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THE TREASURY DEPARTMENT'S REPORT ON INTERNATIONAL ECONOMIC AND EXCHANGE RATE POLICIES

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

ON

THE TREASURY DEPARTMENT'S INTERNATIONAL ECONOMIC EXCHANGE RATE POLICY REPORT, AND EXAMINING THE IMPACT OF ECONOMIC AND TRADE POLICIES WITH CHINA ON THE U.S. ECONOMY

SEPTEMBER 16, 2010

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THE TREASURY DEPARTMENT'S REPORT ON INTERNATIONAL ECONOMIC AND EXCHANGE RATE POLICIES

THURSDAY, SEPTEMBER 16, 2010

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee convened at 10:07 a.m. in room SD–538, Dirksen Senate Office Building, Hon. Christopher J. Dodd, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN CHRISTOPHER J. DODD

Chairman DODD. The Committee will come to order. Let me welcome all who are gathered in the Committee room this morning and welcome my colleagues. We had a very good hearing yesterday on covered bonds. It didn't draw an overflow crowd, the subject matter, but nonetheless, we had a very good hearing for a couple of hours and I welcome back our colleagues who could attend yesterday, and those who were not able to be here yesterday, I welcome them back to the remaining days before the elections in November.

I am going to make some brief opening comments. I will turn to Senator Shelby for any opening comments he may wish to make, and then I am going to move directly to the Secretary, and the reason is this, the following. One is, one, the Secretary is going to appear before the Ways and Means Committee, I believe this afternoon at two. We have got a series of votes, I think, on the floor at 10:45. The Foreign Relations Committee, which several of us here are members of, are voting on the START agreement downstairs on that matter, so we may be pulled out periodically. So it is going to be a little truncated, this process. So normally I would invite my colleagues to make opening statements, but in this case, I would ask your indulgence to have the two of us make opening statements, go right to the Secretary, and then I am going to try and limit questions to about 5 minutes apiece and be fairly rigid with the gavel when it comes to that so we give everyone a chance to be heard on the matter.

So with that, the hearing, of course, this morning is on the Treasury Department's International Economic Exchange Rate Policy Report. And again, we are delighted to have our witnesses here with us this morning. We have a very good second panel, as well, but obviously we want to welcome the Secretary of the Treasury back to this Committee as we discuss this report, specifically the findings regarding China, our nation's largest trading partner. After 19 months working with you, Mr. Secretary, and our colleagues here to stabilize and reform the financial system, we are all eager to hear about the international dimensions of the economic recovery.

As we meet today, our nation is still recovering from the worst economic crisis in almost 80 years. Millions of American families have lost their homes to foreclosure. Millions of American workers have lost their jobs to market forces way beyond their control. And while the United States has weathered recessions in the past, many of the jobs lost this time around, as all of us painfully have to acknowledge, are just not going to come back.

There are many causes of our current predicament, but there is no question that the economic and trade policies of China represent clear roadblocks to our recovery, in my view. China is the world's single largest economy and is our largest trading partner. Both our nations have benefited from this relationship over the past few decades. However, too often, a disturbing pattern of behavior has emerged, which is deeply troubling to the United States and many of our allies around the world. This behavior goes way beyond China's well documented policy of manipulating currency values.

We have seen the Chinese government display an inability to protect intellectual property rights of foreign innovators, from software developers to Hollywood film makers. We have seen calculated acquisitions of natural resources in developing nations in Africa and elsewhere, including regimes with deeply troubling records on human rights. We have seen double-digit increases in military spending, even during the 2009 global recession. And we have seen violations of international trade agreements, unfair dumping of underpriced goods on our shores, and anticompetitive subsidies that threaten to undermine the development of alternative and green energy here in our own nation.

This is an election year. We are all aware of that, obviously, in the coming days. And there is no shortage of political rhetoric when it comes to this subject matter, as we have seen over the years, particularly on the subject of China. However, as all of my colleagues know here and others, as well, I am not on the ballot this year, and so my views here are not designed in any way to reflect some sort of political opportunity but rather to express my deep frustrations after 30 years in this chamber in dealing with the matter before us today.

So what I say here this morning is motivated only by a conviction that the time for action has long since come. In fact, it is long overdue. For three decades, I have served on this Committee and I have listened to every Administration, Democrats and Republicans, from Ronald Reagan to the current Administration, say virtually the same thing, producing the same results. China does basically whatever it wants while we grow weaker and they grow stronger.

And so this Administration, in my view, must be the one who takes a stand, and I know the Secretary will lay out some things that have occurred and actions they are taking. But we clearly need concrete action here. This is not to engage in hostile conversation, but to recognize very clearly what this is and the dangers posed by a continuing path we are presently on.

For years, the Department has relied on a strategy of dialogue which has yielded some meaningful reforms, but clearly not enough. It is clearly time for a change in strategy. It is time to move beyond just the talking that we have heard and action, serious action.

In the last financial crisis, we learned that what you don't know can hurt you. The arcane financial instruments on Wall Street can cause real pain for families and businesses who have never seen or heard of a credit default swap. The interconnection goes beyond the familiar Wall Street-Main Street divide. Something as seemingly abstract as Chinese currency policy can mean a shuttered factory in Ohio, a bankrupt small business in Alabama, or a foreclosed home in Connecticut.

The report we are considering today is one important tool for the U.S. Government to address this problem. Treasury is required to issue this report by law and it requires testimony from the Secretary. Yet for years, year after year, Administration after Administration, Treasury has declined, in my view, to identify currency manipulation and take real formal remedial steps.

The latest report was released in July, following a report from China's central bank that it would enhance currency flexibility after a 2-year period of preventing appreciation. The Treasury Department called this announcement a significant development, yet China's currency has appreciated only by 1.5 percent since the June announcement and analysts estimate that the currency remains undervalued at least by 20 percent, and many argue much higher than that. Years of maintaining an undervalued currency, of course, as we all know, has resulted in lost jobs and a widening trade deficit for the American people.

Today's hearing also takes place just days after the Japanese government intervened in currency markets for the first time in 6 years to halt the appreciation of the yen. It is too early, obviously, to tell what effects Japan's action will have on U.S. economic interests, but one thing is very clear. Unilateral currency intervention by Japan, China, or any other nation represents a gap in international cooperation on exchange rate policy, a centerpiece of the Bretton Woods framework for global economic governance.

A key objective of the International Monetary Fund is to avoid, and I quote, "competitive exchange depreciation among its members." Yet the IMF has only sent two special missions to investigate exchange rate issues in the last quarter of a century, one to Sweden in 1982 and one to Korea 23 years ago, in 1987.

And while we have accomplished much to harmonize financial reforms through the G–20 and the recent announcement news out of Basel, this venue has also produced limited, very limited results in the area of exchange rate policy. More must be achieved at the November G–20 meeting in Seoul to strengthen domestic and international exchange rate surveillance. We must begin to recognize and remedy exchange rate policies that are inconsistent with international standards and harm our nation's interests.

As I mentioned so many times during the financial reform debate, we need to have a system in place to deal with the next crisis, which surely will come, not just the previous crisis. Balanced global growth and job creation are critical to building a sustainable recovery.

Many of my colleagues on both sides of the proverbial political aisle and in both chambers represented in this building have put forth proposals to remedy this situation. Members of this Committee, Senator Schumer and Senator Brown, Senator Bunning on this Committee have pursued legislation for years. Senator Shelby and I worked very closely on S. 1677, the Currency Reform and Financial Markets Access Act of 2007, which passed out of this Committee, I might add, by a vote of 17 to 4 in August of 2007.

So I am eager to hear this morning, Mr. Secretary, as I am sure my colleagues are, other ideas from not only you but other witnesses and plans for the upcoming G–20 summit and learn how this Committee and the Congress can help to ensure the continued international competitiveness of the United States.

For years, American workers have not been able to compete on a level playing field because of China's policies, and now they are struggling to secure jobs in the midst of a slow recovery from the global economic crisis. While it is clear China's currency is undervalued, the Treasury has been reluctant, in my view, to label China a currency manipulator. So, Mr. Secretary, with so many Americans out of work, struggling to make ends meet, we are eager to hear an explanation for this continued reluctance to act. It is imperative that this Committee and the American people understand what additional tools we clearly need, domestically and internationally, to combat these problems.

And with that, I turn to my colleague from Alabama.

STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Thank you, Mr. Chairman. There is no question in my mind that China manipulates its currency in order to subsidize Chinese exports. The only question is, why is the Administration protecting China by refusing to designate it as a currency manipulator? I think that is the central question here.

Although the previous Administration engaged unsuccessfully with China to resolve the resulting imbalances, this Administration insists on staying the course, doing the same thing. Make no mistake, the Chinese will continue to negotiate as long as they deem it in their interest to do so.

Mr. Chairman, I believe that the time for talking has long passed and the time for action has arrived. It is time for this Administration to recognize the consequences of China's manipulation for American workers and manufacturers and for the stability of the global financial and economic system.

Because the Chinese continue to manipulate their currency, thousands of Americans are out of work. American workers can compete with any workers in the world, but they should not have to compete against foreign firms that receive massive subsidies.

Unfortunately, the U.S. relies heavily on Chinese investment, which we use to finance our exploding debt. Our deficit last year was more than $1.4 trillion, close to 10 percent of our GDP. This year's deficit is projected perhaps to even be higher. Nevertheless, the acolytes of Keynesian economics advocate further doses of economic stimulus funded by additional debt which would most likely be purchased by the Chinese, further weakening our position overall.

I ask, what has the recent stimulus produced besides further indebtedness to the Chinese? The unemployment rate has risen to 9.6 percent from 8.2 since the stimulus was enacted, and 3.2 million payroll jobs have been lost. The housing market languishes and the consumer and business confidence remain low.

The Omnibus Trade and Competitiveness Act of 1988 requires, as we all know, the Treasury Secretary to report on exchange rate policies of major U.S. trading partners, hence the meeting today. Under the Act, Treasury must consider whether countries manipulate exchange rates for purposes of preventing balance of payments adjustments or gaining unfair trade advantage. There is clear evidence that whatever China's stated intent might be, the result of China's currency manipulation has been an unfair advantage to them in international trade.

Many of my colleagues and I, on behalf of a growing population of unemployed U.S. workers, Mr. Secretary, want to know why Treasury refuses to act. Mr. Secretary, this Administration promised to usher in an era of change, and while your ideas of positive change have rarely coincided with mine, in this particular instance, a significant change would be welcome.

I continue to be confused by the Administration's reluctance to take action here. Labeling a country as a currency manipulator does not require draconian action under the Omnibus Trade and Competitiveness Act. The immediate repercussions are merely stepped-up monitoring and greater vigilance and dialogue.

In the face of the previous Administration's failure to take effective action, Senator Dodd, as he mentioned, and I introduced legislation back in 2007 to improve the situation. We may have helped marginally. Our legislation tightened the definition of currency manipulation, imposed specific timeframes and benchmarks, and required the Administration to take more stringent actions the longer a country's currency manipulation continued. Since this Administration, I believe, has decided to follow in the Bush administration's footsteps and not take Chinese currency manipulation seriously, it may be time for new legislation, Mr. Chairman, to ensure that Treasury looks out for American workers and not Chinese creditors.

It is a bit unclear to me why the Administration has chosen to isolate this particular issue from its change agenda. Just prior to the recent Presidential election, then-candidate Obama wrote the following to textile organizations, and I will quote. He said:

> The massive current account surpluses accumulated by China are directly related to its manipulation of its currency value. The result is not good for the United States, not good for the global economy, and likely to create problems in China itself.

In addition, Secretary Geithner, you, in response to the Senate Finance Committee questions during your 2009 confirmation hearing right here, you stated that President Obama, and I quote, "backed by the conclusions of a broad range of economists believes that China is manipulating its currency." Strong words.

Unfortunately, once in office, the Administration showed that it was all bark and no bite. It is clear that when the Administration had to choose between protecting its relationship with its Chinese creditors so that it could grow the size of government and protecting American workers from unfair trade practices, American workers got the short end of the stick.

It is time, I believe, that the Administration reorder its priorities. American workers are tired of hearing about delicate international dialogue between global ministers at resort cities. They want jobs, and they are right. American manufacturers are tired of losing out to subsidized foreign imports while Treasury continues to buck an overwhelming consensus that China manipulates its currency for unfair trade advantage. The American public, Mr. Secretary, is tired of hearing about the sophisticated nuances of international diplomacy. They want the Administration to fulfill its promise of balanced international trade and they want us to overcome our addiction to Chinese funded debt. American households and businesses are acting to restore balances in their finances and they expect us to do the same.

Nevertheless, Federal spending continues to grow unrestricted. Unemployment remains, as you know, far too high, and the Administration refuses to take actions against a currency manipulator. I think it is high time, Mr. Secretary, that we see a little bit of that hope and change that you promised. Thank you.

Chairman DODD. Thank you, Senator Shelby.

I was thinking as Senator Shelby was speaking of the very first hearing that I ever held as Chairman of this Committee in January of 2007, when I became Chairman of the Banking Committee, was on this very subject matter.

Senator SHELBY. It was.

Chairman DODD. Hank Paulson came up to testify. He wasn't happy about coming, I recall. I say that respectfully, but he wasn't overly enthused about coming up.

Senator SHELBY. You didn't have to subpoena him.

Chairman DODD. I didn't have to subpoena him, though. He came up——

[Laughter.]

