy as a whole.

Finally, with China a dominant supplier of many basic consumer products, it is curious why would anyone think that a reasonable policy to address our issues with the Chinese is to impose a huge, regressive sales tax on American consumers—like legislation (S.295) introduced by Senator Schumer (D–NY)—and punish U.S. companies and their workers who depend on trade with China?

A more effective approach is to help the textile industry develop new export markets, including China, and create viable sourcing alternatives to China. This goal can be best achieved by supporting: (1) negotiations at the WTO that will eliminate high tariffs and other trade barriers on textiles and apparel globally on a reciprocal basis; and (2) free trade agreements with flexible and commercially viable rules for textiles and apparel that will provide the incentives retailers and apparel manufacturers need to expand trade and investment in countries other than China. Policy makers should also encourage further rationalization and consolidation of the textile industry, which may lead to job losses, but will ensure that the jobs that remain or are created will be better, higher paying, and higher skilled, and companies will be stronger and more competitive.

Respectfully Submitted,

Erik O. Autor
Vice President
Int'l Trade Counsel

Statement of William R. Carteaux and Karen Bland Toliver, Society of the Plastics Industry, Inc.

The Society of the Plastics Industry, Inc. (SPI) is pleased to submit comments to the House Ways and Means Committee for the April 14, 2005 hearing on United States-China Economic Relations and China's Role in the World Economy. SPI applauds the Chairman and the Committee for addressing this critical issue and appreciates the opportunity to submit these comments.

Founded in 1937, SPI is the primary plastics industry trade association with over 1,000 members representing all segments of the supply chain—plastics products processors, manufacturers of machines and molds, and raw material (resin) suppliers. With more than $300 billion in annual shipments and employing 1.4 million workers across the 50 states, the plastics industry is the nation's fourth largest manufacturing segment. SPI's members range from large multinational corporations to small and medium-sized companies, many of which are family owned businesses, all playing a vital role in the delivery of myriad plastics products that enhance every aspect of our lives.

The emerging consensus that China presents both challenges and opportunities for U.S. manufacturers confirms the importance of a strong and cooperative relationship between the two countries. The United States is China's second largest trading partner, and China has become the fifth largest export market for U.S. manufactured goods. China's rapid domestic growth spurs robust demand for plastics products, creating opportunities for U.S. plastic companies to supply China's large and growing market. However, many of our members who desire to keep their manufacturing operations in the United States have found it difficult to leverage the opportunities of China's vast market because they are forced to compete against low-priced Chinese imports, have lost business to customers that have moved offshore to take advantage of lower Chinese production costs, and confront barriers that hinder export growth. Simply put, we are concerned that the mutually beneficial relationship between the United States and China is increasingly becoming one-sided to the detriment of U.S. manufacturers and workers. China reaps the benefits of an open U.S. market but fails to live up to its international trade obligations. Below, we briefly describe some of the challenges U.S. plastic manufacturers confront in the context of U.S.-China trade relations.

The Plastics Industry's Trade Balance

Over the past decade, the plastics industry enjoyed a large and growing trade surplus, peaking to $6.1 billion in 1997.[1] This surplus has steadily declined in recent

[1] *Global Business Trends, Partners and Hot Products,* August 2004. The *Global Trends* report is an analysis of plastic industry trade flows prepared by Probe Economics on behalf of SPI. Unless otherwise indicated, trade statistics cited in this submission are based upon data contained in the *Global Trends* report. For purposes of the trade data analyses, "plastics industry"

Continued

years, reaching a record low of $2.3 billion in 2003. While a 16.2% increase in total plastic exports last year helped boost the trade balance to $3.8 billion, the industry still observed some alarming trends. We had a $3.3 billion overall trade *deficit* with China. Only 5.5% of U.S. plastics shipments went to China, but China accounted for 19.5% of plastic imports. Moreover, despite a 9.5% increase in plastic product imports, the plastic products trade deficit reached an all-time high of $4.5 billion. Production of plastics products is the industry segment representing about 60% of shipments and over 85% of industry employment. Thus, the plastics product trade balance is an important measure of the industry's overall trade performance.

China stands out as the trading partner having a significant impact on the plastics products trade balance. Last year, China took in only 3.1% of U.S. exports, but accounted for 29.5% of plastic product imports. Indeed, Chinese plastic product imports have grown by more than 15% *every* year for the past 5 years. This analysis does not account for the enormous quantities of Chinese imports that enter the U.S. market as either part of, or as packaging for other products, such as audio and video equipment, games and toys, furniture, and so forth. To illustrate the impact of such "contained trade," whereas in 2003, the $3.3 billion deficit in plastic products trade represented only 2.2% of U.S. plastic product shipments, when "contained trade" is accounted for, the deficit increased to $20.2 billion, or 13.3% of industry shipments.[2] Our preliminary analysis of "contained trade" data for 2004 shows that Chinese imports are continuing to rapidly capture significant U.S. market share.

In light of these trade data in which China stands out year after year as a major contributor to the declining plastics trade surplus, it is no wonder that SPI members identify China as a significant influence on the industry's ability to remain competitive both in the United States and abroad.

China's Currency Manipulation

In recent periods, many of SPI's members have experienced a difficult cost-price squeeze that has eroded their profitability. For some, the price pressures have stemmed from low Chinese import prices reflected in the substantially undervalued yuan. As demonstrated above, the U.S. plastics industry has borne a heavy burden from the distorted yuan-dollar relationship, which has effectively made U.S. exports more expensive and Chinese imports cheaper than they otherwise would be if market forces determined China's yuan value. Our members believe that the alarming bilateral trade deficit with China will continue to increase unless China's exchange-rate system reflects fundamental economic conditions. While we are heartened by President Bush and Secretary Snow's recent admonishments to the Chinese government that the time is ripe for exchange-rate reforms, we implore the Committee to continue to press the Administration for concrete results in the near term. The Administration and Congress should immediately pursue all WTO-consistent measures to eliminate the unfair competitive advantage that China enjoys from its substantially undervalued yuan. Even a small increase in the yuan value would curb the lost sales that some U.S. plastics companies have experienced from low-priced Chinese imports.