Chairman DODD. He came up, and——

Senator SHELBY. But he knew you would.

Chairman DODD. So when I hear my good friend, Dick Shelby, talking about—as I said earlier, this is from Administration to Administration. I mean, Hank Paulson did a dance at that table on manipulation going back to the days of Ronald Reagan and that Administration. So this is nothing new. It just goes on. Whoever is in town on this issue basically ends up with the same script, and there is something clearly needed more than a new script. We need some new policies here. It gets worse by the hour, and all of us up here, those of you who will be here and those of us who are leaving, just hope at some point here we are going to see some change. And we are not looking for some huge battle with China. But if we continue down this path, it poses huge, huge issues for our ability to have any kind of meaningful recovery.

So, Mr. Secretary, the floor is yours.

STATEMENT OF TIMOTHY F. GEITHNER, SECRETARY, DEPARTMENT OF THE TREASURY

Secretary GEITHNER. Mr. Chairman, Ranking Member Shelby, and Members of the Committee, I appreciate the chance to come talk to you about China today, and I just want to say at the beginning that we share your concerns, we share your objectives, and we look forward to discussion about how best we can better accomplish those objectives. You are going to find us in strong agreement with the concerns you expressed today. And, of course, I want to say that your concern about this issue is welcome and helpful. It is helpful for people to hear it not just from us but from Members of Congress on both sides of the aisle, Republicans as well as Democrats.

We have very significant economic interest in our relationship with China. U.S. companies and industries across the country, from high-tech to agriculture, are playing a major role in supplying China's growing economic needs. U.S. exports to China are growing very rapidly, much more rapidly than our exports to the rest of the world and supporting a growing number of American jobs. The goods we sell to China have risen in value about 36 percent so far this year, which is one reason why manufacturing has been so much stronger than other parts of the American economy in the early stages of this economic recovery.

Now, we also face very substantial challenges in this relationship with China. I am going to provide today a candid assessment of where we are making progress, where progress is inadequate, where we are going to focus our efforts in the months and years ahead, and today, I want to focus in my opening remarks on two of those challenges.

First, on the exchange rate, China took a very important step on June 19, earlier this year, when it announced it would renew the reform of the exchange rate regime and allow the exchange rate to move higher in response to market forces. In the roughly 3 months since that announcement, however, the Chinese have allowed their currency to appreciate against the dollar by only 1.5 percent and the currency has actually depreciated against the weighted average of the currencies of its trading partners.

The pace of appreciation since September 2 has accelerated. That is welcome. If it were sustained, that would be meaningful. But in the period since the initial announcement, China has continued to intervene in the exchange markets on a very substantial scale to limit the upward pressure of market forces on the Chinese currency.

Now, it is the judgment of the IMF that in view of the very limited movement in the Chinese currency, the rapid pace of productivity and income growth in China relative to its trading partners, the size of its current accounts surplus, and the substantial level of ongoing intervention in exchange markets, that the Chinese currency is significantly undervalued. We share that assessment and we are concerned, as are many of China's trading partners, that the pace of appreciation has been too slow and the extent of appreciation too limited.

We will take China's actions into account as we prepare the next Foreign Exchange Rate Report, and we are examining the important question of what mix of tools, tools available to the United States and what multilateral approaches might help encourage the Chinese authorities to move more quickly.

Now, two key factors worth highlighting in evaluating progress should be the pace and extent of appreciation and the level of ongoing intervention required to slow the rate of appreciation. As the exchange rate gets closer to a level that reflects underlying economic fundamentals, the level of intervention should decline. Continued heavy intervention, in contrast, would support the judgment that the currency remains undervalued.

Now, during the last period in which Chinese authorities allowed the currency to move higher, it appreciated by about 20 percent against the dollar and about 13 percent on a real trade-weighted basis.

The second major challenge we face is that China has for a long time combined the pursuit of an export-driven growth strategy with a very substantial set of protections and preferences for its domestic industries, and we are committed to working with you to help level the playing field. It is a simple principle of fairness to the American firms competing in China's markets should have the same rates enjoyed by Chinese firms in the American market. We should be able to compete on a level playing field in China just as Chinese firms compete on a level playing field in the United States.

China pursues industrial policies to promote what it calls indigenous innovation, aimed at promoting innovation and technological advancement in China in ways that potentially discriminate against U.S. firms, their products, services, and technology. The Chinese government still plays a very, very large direct role in the economy through state-owned enterprises and in the allocation of credit and the provision of other inputs that are important to production. China has yet to sign onto the disciplines provided by the World Trade Organization, the WTO's government procurement arrangement, and even with recent improvements in Chinese law designed to protect intellectual property, piracy and theft of intellectual property are widespread.

We are very concerned about the negative impact of these policies on our economic interests and we are pursuing a carefully designed targeted approach to address these problems. Last year, we won two WTO cases against China related to intellectual property rights and settled a third. We took action in 2009 under Section 421, the first time ever by any Administration, to address a surge in Chinese imports in a particular sector. Our antidumping and countervailing duty regimes provide very substantial protections for U.S. companies against unfair trade practices, and we will continue to enforce those laws to safeguard the rights of America's firms and workers.

Yesterday, Ambassador Kirk announced the filing of two new WTO cases against China, one involving discrimination by China against suppliers of electronic payment services and the second challenging China's imposition of CVD, countervailing duties, on U.S. exports of a high-tech steel product known as grain-oriented electrical steel.

We are in the process of reviewing carefully the evidence presented in the Section 301 petition filed by the United Steelworkers

Union challenging a wide range of Chinese policies in the renewable energy sector. We are exploring ways to encourage a substantial improvement in intellectual property protection in China.

Now, we are pursuing these important objectives at the highest levels of the U.S. Government with a careful assessment of priorities led by the White House using all available tools that are consistent with our WTO obligations. We are making some progress. We welcome the recent assurances by the Chinese government, including Premier Wang's statement this week that China will afford national treatment to U.S. companies operating in China, but we want to see that commitment to a level playing field extended to U.S. exporters that sell to China from the United States. This is the basic premise of the multilateral trading system from which China and the United States have benefited so greatly.

Now, Mr. Chairman, we welcome your attention to these issues and we will work closely with this Committee and with your colleagues in both Houses of Congress to find ways to best advance and protect our economic interests in this important relationship.

China has a very substantial stake in continued access to the U.S. market and China has benefited greatly from the rules and protections that underpin the multilateral trading system, and we, the United States, have a very strong interest in a more level playing field in the Chinese market so that U.S. businesses and U.S. workers do not face unfair trading practices. We need a more balanced economic relationship. This is imperative for us, but it is important for China, as well.

Thank you very much.

Chairman DODD. Well, thank you very much, Mr. Secretary, and I appreciate the comprehensiveness of your statement and again recognize some of the steps that have been taken, and we welcome those.

Let me, if I can, I will ask the Clerk here to keep this clock on that 5 minutes, so we can move through as many members as we can with their questions.

Mr. Secretary, I mentioned in my opening comments about how the G–20 actually played a pretty important role in the financial reform area. They outlined in April, I believe it was, of 2008 some 20 principles that they thought ought to be pursued in the financial regulatory structure. While we did not write a bill written by the G–20, candidly, we did follow those principles to a large extent.

And I notice with some interest that the last couple of days the European Union has established some principles dealing with derivatives that virtually take almost every dotted I and crossed T of our work in the derivatives section on this bill and copied it—a form of compliment, I suppose, to the efforts here but also the harmonization that has been so critically important.

Yet, the global economic issues, such as exchange rate reform, we have not seen the same degree of progress achieved through the G–20.

And obviously that meeting coming up in November in Seoul, what do you intend? What does the Administration intend to try and do on this issue at the G–20?

Secretary GEITHNER. A very important question, and you are right to highlight the very important role that the G–20 played in advancing the broader international reform agenda, and the broad principles that they agreed in April of 2009 were largely embodied in the financial reform bill that this Congress passed in July.

The focus of these discussions at the G–20 in Korea will be on ways to help strengthen and reinforce this global recovery, and how to make sure that on the financial reform agenda we have a strong set of global standards in place, so that again we have a level playing field that applies to all the global institutions, financial institutions that compete in global markets.

Now in the broader discussion about the economic recovery, we expect there to be a significant focus of attention, as there has been in these previous meetings, on China's exchange rate policies because this is a multi-lateral issue. It is about the broad interests of all of China's trading partners in a level playing field. There is very broad multilateral concern with the impact of these policies. It is not just concerns that we have in the United States. It is in our interest as a Country to maximize the chance that other countries express these concerns directly to China, so that China feels more of an interest in moving in response.

Reform of the Chinese exchange rate regime allows the market to move that currency higher over time, would be good for global economic growth, very important for growth of the United States, good for growth in China over time as well, and we are going to maximize the chance we can use that G–20 process to try to mobilize support around the world for progress on these issues.

Chairman DODD. Well, I appreciate that, and obviously we are watching to see what happens there. But I notice as well, as I mentioned in my comments here, the International Monetary Fund, as you well know, was established for the very core objectives of avoiding competitive exchange rate policies. That is their primary function, their central function. Yet, I mentioned there were only two actions taken, in one case almost thirty years ago, in the case of Sweden, and one twenty-three years ago in the case of Korea, and that has been it. Other than that, some rhetorical concerns being raised by them.

You said in your testimony that Treasury shares the IMF's assessment with China's current, that China's currency is significantly undervalued. However, apart from issuing reports on the subject matter, the IMF has not taken any formal steps, despite the fact this has been egregious manipulation of currency by China. So, one, I would ask you how you assess the IMF's performance in fulfilling its core objective, given the paltry examples of its intervention.

And second, I know that on the agenda of G–20 and the upcoming IMF/World Bank meetings are the IMF's governance reforms. It has been reported recently in the press that some reforms are necessary. Now I think we pay about 17 or 18 percent of the IMF funding. That is based on, although many argue that, some nations have less importance economically today and so there should be some greater participation by others. One is, of course, the argument that China will have a greater role in the IMF because of its growing economic influence.

And I know there is an argument that somehow by providing China with a greater say in the IMF that this may encourage improved behavior on behalf of China. Frankly, there are historical examples where that kind of approach has not produced the best results. And I am curious as to why we would even be talking about enhancing their role, given the fact that they have been so recalcitrant, and I am being polite in using that word, when it has come to currency manipulation over the past number of years.

So tell me, if you will, why it is that there are those who believe that by increasing China's stake in the IMF it will have the positive impact on appreciating the currency.

Secretary GEITHNER. Well, Mr. Chairman, I just want to say at the beginning that I agree with you that the members of the IMF and the IMF itself have not covered themselves in glory on this. The IMF is an institution of its members. It is designed in a way—the comparisons with the Senate are not fair, but in many ways it is designed in a way that it is hard to do some things without the consent of its members, and I think that is the principal reason why you are not seeing more effective action by the IMF in this area

Now it is very important though that the IMF, because it is an international institution and its job is to provide objective assessments of things like whether a country is running an undervalued exchange rate, that the IMF continue to provide that assessment. That helps a lot because they can be a better independent arbiter of that basic question, and them saying it helps our basic objectives.

And you know fundamentally it is also true that even though many other countries share our concerns with China, frankly they are reluctant to pursue them as aggressively as we have been, and to be as open and direct with the Chinese authorities about them in the hopes, frankly, that we will deliver those changes for them.

So the multilateral process is important to use, but as you have seen it is not delivering greater leverage or impact. We would like that to change, and we are working hard to do that, but it is not something we can bring about on our own.

Now you are right to say that we have supported a set of changes to the governance structure of the IMF, and let me explain why we are doing that.

The IMF, as you know, which was set up in the wake of World War II, still has a very unbalanced governance structure where a set of countries, principally European countries, have eight seats on the board and they have a much more disproportionate share of votes in the IMF than is commensurate with their relative economic strength in the world. And to try to make sure that all emerging market economies in countries around the world feel a stake in making the IMF work on questions like this, we support a change in the balance of power to catch up to this big shift in global activity. With this shift, countries, the most rapidly growing emerging economies, including China but a range of other countries as well, will get, and they need to get, a somewhat larger increase in their relative vote in the institutions.

I think that is very strongly in our interest and in the interest of the IMF, but of course that is not going to bring about, on its own, big changes in how countries perceive their interest in the IMF. But I think they are important things to do.

So we are going to continue to use the G–20 as much as we can, the IMF as much as we can, to make sure there is broad-based multilateral attention to these issues. We think that will help reinforce our issues, our interest, but we share your frustration with the impact and effectiveness of those institutions and fora to date.

Chairman DODD. Senator Shelby.

Senator SHELBY. Thank you.

Mr. Secretary, in my opening statement, I referred to a letter that President Obama wrote to the textile organizations during his Presidential campaign, where he wrote, and I quote again, and he said, "The massive current account surpluses accumulated by China are directly related to its manipulation of its currency value."

I also referred in my opening statement, Mr. Secretary, a few minutes ago, to something you wrote in response to confirmation hearing questions put before you by this Committee. You stated the following, and I quote: "President Obama, backed by the conclusions of a broad range of economists, believes that China is manipulating its currency."

As I said earlier, these are strong words. You and the President made clear you believe that China, and you both specifically used the word "manipulation." Yet, when the Obama Administration and you, the Secretary of the Treasury, have had the opportunity to take formal action and label China a manipulator, you have refused. That is hard to explain. Are you denying reality? Are you worried about China?

To the three and a half million jobs, I do not say we can attribute all of that to China, but a lot of it you could. It is baffling to the American worker and to the American people.

Could you explain, if you are not going to label them a currency manipulator when you know and have said before, you and the President both, that you know they are—we know they are, everybody in the world knows they are—why do you not do it? Explain.

Secretary GEITHNER. Thank you, Senator. I have said consistently in public, and I believe and I said again this morning, that the Chinese currency is significantly undervalued. It is also unambiguously true that China is intervening, and has intervened aggressively, to maintain that practice. Even though China has begun to allow the exchange rate to appreciate again and even though that process has accelerated in the last few weeks, it does not change the basic judgment that the currency is undervalued, and we would have to see a very substantial change over time for that judgment to change. That is my view.

Now you, in your opening remarks, raised concerns with the law as it is written, and I think that is really the answer to your question because the way the law is written it requires a different set of judgments than the one I just said. And we do not believe, as you noted, as my predecessor have reached the same judgment over time, that those set of practices meet the test in the law.

Now they may meet the test in the law at some point, but the way that law is written, how should say, does not make it a particular effective tool at the moment for advancing our basic interest in trying to get the exchange rate to move up over time.

Senator SHELBY. Mr. Secretary, in the area of systemic risk, you, the Secretary of the Treasury, under the Dodd-Frank Act established a Financial Stability Oversight Council which is chaired by you and contains nine other voting members. This new oversight body is intended to monitor the U.S. and global financial system for systemic risk. Many analysts have warned of systemic risk stemming from global imbalances, which stem in large part from China's huge trade imbalances and exchange rate policies. Do you believe as Secretary of the Treasury that China's exchange rate policies create systemic risk for the U.S. financial system or could create systemic risk?

Secretary GEITHNER. I do not. I do not now in current conditions, but they are very substantial economic policy problems for us and for the world economy and for China, and that alone makes it a worthy focus of attention by this Committee and by policies of this Administration. But I do not think I would say that in these conditions today that they present systemic risk to the U.S. financial system.

Senator SHELBY. Secretary Geithner, the Fed Chairman, Chairman Bernanke, has identified China's exchange rate policies as effective trade subsidies, favoring Chinese exports to the United States. Do you disagree with Chairman Bernanke's assessment?

Secretary GEITHNER. I would not use exactly that term because, as you know, that is a technical term with deep meaning in the WTO context, and it is not my judgment to make that kind of conclusion. But I would say, and it is unambiguous——

Senator SHELBY. Do you disagree with his language, his statement?

Secretary GEITHNER. I agree with the Chairman of the Fed on almost every issue, but on this particular question I would say it this way, Mr. Senator: China is running a set of policies that are designed to keep the currency undervalued.

Senator SHELBY. Right.

Secretary GEITHNER. It is undervalued. They are moving to let it rise, but not very quickly.

Senator SHELBY. Not very much too.

Secretary GEITHNER. Not very much either. And the impact of that has the effect of providing a relative disadvantage to companies that compete with products that the Chinese make. That is the effect of the policy. That is why we are worried about it. That is why we would like to see it changed over time.

Senator SHELBY. My last question, since the beginning of 2000, 10 years, there has been a loss of close to 5.6 million payroll job in manufacturing in this Country, as you well know. Secretary Geithner, what is your estimate of the share of America's manufacturing job losses that can be attributed somewhat to China's manipulation of the currency?

Secretary GEITHNER. You know, I think that is a good question, but I think you should direct that question to the economists you are going to be discussing this issue with over time. I have not seen particularly good estimates. I can tell you that I think that it is a material economic problem.

Senator SHELBY. That is a question that should be answered, should it not?

Secretary GEITHNER. I think it is a reasonable question to deal with. You are going to have a hard time finding—economists, you know, do not agree on anything. You are going to have a hard time finding a credible assessment of that, but I would say this; it is material.

Senator SHELBY. Are you claiming that you are not an economist?

Secretary GEITHNER. I definitely am not an economist.

[Laughter.]

Senator SHELBY. We are not too. We know that, and we are not either.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much.

Senator Johnson.

Senator JOHNSON. Some analysts suggest China's current policy has cost the United States 1.4 million jobs and that if China did not undervalue its currency we could add about half a million jobs and reduce our current deficit by at least $50 billion. What do you think of this assessment and at what rate would appreciate have to happen to have a positive impact on the U.S. Government?

Secretary GEITHNER. Senator, I think the overall impact of China's economic policies, including its exchange rate policy, have these two—it is important to look at both—sides of it.

Again, we export a lot to China. Our exports are growing very rapidly. They have been growing much more rapidly than our imports from China over the last 5 years or so. That has huge benefits to the United States and to American workers. There are more jobs today in America because of the opportunities we face in that market, and that is true in spite of these concerns we have, very substantial concerns we have, with their exchange rate practice and their trade policies.

However, the exchange rate policies and the broad trade practices I described to you have a material adverse effect on our economic interests, and we would like to see those changed overtime. I do not know how to quantify them. I have seen the estimates you said. I do not know if those are fair or not, but I can tell you they are material enough to matter to us, and we should care about it.

But on your second question, which is how large a change in the value of the currency would be necessary to correct for this evaluation, this is an issue again where there are a lot of ranges of estimates out there. This is not something you can know with precision, but I would just offer the following observations that I did in my opening statement.

The last time the Chinese authorities allowed their currency to move, they allowed it to move by 20 percent against the dollar over a period that was roughly 2 years, in terms of the most rapid pace. That was a very substantial move, not adequately obviously, which is why we are still discussing this question, but we would like to see a sustained period of appreciation at a pace that offers the prospect of correcting the degree of undervaluation that still exists.

Senator JOHNSON. While it is only a few months since the report, the July report, is there any new data that would shed light on the impact of China's decision to allow limited appreciation?

Secretary GEITHNER. I think it is as it looks. It offers the possibility of another period of a sustained appreciation of the currency, but not enough confidence in the action they have taken so far that that is going to be forthcoming again on a pace that is appropriate to us. So you cannot tell from the path they have adopted so far whether they are going to let it loose far enough. That is why I said the ultimate test of this reform is going to be how far and how fast do they let the currency move, and that is something we are going to have to be watching very closely.

Of course, the virtue of this, you can see every day what they are doing. They have let it move up almost 1 percent in just the last 10 days or so, which is a good and encouraging 2 weeks. But what matters is what they do over a long period of time because, again, it has only been 1.5 percent.

Senator JOHNSON. Yes. What steps have been proven effective in getting China to address problems that U.S. companies face in its market?

Secretary GEITHNER. Frankly, it has been extraordinarily difficult. The approach we take is every time we hear about a particular concern about discrimination, in fact or in policy or in promise, we raise that issue with the Chinese authorities and tell them it is important to us that we fix those problems. Sometimes that makes a difference. It has not made enough difference, frankly, to us. But I think the only way to do this is to make sure that we are relentless in raising these concerns when we hear them, when they have merit, with the Chinese authorities, and we use every tool we have available under U.S. law and in the WTO to convince them to end those practices. That is the most important approach.

But as I said in my opening remarks, in intellectual property piracy, in subsidies, in government procurement, in these policies they call indigenous innovation, we are seeing a pattern of practices that we think have substantial adverse effects on our economic interests as a Country. I think they are basically unfair and they are unacceptable to us, and we need to make sure that we will continue to look for ways, working with you, to encourage China to address them more effectively.

Senator JOHNSON. Thank you, Secretary Geithner.

Chairman DODD. Thank you, Senator.

Senator Bennett.

Senator BENNETT. Thank you very much, Chairman, and welcome, Mr. Secretary.

We have had a lot of discussion about currency manipulation, and I am not sure I can add anything to that discussion, so let me take advantage of your being here and this subject and ask some related questions about China and the impact of China on our economy.

First, what do you see with respect to property rights, particularly intellectual property protection of China? At one point, that was a very major problem. I would like your assessment of how it is affecting our exports and our circumstance.

I share with you this anecdotal circumstance when I was in Vietnam, and the Vietnamese said: You should not be trading with China. You should be trading with us because we are cheaper.

Then some experts said to me: And the Vietnamese are driving the Chinese crazy over the issue of intellectual property rights because the Vietnamese are knocking off things that come from China, and China is beginning to learn how important intellectual property rights really are.

As you view the whole question of U.S.-China trade, what is your sense on this question of intellectual property rights.

Secretary GEITHNER. I think it is a huge problem and, to be fair, progress has been uneven. Their laws are better, but enforcement is very uneven. Some companies and some industries report that things are really getting substantially better over the last decade, but in a lot of industries, I will mention computer software for one, people have not seen a material improvement in the level of piracy.

I will give you one example from my written statement which is that every year of course we seize at the U.S. border goods that have pirated or stolen intellectual property, or infringe on U.S. property rights. In 2009, 80 percent of those goods seized were Chinese goods. So it is a very substantial problem still.

And frankly, it is a terrible problem for China. I mean how do you as a country encourage innovation, encourage future growth if you do not give your innovators the property rights that come with their ideas. So, for that reason, there is a lot of people in China very worried about this too. But as they would admit, I believe, they are not doing enough to enforce their own laws, and their own laws probably need to be stronger as well.

Senator BENNETT. We talk about the Chinese as the second largest economy in the world now, having passed the Japanese, and part of that of course is the Japanese economy has been stagnant while the Chinese economy has been growing. But I have a sense that part of the fact that the Chinese economy is growing so rapidly is that they may very well be setting themselves up for a bubble that will burst, particularly again in the area that hit the United States so hard which is real estate. Now you do not have the housing kind of boom in real estate that you did in the United States, but you have commercial real estate.

What is your sense of the stability of the Chinese growth? Can it continue at the present very, very attractive rates?

And while you are commenting on that, comment on the accuracy of the economic data coming out of China. I am very suspicious of an economy that tells on the 31st of December what it has done in the previous year. It takes our economy months to sift through all of the data.

If you could address those two questions, I would appreciate it.

Secretary GEITHNER. Let me start with the last question. You are right that there——

Chairman DODD. Mr. Secretary, I want to just interrupt you for 1 second. The second bells have started. We are going to head over. When Senator Bennett finishes up, quickly a response to this question, I am going to recess until 11:30. We have two votes. We will come back here and pick up with Senator Bunning and Senator Bennet who have also been in the room.

Secretary GEITHNER. Senator, you are right that there have been a lot of concerns expressed by independent economists about the integrity, reliability, accuracy of that data. China is not unique in that way, of course.

My own sense is that China's growth looks very resilient now. It looks actually quite strong, and we are seeing encouraging signs of them shifting away from the export-intensive model of growth in the past toward a growth strategy more led by domestic demand and consumption, which would be very much in the interest of our interests in bringing about a more balanced global economy. But they are just at the beginning of that transition, and they need to do a lot of things to reform basic practices to sustain that progress. But the recovery there looks very strong.

They are very concerned and have talked publically about concern that they see a rise in asset prices, real estate prices that could threaten their recovery, and they have taken a number of actions to slow the growth of credit, bank credit and to reduce the risk again that they see the kind of bubbles in asset prices that were so damaging in the United States. That is one reason why they have restarted this reform of the exchange rate system.

And that is one reason why there is a lot of support in the Chinese government for trying to move further on the exchange rate, and it is for the following reason: If you tie your monetary policy as a country to the Federal reserve's monetary policy, then it is harder for you to run a set of policies that are designed to contain inflation, provide more balanced growth domestically and resist this risk of asset price bubbles. So the longer they tie their currency to ours, the harder it is going to be more for them to contain the risks that you referred to of future asset price bubbles. The more they care about making sure that growth is sustainable, to take this risk out, the more important it is for them to move on the exchange rate, so they can run an independent monetary policy that is more suited to China's challenges.

And again, that is why it is fundamentally in China's interest to move, that is why they began the process again in June, and that is why I believe that you are going to see a pretty sustained, significant movement over time. It will come gradually, but it will come.

Senator BENNETT. [Presiding.] The Chinese middle class, I am told—and I would just get your reaction to whether or not this information is correct—is about 300 million people. The total American population is 300 million people. So you could say in that circumstance our economies are beginning to reach par.

Now that means they have another 800 million people who are still living at the level of $2 a day, and that kind of difficulty.

Back to your point that they are going to start talking more about the domestic economy, are those numbers roughly accurate and do we have a domestic economy of 300 million people? And can that economy continue to grow at, say, 8 percent, or with the drag of the other 800 million people is the growth going to start to slow down in your view?

Secretary GEITHNER. Those numbers sound broadly right to me, and again I think if you—there is no science to this and a lot of uncertainty around it, but I think most economists would say China is likely to be able to grow at a rate like 8 percent for a sustained period of time because they have a long way to go to bring those people from agriculture into industry and to take advantage of the huge gap they still face between how people produce stuff in China and the frontier of technology. So that process of catching up would for China—it is true for India too, for many emerging markets—justify some confidence of quite high levels of growth rate for a long period of time.

But what matters to us and to the world economy is the shape of growth, the pattern of growth, how they grow the growth strategy. And for that to work for them over in China, it is going to have to come from a rising middle class and from stronger domestic demand. It cannot come from the export-intensive model of the past. It is just not a tenable strategy for them. They are beginning that shift, but they are just at the beginning of that shift.

Senator BENNETT. Thank you very much. As the Chairman said, we are adjourned until 11:30.

Secretary GEITHNER. Thank you.

[Recess.]