For example, in 2003, a plastics cutlery and housewares manufacturer lost 14% of his sales valued at $4 million to Chinese imports. The imported products were sold for less than the manufacturer's raw material costs alone. The manufacturer could not understand how this was possible given that the products had to be produced and shipped half way around the world. Lower labor costs in China did not account for this anomaly because the manufacturing process for this particular product is quite automated, even in China. It stands to reason that the undervalued yuan drove the extraordinarily low prices this manufacturer was compelled to compete against.

This is just one example of many illustrating the growing frustration that some plastics companies express when facing the harsh reality of lost sales due largely to the prolonged undervalued yuan. As Jon McClure, a SPI member and President and chief executive officer of ISO Poly Films, Inc., attests: "I've compared my costs to a hypothetical Chinese film producer's costs. And based on average selling prices of imported Chinese film sold in the U.S. market, it is absolutely clear that the low

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includes four sectors: resins, plastics products, molds for plastics and plastics machinery. In the case of plastics products, trade data are analyzed for items categorized under HTS 3916 to 3926, consistent with the categorization applied by the U.S. Census Bureau.

[2] "Contained" plastics trade is quantified using an input-output methodology based upon data compiled by the U.S. Bureau of Economic Analysis.

yuan value is only way China can compete head to head with us in films. It's not cheap labor or about being competitive. It's the exchange rate." [3]

Severely Lax Protection of Intellectual Property Rights

The widespread illegal counterfeiting and pirating of U.S. goods extends to U.S. plastics products. Although extremely difficult to track down, several SPI members possess evidence of egregious counterfeiting of their products in China. Some notable examples include:

A medical device manufacturer makes Class II patented medical devices which are registered with the FDA and sold globally. He discovered that unauthorized copies of his patented products made in China were being offered for sale in Canada.

A household goods manufacturer found his product for sale in Europe packaged to look like it was produced by his company. The packaging even included a counterfeited "Made-in-the-USA" label. However, the company never sold this product in Europe. It was counterfeited in China.

A molder that makes proprietary stints for the medical imaging market saw his product knocked-off and sold in China. The counterfeited product was of inferior quality, but was sold in China and exported to other markets with less stringent health and consumer safety regulations.

A manufacturer of plastic flashlights with registered design and functional patents, trademarks, and copyrights found blatant counterfeiting of his products in China. The illegal counterfeiters are massively producing these knock-offs and using the company's own logo to market and sell the flashlights around the world. The manufacturer has been unable to stop the illegal counterfeiting in China, but after expending enormous resources was able to ban them from importation in the United States. The company is now having to grapple with the fact that these knock-offs are sold by a major retailer in Canada. However, because Canada does not offer the same protections as the United States to ban imports of counterfeited goods, the manufacturer is hoping to persuade the Canadian retailer to terminate its purchases of the knock-offs.

Despite China's steps to strengthen protection of intellectual property rights, far more work remains to be done in this area, as even the U.S. Trade Representative's Office acknowledged in its 2005 *National Trade Estimate Report on Foreign Trade Barriers*. In fact, it is in China's best interests to stop this criminal activity because the pervasive counterfeiting is not limited to electronic and media devices, but as shown above, extends to plastic products used for medical purposes. Needless to say, counterfeited medical products pose a dangerous threat to public health and safety in China.

For the U.S. plastics industry, the severely lax protection of intellectual property rights is a *de facto* trade barrier that hinders plastics exports to China. The Chinese plastics market offers great opportunities for U.S. plastics manufacturers, who are constantly innovating and producing superior quality products to serve a variety of end-use markets. However, many companies are understandably weary of even attempting to sell their products in China for fear of having their proprietary designs and trademarks illegally ripped off. Equally disturbing is evidence that counterfeited products are exported to the United States and other markets around the world. The time is long overdue for China to institute a far more stringent enforcement regime that extends *to all levels and sectors of its economy*.

We recognize that stronger protection of U.S. intellectual property rights is a top priority for the Administration, and we certainly support the efforts to date to engage the Chinese government on this issue. However, the unrelenting counterfeiting and pirating of U.S. goods calls for greater urgency. For this reason, after completion of USTR's out-of-cycle review of China's intellectual property regime—which we believe will evidence the devastating impact on U.S. economic interests—we encourage the Administration to seriously consider filing a formal WTO complaint against China on this matter. We hope the Committee will join the efforts of industry and other interested parties in supporting this exercise of U.S. rights under the WTO.

Elimination of Remaining High Tariffs on Plastics Industry Products

Upon joining the WTO in 2001, China committed to tariff reductions of about 10%. Although China has implemented many of these tariff cuts, its overall tariff levels remain high, particularly on plastics imports. For example, as a signatory to the WTO Chemical Tariff Harmonization Agreement, China agreed to reduce tariffs on plastic resins. China currently imposes tariffs of 9.7% on most plastic resins even

[3] Mr. McClure has testified and presented this analysis before the U.S.-China Economic & Security Review Commission's January 30, 2004 Field Investigation on China's Impact on the U.S. Manufacturing Base.

though the Agreement calls for tariffs cuts to 6.5%. China does not intend to reduce these resin tariffs to 6.5% until 2008. Tariffs on polytetrafluoroethylene resin (PTFE), a major input for the production of cookware and other consumer products, remains high at 10%. In addition, on a host of plastic products, such as tubes, pipes, bath items, bags, kitchenware, and construction materials, China imposes a 10% tariff. Extrusion and blow molding machines enter at a 5% tariff rate, and plastic molds at tariffs ranging from 5–10%. When combined with the 17% VAT rate, U.S. exporters outlay significant funds to gain access to China's market.

In contrast, these same plastic products enter the U.S. market at tariff levels *no higher than 6.5%.* Tariffs on imports of machinery and molds are even lower, with most items in these tariff headings entering at 3.1%. The disparity between U.S. and Chinese tariff levels starkly illustrates the relatively less restricted access that Chinese plastics imports enjoy in the U.S. market—a competitive benefit exacerbated by the undervalued yuan.

SPI certainly commends China for the substantial tariff cuts it made when joining the WTO in 2001. However, we strongly believe that further tariff reductions are warranted to help expand U.S. plastics exports to China. Given its competitive position in the worldwide plastics market, China is fully capable of opening its market by cutting tariffs to levels comparable to other major plastics markets such as the United States and the European Union. To this end, SPI will call upon USTR to press for further tariff reductions as part of the non-agricultural market access negotiations in the Doha Round. While we recognize that substantial liberalization of agricultural trade is a top priority, deep cuts in industrial tariffs, particularly among WTO members such as China and India, are needed to obtain a good deal for U.S. manufacturers. We would welcome the Committee's support for our efforts to achieve parity with China on market access for U.S. plastics goods into that market.

Strict Enforcement of U.S. Trade Laws to Combat Unfair Trade Practices

Finally, as the Committee examines the U.S.-China trade relationship, we encourage it to ensure that our trade laws remain effective to combat unfair trade practices. SPI supports strict enforcement of these laws as remedial measures against injurious unfair trade practices. In this regard, we join the National Association of Manufacturers' support for legislation directing the Commerce Department to apply the countervailing duty statute to China and other countries designated as non-market economies. Despite China's WTO commitment to discipline subsidies, Chinese manufacturers' continued receipt of governmental assistance at the federal, provincial, and local levels, is well-documented. Such benefits confer an unfair competitive advantage to these manufacturers when they sell their products in the global market. We feel strongly that U.S. manufacturers who believe they are injured by such unfair subsidization should have an effective mechanism to remedy their harm. Closing this loophole in our unfair trade laws will send an unequivocal message to U.S. manufacturers that Congress will not countenance any relaxation of the mechanisms to combat unfair trade practices.

Conclusion

China is not the panacea to the many challenges confronting the continued viability of plastics manufacturing in this country. Indeed, exorbitant natural gas and health care costs, a shortage of skilled workers and other pressures may pose an even greater threat to the industry's survival if these domestic impacts are not addressed in the short-term. For our part, SPI has been working on all fronts to secure both domestic and international policies that will guarantee the industry's health for decades to come. Our members have stepped up to the challenge of globalization by continuing to innovate and further increase productivity to compete in the global marketplace. They do not want or need protectionist measures but believe *strongly* that all U.S. trading partners, and particularly, *China*, must be held accountable for their international trade commitments.

SPI appreciates the opportunity to present the plastic industry's concerns regarding China on the record. We look forward to the Committee's continued work in this area and would welcome the opportunity to work further with you on developing mechanisms to address the complex issues arising under U.S.-China economic relations.

Statement of Terrence B. Stewart, Esq., Stewart and Stewart

A. Introduction

Over the past 25 years, the U.S.-China trade relationship has grown to be an important one for both countries. On the U.S. side, China is now the U.S.' third largest trading partner, surpassing Japan in 2003. In 2004, China was the second largest supplier of imports to the U.S. (behind Canada) and the fifth largest purchaser of U.S. exports (after Canada, Mexico, Japan, and the UK). If current trends continue, China is likely to surpass Canada and become the U.S.'s largest source of imports by 2006. On the Chinese side, the U.S. is China's second largest trading partner overall, the number one destination for exports from China, and the sixth largest supplier of imports into China.

The most significant aspect of U.S.-China trade, however, is that it is seriously imbalanced. Since 1985, the U.S. trade deficit with China has increased year by year. In 2004, the deficit reached $162 billion, the largest bilateral trade deficit ever recorded. See tables and chart below.

U.S.-China Trade Balance U.S.$ (billion)

Year		Year		Year		Year	
2004	−162.0	1999	−68.7	1994	−29.5	1989	−6.2
2003	−124.1	1998	−56.9	1993	−22.8	1988	−3.5
2002	−103.1	1997	−49.7	1992	−18.3	1987	−2.8
2001	−83.1	1996	−39.5	1991	−12.7	1986	−1.7
2000	−83.8	1995	−33.8	1990	−10.4	1985	−0.6

U.S. Trade with China

Data are in Millions of US $s.

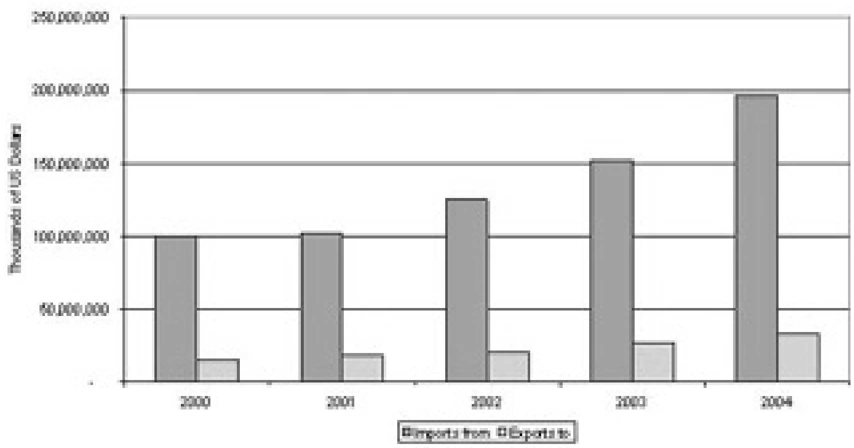
US Imports from:	2000	2001	2002	2003	2004	% Change 2000-04
World	1,218,022	1,140,999	1,161,366	1,257,121	1,469,864	20.7%
All Other	1,118,004	1,038,721	1,036,173	1,104,685	1,273,165	13.9%
China	**100,018**	**102,278**	**125,193**	**152,436**	**196,699**	**96.7%**
China % World	8.2%	9.0%	10.8%	12.1%	13.4%	5.2%