Senator REED. [Presiding.] Mr. Secretary, if you could take your seat. Senator Bunning is in order to ask his questions. Senator Bunning?

Senator BUNNING. Thank you, Mr. Chairman.

You made a statement recently, but I totally disagree with it. The problem is not with the law on currency as it is written. The problem is with the twisted way that the administrations have interpreted it. So even if we rewrote the law, you would interpret it as you choose.

Now, I am going to ask you some questions about your own testimony. I am going to read you a couple of sentences that you wrote in your testimony and then I am going to ask you if you actually believe they are true.

First, you said the Administration is using all available tools to ensure that American firms and workers can trade and compete fairly. So let us do a fact check. The Currency Report, the subject of today's hearings, by the way, is one of the most powerful tools in your toolbox. First, you violated the law by missing the report's April 15 deadline by almost 3 months. Then when you actually issued the report, you ignored reality and refused to tell the truth about a Chinese currency manipulation. And if you had just told the truth and cited China as a manipulator, it would have simply triggered negotiations, not a trade war. You left one of America's best tools on the table. Do you still stand by the statement that the Administration is using all tools available?

Secretary GEITHNER. I do.

Senator BUNNING. You do?

Secretary GEITHNER. And we will continue to do it. I mean, Senator, what Senator Shelby said was, I think, correct, which is to say that a number of Senators have looked at that law in the wake of events since it was written and explored ways to improve it and strengthen it, and I think that recognizes that, as is true with many laws, they are not perfect and they are exploring ways to figure out a way to make it a more effective tool in this context. I don't think it has been a particularly effective tool. It doesn't mean it can't be——

Senator BUNNING. The International Monetary Fund should have nothing, absolutely nothing to do with whether you or any Secretary of the Treasury designates China as a currency manipulator.

Let me read you another statement from your testimony.

Secretary GEITHNER. I think I agree with that, by the way, just to say, and I don't think they need to. I think the only thing I said is that when they conclude that a country is running a significant valid exchange rate, that matters. It is important. It is the judgment that has some weight.

Senator BUNNING. Let me read you another statement from your testimony. We are aggressively using the full set of trade remedies available to the United States under U.S. law to address unfair trade practices and safeguard the interest of U.S. workers. So let us do another fact check. Countervailing duties are a trade remedy. They are supposed to protect U.S. workers and businesses from unfair trade subsidies.

Two separate countervailing duty cases were brought before the Commerce Committee recently by U.S. workers and businesses. By the way, we will hear from the businesses on the next panel, one of them. In the aluminum case, the Commerce Department refused to even investigate China's currency manipulation as a trade subsidy, even though that is exactly what it was. How can you say that the Administration is aggressively using the full set of trade remedies when the Commerce Department won't even investigate the use of a trade remedy to protect U.S. workers? Do you think the witnesses from Hydro Aluminum on the next panel will agree that you are using the full set of trade remedies?

Secretary GEITHNER. Well, I don't know what they will say, but I will say that that is our policy and we will continue to do that. I can't speak—you should ask Commerce about the factors that informed their judgment, but I think as you know, Senator, they are making a judgment that I think is consistent with almost every other similar case in the past. It doesn't mean they won't change that in the future, but you should let them speak to that judgment.

Senator BUNNING. Yes, but Mr. Secretary, if you understand the 24 years of frustration I have had up here on every Banking Committee, House and Senate, for 18 years, we have tried to get five Administrations to act on this and they have all sat on their hands. You are not by yourself. There are four predecessors of yours, maybe more—probably more—that have done the exact same thing that you have done, not indicated that China is a currency manipulator when all the facts, when all the facts indicate otherwise. And I am frustrated, and I know my colleague, Senator Schumer, is frustrated. We are trying to act in the best interest of our workers and the United States of America. Thank you.

Chairman DODD. [Presiding.] Thank you, Senator.

Jack, you have not been heard, have you?

Senator REED. I have not been heard.

Chairman DODD. Senator Reed.

Senator REED. Thank you. Thank you, Mr. Secretary. This is an issue, and all of my colleagues have said that at this point, it has been years where we have been negotiating with the Chinese, and frankly, I think we are all coming to the conclusion that they don't believe we are serious. As a result, they will listen to you politely, but they will not take any effective action.

I think the only way that we will begin to be viewed more seriously is if we start moving legislation here in this Congress that has more teeth, *et cetera*. That in and of itself might provide an opening for more constructive talks. We have been ritualistic berating Secretaries of the Treasury. I think we probably have to do a lot more with our own house to get it done. But it would be helpful if the Administration would signal that a legislative response would be useful, maybe even in a procedural sense of making your presentation more serious. Any reaction, Mr. Secretary?

Secretary GEITHNER. I would just say the following. I think it is very important for people to understand how strong the sentiment is here in the Congress on both sides of the aisle. It is very important for them to know it is bipartisan. It is very important to know that there is very strong concern not just among Democrats, but among Republicans. And as I said, we will be happy to work with you to figure out ways to get more effective approaches to reinforce our interests.

We are in strong agreement with you on the problem, on the concerns, but as you have said, the challenge is trying to find a way to make more progress on these things and we are open to ideas.

Senator REED. Let me open up another perspective, I think, on this issue. My impression, for what it is worth, is that China has a definite economic strategy. It is jobs. Anything they can do to maintain employment in the country, they will do, and this currency has been handed to them through the international system as a great way to give advantages to their employers. I do not think, and this is not a reflection on the Obama administration, this goes back through multiple administrations, in fact, probably even more pronouncedly in the Bush administration, where the strategy was not about jobs, or not about jobs and manufacturing jobs on Main Street in America.

We have to not only counter this currency inflation, we have to come up with a jobs strategy, and in doing that, we are going to be face to face with the Chinese on a number of issues in addition to currency. So again, could you comment on that, Mr. Secretary?

Secretary GEITHNER. I would just offer the following. The most important factor which will determine how effective we are in competing with China, how effective we are in raising income growth in this country, in bringing people back to work, are the things we are going to do in the United States to strengthen incentives for investment, for innovation, long-term investment, those types of things, and we are, as you know, with support of the Congress, because we need Congress to do it, are making the largest investments in basic research, in research and development. We have proposed—the President proposed over the last 2 weeks a set of much stronger, much more powerful incentives to business investment than we have considered in a very long period of time.

Doing those things to encourage investment here in the United States in ways that are fiscally responsible, that are consistent with our objective of bringing down our long-term deficits, reducing our reliance on borrowing overseas, are the most important things we need to do.

Now, those are not enough. Alongside those things, we have to be aggressively making sure we are going after unfair trade practices in China and other countries around the world. But you are right to emphasize that, overwhelmingly, the obligation on us is to find ways to strengthen incentives for investments for innovation, for job creation here, not just in manufacturing, but across the board. And again, we face an enormously difficult challenge as a country.

We have got a long way to go to dig out of the mess caused by this crisis. But look at what has happened to manufacturing just over the last 12 months. Look at what has happened to high tech. Look at what is happening to exports. There are very encouraging signs of growth and dynamism in those areas and our job is to reinforce those.

Senator REED. Well, just—and I will finish, and I think you are right, because when I talk to my manufacturers, they are doing well, they would do much better if they didn't have a built-in barrier of Chinese currency to overcome. And there is another issue——

Secretary GEITHNER. I agree with you. I completely agree with you.

Senator REED. And so that is another reason why that might be, rather than simply saying they are doing great here, that is a strong signal that we could do a lot, lot better.

The other thing, too—two quick points, because my time is running out. I fully concur with you and the investment that the President has done, fully supported, it is the future. But what we see is if you have a high-tech investment process coming out of a university research lab, *et cetera,* well, that is generating jobs, Ph.D., Master of Science, *et cetera.* We have scores of Americans that need to get employment that don't have those skills, won't have them even if they go back to school for 4 or 5 years. We need those now.

And the other point about investment, you are right about the investment has to be in the United States, because candidly, there are major American companies that have significant positions in China who, I would presume, have some ambivalence about what we do with respect to the Chinese government, their economic policies, particularly the currency policy. Do you sense that, and are you getting push-back by American interests that have these positions?

Secretary GEITHNER. Two very thoughtful questions, so let me try to respond to both of them. You are absolutely right that you need to do more than just provide better incentives for businesses to invest in research and development, buy equipment, increase capital expenditures here in the short-term. We need to do things that help provide long-term sustained support for public infrastructure. That is one of the most important things we can do to help bring people back to work, and if you invest sensibly in public infrastructure, you are going to have stronger growth in the future and you help create new opportunities for jobs for many of the people that are affected most directly by the crisis.

Now, what China has been doing, and I think it is fair to say it this way, is for a long period of time, it has been running a strategy that had the following basic dimensions to it. If you want to come sell in this large growing market, we would like you to come invest here and produce here. If you come invest here and produce here, we want you to transfer technology to Chinese companies. If you want to continue to invest here, produce here, and sell to our markets, we want you to export to the United States from these production facilities to the United States, and they have been systematically over a long period of time very openly pursuing that basic strategy.

Now, for many reasons, we find that untenable and we want to deter them from pursuing that and change that strategy. It does put U.S. companies in a difficult position, because, as I said, they are substantially expanding and growing at a very rapid pace what they are selling to the Chinese market. It is very, very rapid growth. It is billions and billions of dollars of things that matter a lot to our incomes here in the United States, jobs in the United States. But they are reluctant to be associated with aggressive use of U.S. trade laws because of fear the Chinese will retaliate against them, and if they don't say that in public to you, they will say it in private to you. You know that is the truth.

So part of our challenge in finding ways that have some more leverage is to find things that we think will be effective in changing Chinese behavior. And again, the best way we can do that is try to underscore how important it is to China that they continue to enjoy access to this open multilateral trading system and access to this market in the United States. But that is the challenge we face.

Senator REED. Thank you, Mr. Chairman. Thank you.

Chairman DODD. Very good. Thank you.

Senator Schumer.

Senator SCHUMER. Thank you, Mr. Chairman, and thank you, Mr. Secretary. You know, my words are going to be tough, but I have tremendous respect for you on every issue, maybe except this one.

[Laughter.]

Secretary GEITHNER. Always a pleasure.

[Laughter.]

Senator SCHUMER. First, let me say, 5 years—6 years ago, Senator Graham and I came up with the idea of doing something about manipulation of currency. At first, everyone said, oh, no, this is not a problem. So the only progress I think we feel we have made is now everyone admits it is a problem, you do and everyone else, but no one does anything about it. No one does anything about it.

You laid out the policy China has, which is mercantilism, not free trade. And when we ask that people do something about it, whatever Administration, they shrug their shoulders and say, well, nothing much we can do. Not so. At a time when the U.S. economy is trying to pick itself up off the ground, China's currency manipulation is like a boot to the throat of our recovery and this Administration refuses to try and pick that boot—take that boot off our neck. China's overt and continuous manipulation of its currency to gain trade advantage over its trading partners is about as close to a fact in economic policy as you can get.

Now, those of us on the Committee, some of us—very few, actually—disagree about what to do about it, and maybe there are some who think even though it is a problem, we shouldn't do anything about it. But Mr. Secretary, although there may be some modest disagreement about what to do, I am increasingly coming to the view that the only person in this room who believes China is not manipulating its currency is you.

And so the question I ask is, what is the Administration afraid of when every month we lose jobs and wealth that we will never recover? It diminishes America, our standard of living here in America, and America as a world power, for a reason that just about everybody admits is wrong.

Now let me ask you, are you afraid that if the Chinese, if we cite the Chinese, they will retaliate by limiting access to their market for U.S. firms, or their central government will provide billions of dollars of financial assistance to state-owned domestic enterprises? It can't be that. They do already.

Are you afraid that if you cite the Chinese, they will retaliate by stealing our intellectual property? Don't they do that already?

Are you afraid that if you cite the Chinese, their government will force U.S. firms to give up technological secrets in the future in return for access to their market? They do that already.

Are you afraid if you cite the Chinese, they will respond by selling some of the trillions of dollars of Treasuries they hold? But by doing that, they would cut their nose to spite their face.

So, Mr. Secretary, you are vowing today to take a tougher stance against China's currency manipulation. In all due respect, I will believe it when I see it. I will believe it when I see it. Each Administration thinks it can resort to diplomacy. Let us go over and talk. It can persuade the Chinese it is in their best interest to move to a market-based regime. But each time, it is rather like a bad China currency "Groundhog Day" movie, except the difference is the alarm clock wakes us up each morning and we do the same thing over and over again. We don't learn our lesson. We don't change our tactics. And the Chinese have taken advantage of this for close to 10 years now.

What is the Administration afraid of? You know we are right. You know the United States is put at a terrible disadvantage. You refuse to act. What are you afraid of?

Secretary GEITHNER. Senator, strong words, and you said them before, and I share many of your concerns. And as I said before, the attention you and your colleagues have brought to this issue over time has helped. I mean, China did allow the currency to move up 20 percent in that period between 2002 and 2008 in part because so many people at that time were so effective in bringing persuasive power or argument to bear.

But let me just make one comment in response to your question, and this is for a longer discussion about what is a more effective strategy in terms of tools, but——

Senator SCHUMER. Do you think your present strategy has been effective?

Secretary GEITHNER. As I said before, and is unambiguously the case, and I have said this consistently, China has not allowed the currency to move meaningfully even since the June 19 decision that they were going to reform it.