US Domestic Exports to:	2000	2001	2002	2003	2004	% Change 2000-04
World	781,918	729,100	693,103	724,771	819,052	4.7%
All Other	765,733	709,918	670,975	696,403	784,331	2.4%
China	**16,185**	**19,182**	**22,128**	**28,368**	**34,721**	**114.5%**
China % World	2.1%	2.6%	3.2%	3.9%	4.2%	2.2%

Trade Balance	2000	2001	2002	2003	2004	% Change 2000-04
World	(436,104)	(411,899)	(468,263)	(532,350)	(650,812)	49.2%
All Other	(352,271)	(328,803)	(365,198)	(408,282)	(488,834)	38.8%
China	**(83,833)**	**(83,096)**	**(103,065)**	**(124,068)**	**(161,978)**	**93.2%**
China % World	19.2%	20.2%	22.0%	23.3%	24.9%	5.7%

Source: Bureau of Census import and export statistics. Imports are imports for consumption, f.a.s. basis. Exports are dometic exports, f.a.s. basis.

U.S. Trade with China



Although China is currently the fastest growing export market for U.S. goods, the much smaller U.S. export base means the U.S. runs an increasing trade deficit with China, with the result that the growth in U.S. exports to China is dwarfed by the growth in U.S. imports from China.

The ever-growing trade deficit with China is not sustainable. The trade deficit flows from factors that are not market-driven, such as WTO compliance problems, currency issues, and intellectual property violations, among others. The U.S. needs to take forceful and effective action to shrink the trade deficit with China, to bring the trade flows between the US and China into a realistic balance, and to work to improve respect in China for the rule of law.

B. Summary of Presentation

This paper is largely drawn from a report prepared for the U.S.-China Security and Economic Review Commission earlier this year and testimony provided to that body in February. *See* www.uscc.gov/hearings/2005hearings/written__testimonies/05__02__3__4wrts/ stewart__terence__wrts.pdf. The paper provides an overview of the major trade and economic issues in the U.S.-China Relationship. It reviews China's WTO Compliance in its first three years of membership, then outlines the major trade remedies that the U.S. should employ to insure more of a level playing field. The paper then examines the increasingly important exchange rate issue. Then it comments briefly on the range of IPR Protection issues. And finally, the paper identifies some potential WTO cases that the U.S. could bring in the WTO where China is having difficulties bringing itself into compliance and where a WTO challenge could be helpful in bringing about compliance in fact.

China has made tremendous strides in meeting its WTO obligations, but it still has a long way to go. While not all parts of the government seem to be fully committed to full compliance, the efforts taken by China have been extensive and are generally viewed as a good faith effort to address the complex challenges China faces in changing its economy to be fully in compliance. China has worked reasonably well on many issues in a bilateral fashion to address a number of problems, and the U.S. and other trading partners have worked hard to provide the technical assistance and other help to permit China to achieve what it appears to generally desire, a system in compliance. Nonetheless, given the particularly problematic disparities in the bilateral U.S.-China trade relationship it is critical that we use all tools available in the WTO and within our own trade laws to help China move toward meeting its obligations both to the U.S. and to the world trade regime generally.

C. Overview of China's WTO Compliance

In 2004, the third year of China's WTO membership, China met its WTO commitments in numerous areas. Nevertheless, in many areas, China has still not achieved full compliance with its WTO commitments. For example, in the following areas, the U.S. Trade Representative's 2004 WTO compliance report noted continuing concerns to both the U.S. government and the U.S. private sector.

- ***Intellectual property rights:*** Although China has undertaken major efforts to revise its IPR laws and regulations, piracy remains rampant and enforcement of IP rights is seriously inadequate.
- ***Trading and distribution rights:*** China implemented its commitment to full trading rights ahead of schedule. However, concerns remained regarding distribution rights in that China had not issued specific rules clarifying how distribution rights would be acquired.
- ***Services:*** In many services sectors, although China met the "letter" of its commitments to liberalize services, it frustrated the "spirit" by imposing new and burdensome licensing and operating requirements, such as high capital requirements and prudential rule requirements that exceeded international norms.
- ***Agriculture:*** U.S. exporters experienced continuing problems with market access and transparency.
- ***Industrial policies: In a number of areas such as the following, China has continued to employ policies that effectively limit or impose conditions on market access, or give preferential treatment.***

- discriminatory VAT policies
- failure to provide national treatment with respect to price controls on medicines and drug reimbursement
- preferential import duties to certain products (particularly from Russia)
- discriminatory application of SPS measures
- disparate standards testing of foreign products compared to domestic products
- inadequate transparency for proposed technical regulations and conformity assessment procedures
- development of unique standards for products in spite of existing international standards
- inconsistent application of the China Compulsory Certification (CCC) mark
- investment laws and regulations that continue to "encourage" technology transfer
- an auto industrial policy that discourages auto parts imports and encourages use of domestic technology
- government procurement policy that mandates purchases of Chinese-produced software to the extent possible

D. Overview of Trade Remedies

When China acceded to the WTO in December 2001, its trade regime was not fully consistent with WTO rules. As a condition of granting China early entry into the WTO, China agreed that, for certain periods of time following accession, other WTO members would be able to employ two China-specific trade remedy measures to address imports from China causing market disruption or injury to another member's domestic industries.

1. China Product-Specific Safeguard (Section 421)

Article 16 of China's Protocol of Accession established a general "product-specific special safeguard" measure with respect to Chinese goods. This measure permits WTO members, for 12 years following China's accession (*i.e.*, December 11, 2013), to take action to curtail surges of imports of Chinese goods that cause or threaten to cause "market disruption" to a domestic industry producing similar goods. This product-specific safeguard, unique to China, is applicable to any type of product (both industrial and agricultural goods).

In U.S. law, the China product-specific safeguard was enacted as section 421 of the Trade Act 1974 (19 U.S.C. § 2451). The rationale of section 421 is that U.S. industries should not lose jobs due to competition from Chinese imports at a time when China is adjusting to WTO obligations. Congress indicated that the measure should be applied vigorously to address import surges from China, noting that "if the ITC makes an affirmative determination on market disruption, there would be a presumption in favor of providing relief."

The ITC has conducted only five section 421 investigations so far: (1) pedestal actuators, (2) steel wire garment hangers, (3) brake drums and rotors, (4) ductile iron waterworks fittings (DIWF), and (5) innersprings. The last active investigation was completed more than 1 year ago, in March 2004. In three of the five investigations, although the ITC made an affirmative injury determination and recommended relief, the President chose to deny relief to the domestic industry. Given this track record, and the strong lobbying by China to discourage the President from granting relief in these cases, domestic industries have been discouraged from filing new petitions. Thus, section 421, unfortunately, has been an ineffective trade remedy. The expectations of its utility as a measure to provide relief to U.S. industries injured from a surge in Chinese imports have not been realized.

2. China Textile Safeguard

The China textile safeguard is authorized by paragraph 242 of the Working Party Report to China's WTO accession. That provision permits other WTO members, until December 31, 2008, to impose a safeguard measure restraining Chinese textile imports if it is shown that they are "threatening to impede orderly development of trade in these products" due to "market disruption." In the U.S., the Committee to Implement Textile Agreements ("CITA") administers the procedures for investigating petitions and imposing safeguards on Chinese textile imports. If a safeguard measure is imposed, CITA may restrain Chinese exports in the safeguard product categories to 7.5-percent growth.

To date, the U.S. textile industry has used the textile safeguard mechanism with mixed success. Because CITA did not issue procedural rules until May 2003, the domestic industry did not file initial petitions until July 2003 and CITA did not impose the first textile safeguards on three product categories until December 23, 2003. Thereafter, in June 2004, U.S. sock producers filed a safeguard petition and CITA imposed a safeguard on October 29, 2004.

In October and November 2004, anticipating the end of global textile quotas on January 1, 2005, a domestic textile industry coalition filed a series of textile safeguard petitions covering a variety of products that were based on the "threat" of increased imports rather than actual increased imports. When CITA accepted the new threat-based petitions, retailer and importer groups filed suit in the U.S. CIT claiming that CITA lacked authority to consider petitions based upon threat alone and asking the court to enjoin CITA from granting relief. On December 30, 2004, the CIT granted the motion for a preliminary injunction and issued an order enjoining CITA from proceeding on the threat-based safeguard requests during the pendency of the court action. The CIT's preliminary injunction is currently on appeal to the U.S. Court of Appeals for the Federal Circuit.

Most recently, on April 4th, CITA self-initiated China textile safeguard investigations on three product categories based on preliminary import data from the first quarter of 2005, and on April 6th, a domestic industry coalition filed seven safeguard petitions covering fourteen products. Thus, after a shaky start, the textile safeguard appears to be being used and at least initial cases suggest it may be effective within the parameters of the provisions.

3. Antidumping Duty Law—Under-Collection of Dumping Duties on Chinese Imports

The trade remedy of antidumping law applies to imports from China as well as other countries. However, in recent years, it has become apparent that, due to significant undercollection of dumping duties by U.S. Customs on Chinese products, U.S. industries that successfully petitioned for antidumping duty relief from Chinese imports have not received the full benefits of antidumping duty orders to which they are entitled under U.S. law.

U.S. Customs and Border Protection Agency reported in its FY 2003 annual report on the Continued Dumping and Subsidy Offset Act (CDSOA) (March 2004) that it had failed to collect $130 million of antidumping and countervailing duties, $103 million of which related to antidumping duties on Chinese imports, such as crawfish, paint brushes, iron castings, roller bearings, silicon metal, brake rotors, garlic and honey. While the reasons for the duty undercollection are multiple and complex, contributing causes include: (1) failure by importers to post adequate cash deposits or bonds on entries, (2) CBP allowing importers to post a continuous entry bond instead of requiring a single entry bond as required by a Treasury Decision, (3) CBP allowing importers to post continuous entry bonds that are too low to cover eventual dumping liability, (4) cash deposits posted on estimated duties are lower than finally determined duties and the importer fails to pay the difference due to bankruptcy or disappearance, and (5) in the case of "new shipper" reviews, a "loophole" that allows importers to post a bond, rather than cash deposits, on estimated dumping duties.

Although the CBP has proposed a series of reforms to address this problem (*e.g.*, such as ensuring that surety bond companies can cover defaults, requiring different bonding requirements where continuous bonds are used, and closely monitoring continuous entry bonds), the CBP's FY 2004 CDSOA Report showed that it had failed to collect $260 million in antidumping and countervailing duties in 2004, $224 million of which related to antidumping duties owed on Chinese imports.

The CDSOA annual reports have identified the magnitude of the undercollection problem which largely stems from Chinese product imports. It is critical that the full amount of duties owed be collected. Effective action by Congress, CBP, and Commerce are needed to ensure the proper functioning of U.S. antidumping law with respect to Chinese products.