Senator SCHUMER. So——

Secretary GEITHNER. Absolutely, and that is not acceptable, but I just want to say one thing, Senator. You, understandably, want to make sure that we are using the law as effectively as possible. The only observation I make is when you look at the terms of that law, what happens when a Secretary of the Treasury decides that the precise definition of the law that determines manipulation is met? What happens? What happens is I am required to go talk to the Chinese authorities, which, of course, we have been doing with a substantial intensity at the highest levels of the U.S. Government on that.

So the only thing I would observe is wishing something does not make it so and issuing a report that requires me to go consult changes nothing. So what we need to do and why we are here having this conversation is trying to figure out ways to alter incentives in a way that might induce better changes in behavior, and we are happy to continue to work with you on how best to do that.

Senator SCHUMER. I just would say, Mr. Chairman—my time is up, and I would hope we will have a second round, I don't know if we will—but it is a lot different talking to them without having any strength. Our legislation would give you strength, and I would bet my bottom dollar if this legislation passed and you talked to them, you would find a lot more changes than just talking to them without any—by going into them disarmed, which you are now.

Secretary GEITHNER. I was only—I wasn't speaking to that other potential legislative option. I was just making the observation that in the terms of the current law, and I respect very much the objectives of that law and the intents of its architects, but just to point out—many of you have said this—issuing a report can change little. A simple judgment of an act that requires us to go talk to somebody doesn't change anything.

Senator SCHUMER. You know the legislation——

Secretary GEITHNER. And we——

Senator SCHUMER. Excuse me. You know the legislation does more than that. You know that. You know it allows—there is a Steelworkers case today. It would make it much easier for lots of companies and lots of organizations to use currency as a way to go and get relief, whether the Administration decided to do it or not.

Secretary GEITHNER. No, you are absolutely right, Senator. There are legislative proposals pending that would change the tools available to us. What I am saying is that the law that we are discussing today that requires this semi-annual report on the exchange rate and a judgment about manipulation in itself has just one consequence, which is that we go talk some more. And we are doing a lot of talking. Talking is not our problem. We have to figure out ways to change behavior. I am happy to work with you on how best to do that.

Senator SCHUMER. So help us change the law.

Chairman DODD. Thank you, Senator.

I am going to ask my colleagues, as well, to try and stay within this time. We have got a second panel to go through and the witness has got to testify before the Ways and Means Committee. We have got two more votes coming up in the middle of all of this, as well.

So Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman.

Mr. Secretary, I want to follow up, maybe not as forcefully, but nonetheless, I share Senator Schumer's views and maybe——

Senator SCHUMER. That is the difference between New York and New Jersey.

[Laughter.]

Secretary GEITHNER. I share many of Senator Schumer's views, too, forcefully, as well, but we can't agree on everything.

Senator MENENDEZ. Well, you don't want to see my Jersey up, so——

[Laughter.]

Senator MENENDEZ. In any event, let me follow up with the discussion. You know, our next panel, when they testify, are going to say that—Dr. Bergsten is going to say that he has estimated that eliminating China's effective subsidy, or undervalue, if you don't want to use the word subsidy, of its exports by manipulating its exchange rate would result in the creation of a half-million U.S. jobs and the reduction of the U.S. global trade deficit by $50 to $120 billion.

Paul Krugman, he has a different estimate. It is much more robust. He says that it is about 1.4 million jobs over the next several years. So whichever estimate is right, or somewhere in between, there is an enormous number of jobs being affected by this.

And I can't think of a more critical time in the country's history when that specific issue, where we are all seeking to find ways to incentivize the private sector, where we are looking at what government can do to grow this economy, and here is one opportunity in which the actions of a foreign country directly affect families in this country.

And so let me pick up where you left off with Senator Schumer. What is it that you need? If you don't have the tools now, then what is it that you need? By all means, let us know so we can work to give you the tools that are necessary to stop what is clearly an unfair balance.

Secretary GEITHNER. Senator, as I said before, this is a very important economic issue. It has big economic effects. I don't know what the right numbers are on the impact on jobs, but it is material and it is a big deal, and it is very important for us, as it has been in the past.

You are asking the vital question. There are a lot of ideas on the Hill that would change current law and some of them may offer the prospect of more leverage, more effective leverage. Anything that is going to work has to meet two tests. It has got to be consistent with our international obligations, because if it is not, it will have no positive impact. And it has to be effective in terms of offering us more benefits than it does risks. And again, we are open to working with you on better approaches that will help reinforce the amount of leverage we have.

Ultimately, of course, China is going to have to decide it is in its interest, too, to move, and our job, of course, is to encourage them to reach that conclusion more quickly.

Senator MENENDEZ. You know, I think that the Chinese have learned the Texas two-step very well. They take a step forward when there is a lot of clamoring here, and then they take two steps backwards in this process. So it is pretty clear to me where their intention is. They continue to dance with us as long as they can dance, and they will continue to achieve what they want to achieve as long as, I think to some degree, we allow them to do that.

So when I hear you say the first, I understand the international obligations. But the second, as long as there is more benefit than risks, outline to me what you consider the risks.

Secretary GEITHNER. It is hard to know. It depends on the particular measure. But again, I would just offer the following perspective. The United States has more jobs today, is creating more jobs every week, including in manufacturing and high-tech, some of the most important industries for our future, in part because our exports to China are growing so rapidly and because our market share in China is so substantial and so growing, and I am very confident that is going to get substantially better for us over time.

Now, that is not sufficient to us, because I think because of the currency and because of a range of unfair trade practices, we are being denied opportunities that we could take substantially greater advantage of, and what we want to do, of course, is to maximize the chance that that happens more quickly over time. That is what we are engaged in and we need—again, it is not something we can do on our own. We need the support of you and your colleagues and we need the support of the American business community to make that work.

Senator MENENDEZ. Well, I want to observe the Chairman's request because I know you have to go to another hearing, but look, we need—is it Senator Schumer has legislation, I think, that is pretty good. But we need the specifics of what you think is going to both help you, help us to give it to you, and then to be able to achieve the goal that we want. But I hear a lot of generalities, but I would like to know and follow up with you on the specific tools that you need that can meet the two standards that you just described and that can help us change this dynamic.

The last point I will make is that the Chinese are great at using all of our international obligations to the maximum of their advantage. They file more complaints, they file more challenges, and yet on a whole host of issues, they sit back on what their obligations are.

Chairman DODD. Thank you, Senator, and I might point out again that given the time constraints of the next few weeks, even with the lame duck session, but I would underscore the point that both Senator Schumer and Senator Menendez have raised. With the G–20 meeting coming up in Seoul, to the extent there could be at least some sort of piece of legislation that would enjoy both executive as well as legislative support, absent, obviously, anything passing up here in this timeframe, I think might enhance tremendously the leverage of the Administration at the G–20 meeting on these issues.

So we have got about a month or so, not that you are going to pass a bill, probably, in that timeframe, given all the other problems we have got logistically, but nonetheless, the idea of a piece of legislation that enjoyed some both executive and legislative branch support could really be helpful to that. That is just a thought.

Senator Bennet.

Senator BENNET. Thank you, Mr. Chairman, and I think that is a very constructive suggestion and certainly one that I would support.

I wanted to pick up, Mr. Secretary—welcome back—on the conversation you were just having. In the absence of that kind of legislation, the absence of making these kinds of changes, what we have seen over and over again is either no response or a very slow and limited response. Are you under the impression or do you think that the Chinese have incentives, their own economic incentives to actually begin to allow their currency to float? Is there some reason for hope there?

Secretary GEITHNER. I think that China, like the United States, has complicated politics. There are people adamantly opposed to letting the exchange rate move over time for reasons you all understand. And there are people who think it is absolutely essential to China's interest to move over time, and as you can see, they are trying to work out the right balance there.

The question is, what is the case for moving. As I was saying in response to Senator Bennett's questions earlier while you were voting, the best case for China to move is that if they don't move, in a sense, what they are doing is letting the Federal Reserve of the United States run their monetary policy and that makes no sense for them. It makes it much harder for them to make sure that they are growing with low inflation, that they face less risk of financial asset price bubbles, financial crises in the future. They need to have the independence to run a set of policies that make sense for the very different conditions they face. That is the most compelling reason they have to break this link and allow the exchange rate to move in response to market forces.

In addition to that, the longer they leave this currency practice in place, the more they are doing to encourage continued over-investment in relatively low value added assembly type work that is not—they are not particularly interested in preserving for the future. It doesn't create a lot of income growth for them. And it is not a sensible strategy for them. But, of course, people don't want to hear what we think is in their interest. They have to decide what is in their interests, and it is not probably enough for us to hope that it is in their interest over time for them to move in this case. We need to make it compelling to them because, frankly, they enjoy such huge benefits from continued access to our markets on this scale and to the global financial system.

Senator BENNET. Well, it also seems to me that they are solving for that problem by taking our IP, as well. I mean——

Secretary GEITHNER. Well, that is a terribly damaging ongoing problem for us and for companies in many, many sectors, and it is deeply unfair and it is completely unacceptable. I cannot believe that we are still in a position today where we are talking about egregious ongoing practices of piracy and theft of things that are—of U.S. ideas, U.S. property that is obviously so valuable.

Senator BENNET. I mean, could you, just along those lines, share with the American people about what the scale of the nature of that problem is that we are facing?

Secretary GEITHNER. Well, again, it is hard to know, but——

Senator BENNET. Because it is the product, clearly, of completely unfair practices.

Secretary GEITHNER. It is absolutely in the billions and billions of dollars.

Senator BENNET. One of the things that I hear from my families in Colorado in this terrible economy that we are going through is once the political sound bites are done and the cable news and all that is sort of talked about and dealt with is a huge anxiety about where the jobs are going to come from as we emerge from this economic downturn. And I read the other day—I think the numbers are directionally right—that our largest single export from this country are aircraft. Thirty-five billion dollars a year is what it represents to our economy. China's export of solar panels this year will represent about $15 billion to its economy, almost half of our largest single export, and to my knowledge, they didn't export a single solar panel 7 years ago and we invented the technology in the 1970s.

You listen to a story like that, you hear a story like that, and you realize that it is not just about currency, although that is a big piece of it. It is not just about the fact that we have $13 trillion of debt on our balance sheet and they have a huge cash surplus that they are using to buy assets all over the world, and natural resources all over the world. It is not just about the fact that we have had a series of tax and regulatory policies that, at least in my view, has not driven innovation in the United States and not driven job creation in the United States.

I wonder if you want to take the chance here to speak broadly about some of the policies that ended up putting us in the position of seeing technology we invented in the 1970s now being used to create enough market share that we may never be able to catch up on that question and what we need to do as a country, both in terms of our fiscal policy and our economic policy, to actually say, you know what? We are going to be the most competitive economy in the 21st century.

Secretary GEITHNER. Senator, we are living through not just the devastating scars caused by the worst financial crisis, worst economic recession since the Great Depression, but a crisis that followed a long period of damaging under-investment in the middle class, in education, in public infrastructure, and a terrible erosion in the basic fiscal position of the country, because we borrowed hundreds of billions of dollars to finance programs we weren't prepared to pay for, tax cuts for the rich. Those sets of policies have been terribly damaging to our country and they are going to take time for us to fix.

The only credible long-term growth strategy for us as a country is going to have to rely on stronger investment in the United States and stronger export performance over time, and that is not going to happen unless we restore what has been the great strength of the American economy over time, which is that the best place to innovate, the best place to come and build a company, the easiest place to come raise capital to finance some idea, and the best universities, highest levels of sustaining investment in basic science, research, and development, those are absolutely essential things for us to do. They are things the government is—better policy is central to doing, because governments have to set the incentives better and they have to provide a meaningful amount of targets for those sorts of things. That is what we are trying to do and we need some support over time from this body to make that possible.

Chairman DODD. We have got a clock and you have got a colleague sitting next to you. I apologize.

Senator BENNET. Thank you, Mr. Chairman.

Chairman DODD. I thank you. Very good questions.

Senator BENNET. Saving me from my colleague.

Chairman DODD. I know. I am trying.

Senator Merkley.

Senator MERKLEY. Thank you. I am certainly prepared to defer to you. That is a very interesting line of questions.

Senator BENNET. May I just add one thing?

Senator MERKLEY. Yes, please.

Senator BENNET. Mr. Chairman, I am sorry. Just it seems to me that it is through that frame that we should be having all the conversations that we are having in this place, and we are not. We seem incapable of being able to do it. And the more we have this sort of siloed back and forth on this tax and that tax and this program and that program, and the less we are having a conversation about how to have the most innovative economy in the world, the less likely we are going to be able to have the most innovative economy in the world.

Senator Merkley, I look forward to working with you on all of that. Thanks for the minute.

Senator MERKLEY. Likewise with you.

Chairman DODD. Very good. Thank you, Senator.

Senator MERKLEY. So my concern is that when China pegs its exchange rate artificially low, it results in a situation where they are able to sell their products at an artificially low price to the world, which means that they out-compete us, which means we lose manufacturing jobs in America. And if we don't make things in America, we don't have a middle class in America, and I feel like that is the path we are on.

I just completed a tour around my State in the course of this year, all 36 counties, and I go to place after place where manufacturing facilities are shrinking and disappearing, largely or often in competition with China.

So it seems fairly clear that China has pegged its rate artificially low in order to pursue this strategy. It gives them greater employment at home and it undermines their competitors. Is that a fair conclusion?

Secretary GEITHNER. Yes. We are in agreement on that, and I think you said it right.