4. Countervailing Duty Law—Non-Application of CVD Law to Imports from China

Since 1984, the U.S. Commerce Department has not applied countervailing duty law to non-market economy (NME) countries, such as China. Commerce reasoned that subsidization is a market economy phenomenon and could not exist in an NME where "markets" do not exist. As a result of this policy, U.S. industries cannot petition for the imposition of countervailing duties when injured by reason of Chinese imports benefiting from government subsidies.

Commerce's policy, however, is not required by statute. Rather, it was established in an administrative determination and could be reversed or changed by administrative action. Indeed, the U.S. position is bizarre at the present time in light of the heavy emphasis the U.S. placed on eliminating or limiting subsidies as part of China's accession process to the WTO. If subsidies cannot exist in China, why did the U.S. insist time and time again that such subsidies had to be eliminated, reduced, identified and/or reported?

The U.S.' continuing concern over Chinese subsidies belies that premise of Commerce's policy that subsidies cannot exist in a NME. In the most recent Transitional Review Mechanism, the U.S. inquired about or identified a large number of Chinese subsidy programs that appeared to constitute either prohibited or actionable subsidies under the WTO Agreement on Subsidies and Countervailing Measures. For example, in one submission, the U.S. asked:

- *Semiconductors*—whether China grants VAT rebates on semiconductor exports;
- *Copper*—whether China grants VAT rebates on imports of copper scrap or on exports of copper-based, semi-fabricated or finished products;
- *Subsidies to State-Owned Enterprises Running at a Loss*—whether China has eliminated these subsidies as promised in the accession agreement;
- *Non-Performing Loans*—China's injection of U.S.$ 45 billion into the Bank of China and the China Construction Bank; China's debt forgiveness as part of the Northeast Revitalization Programme;
- *Price Controls*—whether certain price control programs provide subsidies.

In another submission, the U.S. identified a number of programs and practices that appeared to constitute prohibited subsidies, as well as other programs that appeared to constitute actionable subsidies:

Subsidies Contingent Upon Export Performance

- Honourable Enterprises—preferential benefits
- Export-Contingent Tax Reduction for FIEs in Special Zones
- Income Tax Refund for Foreign Investors Investing in Export-Oriented Businesses
- Special Steel for Processing Exports Policy
- Export-Contingent Income Tax Reduction for FIEs or Tax Allowance for FIEs
- Export Subsidies for High-Technology Products
- Customs Duty and VAT Refund on Imported Capital Equipment Used for Production of Products for Exports
- Government Assistance to Increase Fabric Exports
- Tax Incentives for Dehydrated Garlic Exports
- Guangdong Grants Provided for Export Performance
- Low Interest Loans for Processors of Agricultural Products in Henan Province

Subsidies Contingent Upon the Use of Domestic Over Imported Goods

- VAT Rebate on Purchases of Domestic Equipment by FIEs
- Enterprise Income Tax Reduction for Purchase of Domestically Made Machinery and Equipment

Other Programs

- Assistance provided to Forest Products
- Assumption of Interest on Loans for Technology Upgrades
- Assistance for Capacity Expansion in the Soda Ash Industry
- Assistance provided to the Textile Industry
- Chendu Assistance to the Semiconductor Industry
- Reduction in VAT for Sino-Russian Border Trade
- Subsidies listed in Annex 5A of China's Protocol of Accession

In sum, Commerce's policy should be changed. First, Congress could amend the countervailing duty law to expressly provide that CVD law applies to non-market economy countries. A number of bills (H.R. 1216; S. 593) have been introduced in both the House and Senate to make such a change. Second, Commerce has the discretion to change its present policy on its own. Given that Commerce's policy is not required by statute, a change in policy would likely be upheld by the courts as long as Commerce supports the change with reasoned analysis.

E. Exchange Rate Policy

For 10 years, China has maintained a fixed exchange rate for their currency relative to the dollar (8.28 renminbi to the U.S. dollar). Despite urging by the U.S. that China move toward a flexible, market-based exchange rate and indications both publicly and at senior levels that it would move to a flexible exchange rate, China has not yet done so.

Many economists estimate that China's currency is undervalued by as much as 40% or more. This means that Chinese goods compete domestically and internationally at prices that are artificially low, hurting U.S. producers in the U.S. market, in the Chinese market and in third country markets. Moreover, it is argued that China's pegged exchange rate effectively acts as a tax on U.S. exports and a subsidy to China's exports, which cause the loss of U.S. manufacturing jobs.

A number of attempts have been made to address this problem. For example, Senators Schumer and Graham's bill (S. 295) would impose a 27.5% additional duty on Chinese imports unless the President certified to Congress that China was no longer manipulating its exchange rate and that its currency was at or near its fair market value. In addition, two Section 301 petitions were filed in 2004 with the U.S. Trade Representative seeking U.S. action regarding China's exchange rate policy, but USTR rejected both petitions.

Various bases for a WTO challenge to China's exchange rate policy have been proposed. The primary grounds for challenging China's exchange rate policy are that China's undervalued currency (1) constitutes a prohibited export subsidy within the meaning of GATT articles VI and XVI, and the WTO Agreements on Agriculture and Subsidies and Countervailing Measures, (2) violates GATT Article XV:4, and (3) violates China's obligations under the International Monetary Fund's Articles of Agreement. However, while these potential grounds have prima facie merit, it is unlikely that this Administration, which rejected similar arguments in the section 301 petitions, would initiate a WTO challenge on these grounds.

Separately, another potential way to address the exchange rate problem would be to modify U.S. antidumping law and/or countervailing duty law to permit currency manipulation to be treated as a form of dumping or subsidization consistent with the original GATT notes. This approach is reflected in the recently introduced Ryan/Duncan bill (H.R. 1498).

F. Intellectual Property Rights Protection

How to protect intellectual property rights (IPR) is one of the most serious issues facing U.S. companies vis-&-vis China. Notwithstanding China's efforts to improve its IP legal regime to comply with WTO obligations, China's IPR enforcement system is far from adequate. The problem of intellectual property piracy and counterfeiting is endemic in China and has caused a tremendous adverse impact on U.S. businesses. The rate of piracy is enormous, estimated to be about 90 percent over the last 15 years for certain types of products. USTR's 2004 WTO compliance report notes that "current estimates of U.S. losses due to the piracy of copyrighted materials alone range between $2.5 billion and $3.8 billion annually." The World Customs Organization has estimated that global counterfeiting amounts to more than $500 billion annually with the majority of that originating in China. *See Fakes!*, Business Week, February 7, 2005.

At the JCCT meeting of April 2004, where the IPR issue was made one of the highest priorities, the U.S. secured a commitment from China's Vice Premier Wu Yi that China would undertake a series of actions to significantly reduce IPR infringement throughout the country. In December 2004, as it pledged at the JCCT meeting, China issued a long-awaited judicial interpretation (*Judicial Interpretations on Several Issues Regarding Application of Law in Criminal Intellectual Property Rights Cases*) that was expected to bolster China's IP criminal enforcement abilities and efforts. Many observers, however, view the new interpretation as inadequate because, among other things, it maintains thresholds which offer loopholes for potential counterfeiters.

In USTR's special 301 out-of-cycle review on China's IPR enforcement efforts, comments by industry groups and private sector organizations show that IPR violations abound in virtually all industries. It is urgently necessary that China address its many IPR enforcement shortfalls, including lack of deterrent penalties, lack of transparency, insufficient resources for police investigations, reluctance to enforce IPR by regional governments, and so forth.

The U.S. should continue to emphasize the importance of improving IPR enforcement and should work with other WTO members (*e.g.*, EC, Japan, and others) to provide China with effective training and technical assistance and to coordinate increased pressure on China to make the legal modifications necessary to improve IPR enforcement. Should these efforts not prove effective, the U.S. should then consider the possibility of WTO dispute settlement.

G. Potential WTO Cases

China has now been a WTO member for 3 years. USTR has noted that while China has made impressive efforts to fulfill its WTO commitments, China's actions to fulfill its commitments are far from complete and have not always been satisfactory. So far, only one WTO dispute settlement case has been filed against China—in March 2004, the U.S. filed a case concerning China's discriminatory VAT policies.

After three years, however, the U.S. should give serious consideration to filing dispute settlement cases at the WTO on a number of outstanding issues where China is not fully in compliance with its commitments. If used prudently, WTO dispute settlement cases would be a means to induce and encourage China to come into full compliance with its WTO commitments.

Based on USTR's 2004 compliance report, and to the extent they remain unresolved, there are a number of potential areas where China's non-compliance could be considered as potential topics for WTO dispute settlement cases, such as the following:

- *Customs Valuation:* U.S. exporters are still encountering valuation problems at Chinese ports. These problems include: (1) valuation based on reference pricing instead of transaction value; (2) addition of royalties and license fees to the dutiable value of imported software; (3) non-uniform valuation by ports of particular digital products; and (4) valuation of high-value electronic media to be used to produce multiple copies of products (e.g., DVDs) based on the estimated value of the future copies instead of the value of the carrier medium itself.
- *Export Quotas on Fluorspar:* China has continued to impose export restrictions on fluorspar. China imposes quotas and license fees on fluorspar exports, but does not restrict domestic users of fluorspar.
- *Nondiscrimination:* U.S. pharmaceutical manufacturers have experienced national treatment problems regarding price controls on medicines and drug reimbursement. China has continued to discriminate in applying SPS measures. With respect to fertilizer, China exempts all phosphate fertilizers except DAP (a fertilizer the U.S. exports to China) from a 13% VAT. So far, China has not changed this policy.
- *Consumption Taxes:* The effective consumption tax rate on imported products (e.g., spirits/alcoholic beverages, tobacco, cosmetics and skin/hair care preparations, jewelry, fireworks, rubber, motorcycles and automobiles) is substantially higher than the rate applied to domestic products because China uses different tax bases to compute consumption taxes for domestic and imported products.
- *Standards Testing:* Despite China's changes to its standards testing regime, in some sectors, foreign products are tested in specially designated laboratories that are separate from those laboratories used to test domestic products. Disparate testing can lead to uneven treatment.
- *Conformity Assessment Procedures:* Despite national treatment commitments, to date, China has accredited 68 Chinese enterprises to test for and certify the CCC mark, but has not accredited any foreign-invested conformity assessment bodies.
- *Auto Industrial Policy:* The new auto industrial policy contains discriminatory provisions that discourage the importation of auto parts and encourage the use of domestic technology.
- *Sanitary and Phytosanitary:* Regarding raw poultry and meat, China applies certain non-science-based standards (*e.g.,* zero tolerance for pathogens) to imports that are not applied to domestic raw poultry and meat. This violates national treatment and has slowed imports from the U.S. Regarding food additives, China imposes overly restrictive standards that block imports of many U.S. processed food products.
- *Financial Services—Insurance:* China has been issuing concurrent branch approvals (more than one at a time) for Chinese insurers, but only approving branches of foreign firms consecutively (one at a time).
- *Express Delivery Services:* In July November 2003, China circulated draft amendments to the postal services law, which (1) gave China Post a monopoly on letters under 500 grams (a horizontal commitment violation as it restricted existing scope of activities), and (2) failed to establish an independent regulator. At the April 2004 JCCT, China indicated that the weight restriction would not resurface as a problem. However, the July 2004 draft amendment still con-

tained a weight restriction (reduced to 350 grams).April 14, 2005, Statement for the Record, YKK Corp. of America, Marietta, GA, Alex Gregory, statement