Senator MERKLEY. So I want to understand a little better this definition of manipulation, because GAO said there were three standards for it. One is that there is a global current account surplus, that is, China would have to have, which they do. Second, they would have to have a significant bilateral trade surplus with the United States, which they certainly do. And the third is that they have designed their currency policy to gain a trade advantage, which seems unmistakable.

So I am a little—I hear you saying, well, maybe the designation doesn't matter because it only requires negotiation, but don't they meet these three? Aren't these three standards met for finding manipulation?

Secretary GEITHNER. Let me just try to say this as clearly as I can. It is not that a designation doesn't matter. It is that the designation itself has to meet a certain legal test in the Act, and the act of designation alone only requires that we go talk. So we have had a long time of experience with that particular law and those reports. You have seen how my predecessors have applied that law over a long period of time. You have seen the benefits and the limits of that basic approach.

All I am trying to do is to say that whatever your definition of manipulation is, what matters is the currency is undervalued. They are intervening to hold it down. That adversely affects our economic interests. And there is an overwhelmingly compelling economic case for the world, for China's trading partners, for China, for us, to try to alter that basic practice, and that is what we are focused on doing. And what we should be focusing on doing is—and you all live in the real world—is to try to figure out things that are going to make a difference, not just require more talking.

Senator MERKLEY. OK. So I understand your point, but from the viewpoint of folks back home, when they hear this three-part test and it sounds like all three are met, they don't understand, because it does seem like a reluctance to respond to what the law seems to lay out and that that then translates into a sense that we are reluctant to really tackle this problem, and that the longer we don't tackle it, the more we lose our industrial manufacturing base, and the longer we lose that, the fewer families we have in the middle class, and that we see this happening before our eyes.

It is a striking statistic to me that 1974 until now, American workers have essentially had a flat standard of living, and that is because of a huge divergence from the productivity curve, which wages used to track, and so for my entire—I graduated from high school in 1974, so in essence, my entire adult life, workers have not been participating as they had previously in increased productivity and wealth of our country, and at least it seems linked in part to this Chinese strategy. There are other things going on, certainly, and that is why it feels so important to people that we label it clearly, that we are determined to take it on. And I do think at least it would be a step in persuading the Chinese we are seriously, if we are willing to slap the label on it it so well deserves.

Secretary GEITHNER. If it meets the tests in the law and we think it would be effective in changing behavior, then absolutely, we will do that. But I just want to say that it is important to remember that the most important things we can do to make manufacturing strong in the United States, to make people invest more here rather than overseas, to improve the odds that income growth for average Americans improves over time, are going to be about the policies that we pursue in the United States, including by this body.

Now, they need to be complemented by effective ways to address unfair trading practices like we have seen in the currency, like we see with China. But we could spend months and months debating the optimal design of a new report on China's exchange rate practices, and if we don't at the same time do a better job of passing policies that will help invest more in this country, we will have done nothing.

So I would just say that please make sure that we put as much emphasis on things that are going to make us stronger as a country as in giving us authority to pursue unfair trading practice of our trading partners. We are in complete agreement about the concern and the objectives, and again, we are happy to work with you, Mr. Chairman, and your colleagues on how best to do that.

Chairman DODD. I thank you. Senator, I apologize, but I am afraid you are going to miss these votes.

Mr. Secretary, we thank you. I am going to announce that we have got two votes, so I will come back here as quickly as I can for our second panel to hear them.

I just want to raise, I want to check on one thing, because I am thinking about the unfair trade practices. Someone told me recently that China limits the amount of foreign films that can be imported in China to 19 a year, two of which come from this country out of the 19. I would like someone to verify if that is the case. But then simultaneously, the incredible pirating that goes on. So you get the dual effects of limiting access to a market and then simultaneously, of course, pirating the films themselves to market them at the expense of those who produce them. That is just one example. I don't know if that is an accurate one or not. It has been repeated to me on several occasions, but I would like to have some verification if that is the case. And that is what we are up against. It is something aside from the manipulation of the currency here, the manipulation of a marketplace poses some serious issues, as well.

Mr. Secretary, we thank you very much. You have been very patient.

The Committee will stand in recess for two votes. I will come back as quickly as I can.

[Recess.]

Chairman DODD. The Committee will come to order.

My apologies. You are very patient, and I owe you, but obviously we cannot predict days in advance on a hearing what is happening on the floor of the Senate or the START Treaty one floor down being involved in extensive amendments and negotiations as well, and I serve on that Committee as the Ranking Democrat. So I am trying to get back and forth. So my apologies to our very distinguished witnesses.

In fact, I want to express the apologies of other members, Bob Corker especially. He said he was up until 4 in the morning, reading your testimony and everything else, and of course he is very involved in the START talks, the START negotiations on the bill—and the number of other members who wanted to be here to listen to your testimony this morning.

So we will begin by just asking you to share your thoughts with us as well, and I will introduce you. Some of you have been talked about already: Dr. Fred Bergsten, who is Director of the Peterson Institute for International Economics; Lynn Brown, Senior Vice President of Sales and Marketing, Hydro Aluminum; and Charles

Freeman who is the Chair in China Studies at the Center for Strategic and International Studies.

All three of you will begin in the order I have introduced you, and any documents or supporting evidence you will contribute to this discussion this morning I will include in the record. You are on.

STATEMENT OF C. FRED BERGSTEN, DIRECTOR, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS

Mr. BERGSTEN. Thank you, Mr. Chairman. Let me first start by congratulating you on Dodd-Frank, a monumental achievement.

Chairman DODD. Thank you.

Mr. BERGSTEN. And delighted to see it.

Chairman DODD. I would have had you up earlier if I knew you were going to say that.

[Laughter.]

Mr. BERGSTEN. I will come back.

Chairman DODD. Thank you.

Mr. BERGSTEN. There are two parts to my statement. One is an analysis of the issue, but you have already gone over that extensively. A number of my numbers were already quoted by you and others. So I will just skip over that and go right to the basic question you and your colleagues were raising, what should we do about this, and I think there are a number of things you can and should do about it and that the Administration could and should do.

I think in your opening remarks you rightly stress the importance of multilateral cooperation. You cited how the G–20 was helpful in moving on financial regulation. I think it can be in this issue too. But it is true, as you all said, the Administration itself needs to take stronger positions. So let me suggest three things that the United States ought to do and then conclude by how I think you in this Committee and the Senate might help push that process with legislation.

Chairman DODD. Good.

Mr. BERGSTEN. First, we, and as many other like-minded countries as we can mobilize, should take China to the WTO. There is a WTO provision which proscribes countries from frustrating the intent of the agreement through exchange action. It has never been tested. The lawyers debate whether we could succeed or not.

I think we should take the case. It would put the international spotlight on the China problem. It would give us an incentive to mobilize a multilateral coalition on this problem, which we have not really tried to do, and it uses the right mechanisms.

Second, I think we should follow the economics of this countervailing duty and subsidy issue, not worry so much about debates over what is in the current legislation. I think the Department of Commerce made a mistake not to permit the countervailing in some of the current cases. But the Congress can easily change the relevant law, indicate explicitly that substantially and manipulated undervalued currencies are subsidies for purposes of applying U.S. countervailing duty law. I think we should do that. There is a bill in the House that was considered by Ways and Means yesterday. I am sure they will ask the Secretary about it in an hour or so. I think we should pursue that.

Chairman DODD. Yes.

Mr. BERGSTEN. Third, a fairly new idea, although actually a version of it is in one of Senator Schumer's bills, on this topic, it is what I call countervailing currency intervention. Instead of countervailing import duties which apply case by case, sector by sector, only to imports, we really ought to countervail against the currency intervention of the other countries by currency intervention of our own. Japan's new intervention reminds us other countries set the exchange rate of the dollar against their currency; we do not. They intervene, they set the exchange rate; we sit back passively. I think we should countervail with currency intervention of a like magnitude.

Senator Schumer, in his bill, calls it remedial intervention. I call it countervailing currency intervention, which I believe we could do under current authorities, which would have the United States sort of offset dollar for dollar what the other country does. I think very quickly they get the message, and cease and desist.

I hasten to say there is a big technical problem in the Chinese case because the currency is not convertible. So we cannot go buy it the way we can buy yen, euros, most other currencies. But the principle is clear. In the case of China, we would have to find some proxies, and there are some. We would not be able to do it dollar for dollar, but I think we could send the message through.

So three steps: Take them to the WTO, start countervailing against the subsidies and countervailing currency intervention.

Final point on your legislative strategy, as I listened to Secretary Geithner and Secretary Paulson before him, they say that they are unwilling to label China a manipulator in part because it does not make any difference; all they have to do is submit a report.

Well, I am with you, Senator Schumer. I think it would make a difference. But the answer to that is to beef up your law and explicitly link the manipulation designation to authorities to take the three kinds of actions I suggested.

Chairman DODD. And I think the Secretary was asking for that almost. He must have said at least on four or five different occasions, existing law only says we talk.

Mr. BERGSTEN. Right.

Chairman DODD. Now we have been doing a lot of talking.

Mr. BERGSTEN. So here are three responsible actions. In the case of the trade actions, I would say they have to be demonstrated to be consistent with our WTO, our multilateral obligations. Lawyers can debate that, but maybe change those rules too. But then the currency intervention, I do not think anybody could complain about.

So add those three authorities to the law. Manipulation would then make a difference.

You all are obviously right. Manipulation is a fact. It is a tragedy that we do not do it, and there is an operational implication. If we want to line up a multilateral coalition to take China to WTO, to countervail against its imports, to work against its currency, we are just not credible asking other countries to step up and take China to court if we are unwilling to indict them under our own law.

So I think all this kind of hangs together and could move in the direction of a new policy, a new strategy, a new legislative initiative that would greatly both buck up the Administration to take action and strengthen it when it did.

Chairman DODD. Thank you for that.

Mr. Brown.

STATEMENT OF LYNN BROWN, SENIOR VICE PRESIDENT FOR SALES AND MARKETING, HYDRO ALUMINUM NORTH AMERICA

Mr. BROWN. Mr. Chairman, I appreciate the opportunity to appear today, and I would like to speak about how my company and the U.S. aluminum extrusion industry has been impacted by Chinese exports of aluminum extrusions and particularly by the large and distortive subsidy that Chinese extrusion producers benefit from as a result of China's undervalued currency.

Hydro is a major U.S. producer of soft alloy aluminum extrusions. We operate six aluminum extrusion facilities across the United States, primarily in smaller towns, and one dedicated fabrication facility. Approximately half of our facilities are unionized, with workers represented by the United Steelworkers, the Teamsters and the United Auto Workers. Currently, we employ about 1,500 workers—a dramatic reduction from the 2,300 workers that were on the payroll just 3 years ago.

In 2006, we shipped over 250 million pounds of aluminum extrusions. In 2010, we expect to ship approximately 35 percent less. Imports of Chinese extrusions have created havoc in our industry, growing from a negligible factor a couple years ago to a market share of 25 percent today. During the time when the U.S. consumption of extrusions has fallen substantially due to the recession, Chinese imports have more than doubled.

Earlier, I mentioned our six extrusion facilities. It used to be seven. We have already closed one in Ellenville, New York, with 150 jobs lost. In addition, we idled press lines at three of our plants in 2009. This, along with reductions in employees, in work shifts and in work weeks, has made it very difficult for my company and for our employees.

But we are just one of over 70 extruders in the United States. There are similar stories throughout our industry.

The flood of low-cost, low-priced Chinese imports caused Hydro, along with other members of the domestic industry and the United Steelworkers, to file anti-dumping and countervailing duty petitions covering aluminum extrusions from China. We did so on March 31 of 2010. In our countervailing duty petition, we listed a host of subsidy programs that benefited Chinese extruders, including an allegation covering China's undervalued currency.

Much to our disappointment, and as was discussed earlier, the Commerce Department did not initiate an investigation of the currency allegation, claiming that our allegations were not legally sufficient. We disagree, but Commerce did not give us the opportunity to revise our allegation to address the concerns they had.

Chinese extrusion producers have been able to lower prices, increase exports and gain U.S. market share in part because of the undervalued Chinese currency. The cost structure of our industry is based on global commodity prices for aluminum, and that makes it very difficult for U.S. producers to compete with imports, the imported prices from China. Over 70 percent of our cost structure is represented by the base aluminum, giving us very limited ability to respond to subsidized prices.

Without the establishment of a level playing field, the U.S. industry faces major long-term problems. Our business at home is hampered, and the severe undervaluation of Chinese currency effectively imposes a 20 to 40 percent tax on potential exports from our U.S. facilities where we compete with the Chinese.

This is an issue of basic fairness that needs to be addressed. The best outcome would be for China to allow its currency to float freely and reflect market forces. We have had much discussion this morning about the lack of success, however, in negotiating with China on its currency reevaluation, both bilaterally and multilaterally.

Short of a freely floating currency, whose value is determined by market forces, we believe the best approach is for the Commerce Department to investigate China's undervalued currency as a countervailable subsidy, which it has thus far refused to do.

Again, I appreciate the opportunity to appear today and would welcome any questions.

Chairman DODD. Well, thank you very much and I thank you, Mr. Brown, for your patience here this morning as well. I hope you found it interesting to hear some of this discussion that occurred over the last couple of hours.

Mr. Freeman, welcome and thank you for being before the Committee, we are very grateful to you.