Statement of Alex Gregory, YKK Corp. of America, Marietta, Georgia

My name is Alex Gregory. I am president and chief executive officer of YKK Corp. of America, headquartered in Marietta, Georgia. YKK is best known for the billions of zippers we manufacture globally, but we also make many other fastening products, as well as architectural products for commercial and residential buildings. YKK is headquartered in Tokyo, Japan, with manufacturing operations in 68 countries. YKK has had a presence in the United States since 1960. We opened our first significant manufacturing plant in Macon, Georgia, in 1974. I was among the first American employees hired for that plant—a Georgia Tech Textile Engineer just out of the Navy, so manufacturing is near and dear to me. For going on 4 years now, I have been responsible for YKK's 16 companies in the United States, Canada, Central America, and Colombia, South America. We employ approximately 3,000 Americans across five time zones in the western hemisphere, 1,600 of whom live in Georgia.

YKK has a manufacturing presence in many countries, including China and every other major garment-producing country in the world, but I am here today to speak on behalf of our employees in the United States. In the past thirty years we have invested more than $1 billion in manufacturing plants in the United States. We are very proud of the beautiful plants we have built around this country, many of which we continue to operate, and we are very proud of the fantastic job our employees in the United States have done and are doing. At our peak in production, only 5 years ago, our zipper plants were as efficient and as productive as any others in the world.

Unfortunately, in recent years, we have suffered many painful events caused by imports, mainly from China. Over the past decade, in response to cheap imports from Asia, many of our customers who are owners of major brands of jeans, pants, jackets, and many other apparel products have transitioned from manufacturing their own products in the United States to sourcing, in varying degrees, products from contractors in Mexico, Central America, and, in increasing frequency, from China and other parts of Asia.

Because our customers are sourcing their products from different parts of the world, we in YKK have had to make significant changes in how we do business as well. Employment in our National Manufacturing Headquarters in Macon has declined steadily from around 1100 5 years ago. But we are proud that we have been able to continue to provide jobs for 950 employees in Macon, Georgia, and another 500 in Kentucky, Tennessee, and Alabama, even though many of our customers long ago closed their manufacturing operations in this country. From our 2.4-million square foot facility in Macon, we now ship zippers and other fastening products to our customers and their contractors in Central America, Mexico, South America, and, of course, to those who remain in the United States.

But we have had to make many other painful sacrifices as well. In support of our customers, for the past two years we have worked together with our employees on a Competitive YKK Macon initiative to become as competitive as possible—right now, before all the business moves to China. To become more competitive, we have written off millions of dollars worth of now-excess manufacturing capacity; we have packed up perfectly good zipper-making machines and sent them to other parts of the world where our customers are now sourcing their garments; we have reduced wages and salaries, including my own; as a last resort, we also have reduced our salaried and hourly work force (sometimes painfully, but when possible, by attrition), to reduce the cost of our fastening products. We embarked on this initiative so that our customers would make the decision to continue to source garments from within this hemisphere; we want them to know they have our support in competing with the flood of cheaper garments from China.

And believe me when I say we are petrified about the acceleration of imports from China. Prices from China are down significantly and imports are sky-rocketing. In the two pants categories which primarily affect our business, 347 and 348, imports from China are up over 1600% in the first quarter of 2005 compared with the first quarter of 2004. There has been an absolute explosion of imports in the first quarter of this year. Our customers tell me that if this trend continues, they will have to make some dire decisions, including the decision to close plants. I do not want that to happen because it means that we will lose more jobs in America, and I am doing everything in my power to keep that from happening. Something positive must occur going forward or more plants will close and more jobs will be lost.

A main point I wish to make is that market forces exist today which give garment manufacturers in this hemisphere a real competitive advantage. This advantage is "speed to market." Thanks to rapid fashion changes and a shift from basic styles to premium, higher priced products, the marketplace in some instances has become a friend to garment manufacturers in this hemisphere. The key is speed, and we are partnering with our customers to reduce dramatically the time it takes to develop new products, sew them, and deliver them to retail shelves. Strong clusters, or alliances, are forming among American retailers and brandholders, and the suppliers of the materials which go into their garments. We are participating in these alliances with enthusiasm, as proximity to the U.S. market is one of few advantages remaining to us in this hemisphere. Together with our customers and other vendors and suppliers, we have reduced lead times significantly.

CAFTA can go a long way toward helping us maintain a strong garment manufacturing presence in this hemisphere, especially if it is combined with efforts to bring China onto a level playing field. We need relief in the form of strong safeguards against unrestricted imports from China. But CAFTA is an essential element—indeed it is the critical and necessary element—to strengthening the collaborative effort within the rapidly growing alliances in this hemisphere. Restraints on China, coupled with fair trade under fairly valued currencies are important to undertake, but if we do not pass CAFTA, we will do a disservice to this industry. CAFTA can help us save the jobs of our employees in Georgia, Kentucky, Tennessee, and Alabama.

Last week I attended a meeting with many of our top sales professionals in this hemisphere, and each of them stressed to me how important CAFTA is to our customers. They expressed the strong sentiment they have heard from most of our customers, many of whom are well-known U.S. brandholders. I have heard that same plea for approval of CAFTA in my own discussions with customers here and in Central America. I was in El Salvador just yesterday, as a matter of fact, and in Costa Rica the day before that. It seems as if everyone related to our business, and especially our customers, recognizes CAFTA's profound importance.

On behalf of YKK's employees in the United States of America, I urge you to support swift passage of CAFTA and also somehow to bring Chinese imports under control.

Thank you.

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