STATEMENT OF CHARLES W. FREEMAN, III, FREEMAN CHAIR IN CHINA STUDIES, CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES (CSIS)

Mr. FREEMAN. It is an honor, Mr. Chairman, and thanks for the opportunity.

I think my job here is to provide a little sort of political context within China and to answer the question: Why do they do what they do? What will it take to get them to change that and what can we do to push them along the way?

I think I should first say it is hard to over-estimate the fear of political instability that the Chinese leadership has. For them, they look out at a vast country with a huge number of staggering challenges, and they say, we are going to lose our jobs here unless we kind of keep the lid on this place.

And they have done a back-of-the-envelope calculation about 10, 15 years ago and said, we need about 8 percent annual growth in order to provide 50,000 new jobs a day to Chinese, and if we do that we can kind of keep the wolf from the door, the people from rioting in the streets, and we can all sit in Beijing and continue to be comfortable and in control.

The currency is a big part of that and has been since the early 1980s when China moved to open its marketplace and become more integrated with the global system, to try to generate that kind of 8 percent return. What they did is they went from about a 1.5 renminbi to the dollar to about 8.62 in 1994 strictly so that they could have a competitive currency to allow them to export. That has been goal.

And ultimately when you are looking out and you are saying you have to provide 50,000 new jobs a day, if it ain't broke, do not fix it. So their incentives at the basic level to continue to subsidize—I use that term advisedly—their currency, to subsidize exports, are designed to prevent political instability, plain and simple. And they, frankly, will do everything possible to resist U.S. pressure to change that policy.

We should remember, of course, that China is not a monolith and there is no puppet master sitting in Beijing that is controlling every aspect of Chinese policymaking, in that there is a very fertile and active debate that has gone on for years between policymakers in China.

I think when Treasury, when Secretary Geithner and his team go to China and they talk to members of the People's Bank of China or otherwise, they are frankly preaching to the choir. These are folks who say: Because of the fixed currency, because of the over-reliance on an export-driven growth, we are effectively handicapping our ability to move from the 20th Century to the 21st Century as an economy. We are essentially subsidizing investment into lower margin, over capacity in industries like Mr. Brown's here. We are effectively reducing our capacity to become more of a consumption-driven economy that they think they do need to grow to.

So there are plenty of people within the Mandarins in China that understand that this is a policy they should move for their own purposes.

The challenge of course has been that really since 2001 these kind of pro-reform, pro-market people have been on the wane since China joined the WTO. The change in attitude and emphasis among policymakers in Beijing has gone to a very different approach and not one that is pro-reform.

The other challenge that I think Secretary Geithner and others face when they go and talk to the Chinese is the fact that since the financial crisis, our credibility in trying to say this is the way markets should work, this is the way you should operate your economy has gone down a bit. There are plenty of Chinese that think: You know, the old Washington consensus of how to run an economy, how to develop is out the door. What we have now is a Beijing consensus, and the China model of state-directed capitalism is the one that is right. Why should we listen to you when our model works and yours does not?

Chairman DODD. Yes.

Mr. FREEMAN. I think the other part of that is that they understand since we have been telling them for 15 years, well, the trade deficit that we have with you is unsustainable, and we started saying that to them at $10 billion. They just do not believe it anymore.

The one thing I will say in terms of this specific issue is I do not think the currency is a magic bullet. I agree with many of the Senators here and yourself that there are far more or there are many other issues that are out there, whether it is intellectual property protection, whether it is the indigenous innovation and industrial policies. And I think we need to, instead of just focusing so narrowly on the currency, really need to approach this holistically. There are ways to look at WTO remedies that deal with the nullification and impairment of China's overall commitments to the

WTO, and I think we ought to look pretty seriously at those if we are as worried as we should be about China's role in the world trading system.

I do think multilateral approach is critical, to the currency issue in particular, but I do think that we have to show leadership and take the first step. No one is going to let us work in their wake.

Thank you, Mr. Chairman.

Chairman DODD. Let me ask you if I can, Mr. Freeman, Mr. Bergsten made some suggestions. You heard them, these three suggestions he made. How do you react to those?

Mr. FREEMAN. I am not an economist, but I have worked at USTR, and I am a little nervous about the strict WTO process as a lawyer and as having worked in the U.S. Trade Representative. I am not sure that that process gets you very far, and I am not sure that a WTO panel would particularly welcome that result.

I think as a means to attract attention, it certainly would do that. Whether or not it would actually achieve the ultimate intent, I am not certain.

Dr. Bergsten is also correct that certainly buying shares of renminbi would send an enormous signal and be enormously effective. It is hard to find those pools of renminbi available. There is some that is offshore in Hong Kong, but that would, I am afraid, dry up pretty quickly and not be available to continue to offset the dollar purchases.

I am interested in the subsidy issue and how that would work, and I think that the challenge there is actually finding an appropriate valuation for the currency, but that is certainly something that learned economists like Dr. Bergsten can answer better than I.

Chairman DODD. Well, I agree with your point you made though, that this has to be far more than just a currency debate. And I think you added the point that Dr. Bergsten made out, and that is it also has to be multilateral. I mean there are many more issues affecting these questions of economic growth at home.

I wonder if you might, Dr. Bergsten. How long do you think it will take to achieve a meaningful correction in the currency? We are seeing this. We listened to the Secretary now talk about the changes since June and that it has been slow. Do you anticipate this to be a pattern that will continue, even though it will not achieve getting close to the 20 percent for a long time or do you sense that is just sort of a token response to the pressures of the moment?

Mr. BERGSTEN. Actually, I thought the most important thing the Secretary said this morning was when he almost endorsed as a goal what I said in my testimony, that we ought to seek a rise like the rise in the renminbi that occurred when they let it float last time, between 2006 and 2008. Over 2 years, it went up 20 or 25 percent, depending on how you calculate.

Chairman DODD. Right.

Mr. BERGSTEN. He came pretty close to saying that is his goal, that is what he will measure it against.

I would be satisfied with that. I think that would correct the current disequilibrium. I agree it should not be done overnight because that would be disruptive to them and to us. So if they got on a path that did 20 to 25 percent over a couple of years, I think that would be adequate.

Chairman DODD. Yes.

Mr. BERGSTEN. So far, they have not done. So I am with you and the Committee members, taking some of the steps we have talked about here that would encourage the Chinese to accelerate that movement.

Now you said back earlier this morning, when the Secretary was here you noted that the Chinese accelerated the appreciation of their rate when some things were happening here in the Senate.

Chairman DODD. Yes.

Mr. BERGSTEN. I do not think that was an accident.

Chairman DODD. No.

Mr. BERGSTEN. So if we could get them to move the annual rate up to something like 8 to 10 percent.

Chairman DODD. Yes, that would be large.

Mr. BERGSTEN. Then I think we would be on. What we need to see is a down payment, enough of a move that it is credible and then keep it going, and ongoing pressure undoubtedly will be needed to achieve that.

Chairman DODD. Well, that is why I thought the possibility of working on some amendments to current law between now and November, the G–20 meeting, might have the positive effect, even though we would not have enacted something, showing some unity.

Mr. Brown, there are those who argue that the appreciation of the currency is going to do little to nothing to improve the competitiveness of American companies, that actually our problems are more homegrown, and it is too easy to blame the Chinese for our problems. How do you respond to that?

Mr. BROWN. I think the currency is one issue. Of course, there are a host of other subsidies that Chinese extruders benefit from as well.

You know, I can only really speak to my own company, but we have made a substantial effort over the last several years to continue to improve productivity. When possible, we invest in upgrading our facilities. But the reality is that with the subsidies that we face today we cannot continue to grow the business. We cannot replace business quickly enough, that is lost to the Chinese. So the industry gets smaller and smaller, my own company gets smaller and smaller. We are certainly willing and aggressively going forward to improve our position, but we cannot do that totally on our own.

Chairman DODD. Is it primarily steel? Is that your business product?

Mr. BROWN. No. Our business product is aluminum, and the nature of it is such that typically 70 percent of my total cost structure is aluminum that is traded globally, traded in U.S. dollars on the LME, so that I have relatively, we have relatively small room in which to move.

Chairman DODD. Internationally, aside from the Chinese, who else is in this business? The Brazilians?

Mr. BROWN. It is a global business. There is a very, very active industry in Brazil, in Europe, throughout the world.

And it tends to be a local business. In the United States, the conventional wisdom is you do not make much money more than 300 miles from your plant. The reason for that is with that small manufacturing costs, transportation costs eat that up very quickly. So I go 2 hours from a plant and get beat by the Chinese by 30 percent, that does not make any sense at all.

Chairman DODD. Is that true of your peers and competitors internationally as well?

Mr. BROWN. It is. Let me be a little bit more specific. Certainly this was a major issue in Canada, and the Canadian extrusion industry brought a successful countervailing duty action against the Chinese extrusion industry for exactly the same reasons that we have initiated our action. It is also an issue of concern in the E.U. at this point and is a factor in other markets as well.

Chairman DODD. Well, listen, I thank all three of you, and this has been truncated obviously, but I appreciate your comments. And I will leave the record open, so my colleagues can submit some questions, too, which I think they like to do to complete the record, fill it out. So that will be helpful to us as well.

You have been very, very supportive of our efforts up here, and this was an important hearing.

The Secretary will be testifying before the Ways and Means Committee this afternoon. So we will get a full body of all of this before we are through.

Again, I apologize for this morning. Again, I cannot control the events around here, how they unfold, but I am grateful to you for being here. Thank you all.

The Committee will stand adjourned until further call of the Chair.

[Whereupon, at 1:09 p.m., the hearing was adjourned.]

[Prepared statements and responses to written questions supplied for the record follow:]

PREPARED STATEMENT OF SENATOR SHERROD BROWN

SEPTEMBER 16, 2010

Thank you, Chairman Dodd. Thank you, Secretary Geithner, for being here today.

I just attended the first meeting of the President's Export Council, of which I'm a member.

We discussed how increasing exports is key to our economic recovery.

The President discussed the National Export Initiative and the goal to double exports over the next 5 years.

This is a goal I think we all share.

And it couldn't be more relevant to today's hearing, because unless we confront trade-related barriers to export success, it will be like paddling upstream with one oar in the water.

We must not acquiesce to corrupt trade tactics that render legitimate competition impossible. And China's currency manipulation is at the top of the list of those trade tactics.

By keeping the value of the RMB artificially low, China provides an incentive to foreign corporations to shift production there, because it reduces the price of investing in China and makes Chinese exports cheaper.

This continued undervaluation—which most economists agree is in the range of 25 to 40 percent—has caused serious harm to the U.S. economy and has cost American jobs.

Right now, Chairman Dodd, down the street from the Capitol, there is a hearing going on at the International Trade Commission (ITC) on coated paper from China.

Workers in my State and dozens of other States are affected by the unfair subsidies the Chinese government gives this industry—including a virtually insurmountable currency advantage. Despite businesses in the coated paper industry and the aluminum extrusions industry presenting a solid case for why currency manipulation should be included in this investigation, the Commerce Department has chosen not to include it.

If currency manipulation is a subsidy—and it certainly is—then our workers and producers deserve a trade remedy. It's not just a matter of fairness; it's a matter of pragmatism.

Competition that is skewed by currency manipulation is not really competition—it's actually just a monopoly waiting to happen.

U.S. corporations can out-compete their foreign counterparts on efficiency, on innovation, on quality, on productivity, on marketing strategy. The list goes on and on.

But it's not realistic to expect them to overcome false price discounts deriving from currency manipulation and huge government subsidies.

Still, this Administration has chosen not to include currency manipulation in the coated paper case.

This is despite the facts being clear and the law being on their side.

Senator Schumer, Graham, Snowe, Stabenow, and I have a bill to make the law even more straightforward and clarify the process for taking action against countries that manipulate their currency.

To not act is unjustifiable. It costs American jobs.

Dr. Fred Bergsten of the Peterson Institute, one of our witnesses on today's second panel, estimates that eliminating this subsidy would result in the creation of half a million U.S. jobs and a reduction in the U.S. global current account deficit by $50–$120 billion.

Paul Krugman estimates that China's currency policy—and resulting large trade surpluses—might end up costing about 1.4 million jobs in the U.S. in the next couple of years.

I appreciate Secretary Geithner's work to address trade imbalances through the G20 and bilaterally with the Chinese.

I agree we should continue to talk with the Chinese on this issue.

But we cannot just talk when we have tools to address the imbalance caused by currency manipulation. We must act.

I look forward to the testimony of Secretary Geithner and our second panel witnesses.

Thank you.

PREPARED STATEMENT OF TIMOTHY F. GEITHNER

SECRETARY, DEPARTMENT OF THE TREASURY

SEPTEMBER 16, 2010

Chairman Dodd, Ranking Member Shelby, Members of the Committee, thank you for the opportunity to testify on Treasury's semiannual Report to Congress on International Economic and Exchange Rate Policies, and in particular on China.

I want to focus today on the importance of the U.S.-China economic relationship and the challenges that we must overcome in order to secure the full benefit of this relationship for the American people.

We have very significant economic interests in our relationship with China. With over 1.3 billion people and an economy continuing to grow at or near double-digit rates, China is our fastest-growing major overseas market. China's record of bringing hundreds of millions out of poverty, building a rapidly growing middle class, and now its efforts to encourage growth led by domestic demand, ultimately mean more demand for American goods and services. Increasing opportunities for U.S. firms and workers through expanded trade and investment with China will be an important part of the success of the President's National Export Initiative and our efforts to support job growth more broadly.

U.S. exports to China have grown much faster than our exports to the rest of the world, and they have recovered much more quickly following the global crisis.

So far this year, U.S. exports of goods and services to China exceed $53 billion. U.S. merchandise exports to China this year are up 36 percent compared to 2009 and are 16 percent higher than comparable 2008 (pre-crisis) levels. By comparison, merchandise exports to the rest of the world are still 8 percent below 2008 levels, highlighting the importance of the Chinese market as we continue our recovery.

And China is a critical market for a broad range of American products, from agriculture, to manufacturing, to services. To name just a few examples, China was the largest market for U.S. soybeans last year, importing over $9 billion. In the manufacturing sector, the United States has already exported nearly $3.5 billion in aircraft to China this year alone, and U.S. exports of automobiles and parts to China have grown over 200 percent. In 2009 China was one of the top three merchandise export markets for nearly half of U.S. states, and nineteen states exported more than $1 billion to China. The Administration's policy is to ensure that American opportunities in the Chinese market expand as rapidly as possible.

But we also face substantial challenges in this relationship with China. I want to provide a candid assessment of where we are making progress, where progress remains inadequate, and where we are going to concentrate our efforts in the months and years ahead.

To address these challenges, we are focusing on three core objectives with China: encouraging China to change its growth model to rely more on domestic demand and less on exports; moving toward a more market-determined Chinese exchange rate; and leveling the playing field for U.S. firms, workers, ranchers, farmers, and service providers to trade and compete with China. With China's economy on a strong footing, it is past time for China to move.

We are pursuing a comprehensive, proactive strategy to push China for progress. This includes direct engagement by President Obama and this Administration with China's senior leaders. It includes coordinated and intense engagement through the Strategic & Economic Dialogue (S&ED) and the Joint Commission on Commerce and Trade (JCCT), as well as multilateral channels like the G–20 and International Monetary Fund (IMF). It includes taking dispute settlement cases when China does not comply with World Trade Organization (WTO) obligations, and enforcing U.S. trade remedy law to safeguard the rights of American firms and workers. And it includes working closely with this Committee and your Congressional colleagues to make sure we are taking the best possible approach to shape a balanced and fair relationship.

China's Growth is Critical to Our Growth

While the global financial crisis had little direct impact on China's financial system, China's leaders quickly recognized that the weak global economy would hurt demand for China's exports. China responded early and aggressively with a massive stimulus program designed to offset weaker exports with domestic demand, particularly fixed investment. Through its efforts to stimulate domestic demand, China maintained growth of about 8 percent in 2009. And the resulting boom in China's imports supported the global economy and contributed substantially to recovery around the world. With this boom in imports and its exports limited by the recessions in the United States, Europe, and China's other key export markets, China's external surpluses fell significantly in 2009.

However, as growth in the rest of the world recovers and China returns to a more normal pace of growth, the factors that led to the decline in China's external surpluses are now reversing. It is critical for sustainable growth in China, the United States, and the rest of the world that China and the United States both do our part to prevent a return to pre-crisis global imbalances.

Clearly, China's exchange rate must play an important role in this effort. However, exchange rate appreciation also needs to be complemented with structural reforms to reduce the gap between saving and investment in China in order to bring about a durable rebalancing.

China responded to the financial crisis with several steps that, if sustained, would help to reduce its reliance on exports and stimulate domestic demand, including a large increase in spending on health care, education, and pensions that should reduce the need for Chinese households to save for precautionary reasons. Top priorities for further structural reform include liberalizing interest rates, lifting energy price subsidies, and removing barriers to investment in the service sector. Each of these measures would reduce the current bias in China's economy toward heavy manufacturing and exports and away from services and household consumption.

China's Exchange Rate Policy

We share the concern of the Committee and many of your colleagues about China's exchange rate policy. After allowing the renminbi to appreciate over time against the dollar from mid- 2005 through mid-2008, in July 2008, as the financial crisis intensified, China effectively "repegged" to the dollar, and there has been essentially no movement of the renminbi against the dollar over the past two-plus years.

On June 19, 2010 China took a very important step when it announced that it would renew the reform of its exchange rate and allow the exchange rate to move higher in response to market forces.

In the roughly 3 months since that announcement, however, the Chinese have allowed their currency to appreciate against the dollar by only 1 percent, and the currency has actually depreciated against the weighted average of the currencies of its trading partners.

During this same period, China has had to continue to intervene in the exchange markets on a very substantial scale to limit the upward pressure of market forces on the Chinese currency.

Even with the appreciation of the renminbi against the dollar that has taken place since this process began in 2005, China's real trade-weighted exchange rate is now only 4.9 percent stronger than it was on average from 1998–2002, an unjustifiably small change given that China's productivity doubled during that time.

It is the judgment of the IMF that, in view of the very limited movement in the Chinese currency, the rapid pace of productivity and income growth in China relative to its trading partners, the size of its current account surplus, and the substantial level of ongoing intervention in exchange markets to limit the appreciation of the Chinese currency, the renminbi is significantly undervalued.

We share that assessment. We are concerned, as are many of China's trading partners, that the pace of appreciation has been too slow and the extent of appreciation too limited.

We will take China's actions into account as we prepare the next Foreign Exchange Report, and we are examining the important question of what mix of tools, those available to the United States as well as multilateral approaches, might help encourage the Chinese authorities to move more quickly.

The undervalued renminbi helps China's export sector and means imports are more expensive in China than they otherwise would be. It undercuts the purchasing power of Chinese households.

It encourages outsourcing of production and jobs from the United States. And it makes it more difficult for goods and services produced by American workers to compete with Chinese-made goods and services in China, the United States, and third countries.

China needs to allow significant, sustained appreciation over time to correct this undervaluation and allow the exchange rate to fully reflect market forces.

Specifically, in evaluating progress two key factors should be the pace and extent of appreciation and the level of ongoing intervention required to slow the rate of appreciation.

During the last period in which the Chinese authorities allowed the currency to move higher it appreciated about 20 percent against the dollar and 13 percent on a real, trade-weighted basis.

We recognize that this movement will not be a steady, uninterrupted path—there will be days when the exchange rate goes down, as one would expect as the exchange rate becomes more determined by market forces. And China is going to be careful to try to avoid creating a market expectation of a "one-way bet" that could cause a large speculative inflow. But the exchange rate must demonstrate a sustained, trend appreciation.

As the exchange rate gets closer to a level that reflects underlying economic fundamentals, the level of intervention should decline. Continued heavy intervention, in contrast, would support the judgment that the currency remains undervalued.

As China's leadership has acknowledged, a more market-determined exchange rate is in China's interest. A more flexible exchange rate will allow China to pursue a more independent monetary policy better suited to responding to China's economic conditions. It will provide greater ability to pursue needed structural reforms to encourage consumption with less fear of feeding inflation. And it helps China prepare for further opening and internationalization of its capital markets.

Going forward, sources of global demand growth have to adjust to the new economic realities. China and other surplus countries like Germany and Japan will have to increase domestic demand as the United States and other deficit countries save more and consume less. By continuing to maintain a rigid exchange rate, China is impeding the adjustments needed to secure the strong, sustainable global growth we all need.

Creating a Level Playing Field for American Firms and Workers

Beyond the exchange rate, China has for a long time combined the pursuit of an export-driven growth strategy with a substantial set of protections and preferences for its domestic industries. We are committed to leveling that playing field.

It is a simple principle of fairness that American firms competing in China's markets should have the same rights enjoyed by Chinese companies, just as Chinese firms compete on a level playing field with U.S. companies here.

For example, the government still plays a very large direct role in the economy, through stateowned enterprises, and in the allocation of credit and other inputs to domestic production. China pursues industrial policies to promote what it calls "indigenous innovation," aimed at promoting innovation and technological advancement in China that potentially discriminate against U.S. firms and their products, services, and technology. China also has yet to meet its 2001 commitment to sign on to the disciplines provided by the WTO Agreement on Government Procurement (GPA). And China continues to maintain investment barriers that prevent U.S. firms from having the same opportunities that Chinese firms enjoy in the United States.

China's indigenous innovation policies include proposed government benefits for specific products designated by the Chinese government such as preferential access to China's government procurement market. These and other measures, if implemented, would threaten normal, commercial intellectual property-related transactions and undermine market competition.

China, like all countries, has a legitimate interest in promoting domestic innovation and technological progress. At the same time, its policies should not disadvantage U.S. firms and workers.

We have made some progress on this front but much more must be done. We are pursuing this through all available bilateral and multilateral channels. At the S&ED, China committed that its innovation policies would be consistent with the principles of nondiscrimination, strong intellectual property rights enforcement, market competition, and open trade and investment, as well as to leaving the terms and conditions of technology transfer to individual enterprises. China also agreed to a high- and expert-level process led by Office of Science and Technology Policy Director Holdren that includes all relevant U.S. and Chinese agencies, to address our unresolved issues so that American firms and their workers are not disadvantaged by these policies. This process was launched in meetings in Washington in July and we will hold the next meeting in China this fall.

Under the leadership of Secretary Locke and Ambassador Kirk, we will address specific trade and investment issues relating to innovation in detail with China at the next meeting of the JCCT later this year.

On intellectual property rights (IPR), rampant IPR violations and the overall level of IPR theft in China remain unacceptable. Even with recent improvements in Chinese law designed to protect intellectual property, piracy and theft of intellectual property are widespread. For example, the share of IPR-infringing product seizures just at the U.S. border that were of Chinese origin was nearly 80 percent in 2009. Despite recent positive steps by China, including the largest software piracy prosecutions in Chinese history and an increased number of civil intellectual property cases in the courts, widespread IPR infringement in China continues to impact U.S. products, brands, and technologies in a wide range of industries. IPR enforcement is an important economic issue, and robust enforcement provides incentives for innovation and creativity, crucial to our economy.

We will continue to press China to strengthen its IPR enforcement and its prosecution of violations so that U.S. firms are not being undercut by pirated technology and counterfeit goods.

When China fulfills its WTO commitment and completes the negotiations to join the WTO's rules-based GPA, as we have been pressing China to do, China's ability to use government procurement to pursue discriminatory policies, including China's proposed product accreditation system, will be limited. In line with its commitment to us in the S&ED, China submitted a revised offer in July to join the GPA. While improved, it is still insufficient, and we will continue to make clear to China that it must provide broad coverage consistent with that of other GPA members.

Investment barriers continue to prevent or constrain U.S. firms' ability to invest in specific sectors of the Chinese economy. Reducing these barriers, as well as maintaining the longstanding open investment policy of the United States, is vital to creating more jobs for American workers.

In many cases, foreign investment by U.S. firms, including in China, provides a major channel through which U.S. exports flow, and as a result contributes to creating jobs here at home at our exporting firms.

Again, it is a simple matter of fairness that U.S. firms enjoy the same access in China that Chinese firms have here. We intend to hold China to its S&ED commitment to expand areas that are open to foreign investment, including certain services, high-technology goods, high-end manufacturing, and energy saving products, and will push for further opening to expand opportunities for U.S. firms.

For our part, we are fully committed to welcoming foreign investment, including from China, consistent with safeguarding our national security. Foreign investment benefits the United States. It creates high-paying jobs, and brings new skills and technologies. According to the latest data available, 5.5 million Americans—approximately 4.6 percent of U.S. private industry employment—are employed by U.S. affiliates of foreign firms.

U.S. Policy Options

We are very concerned about the negative impact of these policies on our economic interests, and are pursuing a carefully designed, targeted approach to address these problems.

The Administration is using all tools available to ensure that American firms and workers can trade and compete fairly with China. We are committed to promoting policies in both the United States and China to create new opportunities for Americans and grow jobs in the United States. And we are not leaving these outcomes to chance.

We will continue to encourage China to rely to a much greater extent on domestic demand for growth—particularly by giving households the income and the confidence to spend more and enjoy higher living standards. We are urging China through all channels to allow significant, sustained appreciation of the renminbi over time to accurately reflect market forces and correct the distorting undervaluation. We are urging China to end discriminatory trade and investment measures, protect intellectual property, and adhere to international best practices in promoting innovation.

We are working in multilateral channels, including the G–20, APEC, and the IMF to press China to achieve balanced, sustainable growth, particularly by allowing prompt, meaningful, and continuing appreciation of the renminbi. A more flexible renminbi is in the best interests of the entire global community. At the IMF, China allowed publication of the annual Article IV report for the first time since 2006, a step we strongly encouraged. In the G–20, we expect China's commitment to rebalancing to be a key part of the agenda at the Leaders Summit in Seoul later this year.

We are aggressively using the full set of trade remedies available to us under U.S. law to address unfair trade practices and safeguard the interests of U.S. workers. The Commerce Department has moved actively, consistent with WTO rules, to defend U.S. companies and workers from unfairly traded goods from China. And last year, the President imposed temporary import relief under Section 421 when imports from China disrupted the U.S. market.

We also will continue to use all tools we have to hold China to its international trading obligations, including in the WTO. Yesterday, Ambassador Kirk announced the filing of two new WTO cases against China, one involving discrimination by China against U.S. suppliers of electronic payment services (EPS), and the second challenging China's imposition of countervailing duties on U.S. exports of a high-tech steel product known as "Grain-Oriented Electrical Steel" (GOES).

Last year, the United States won two WTO cases against China relating to intellectual property rights—one on copyright and trademark protection and another on the importation and distribution of certain publications and audiovisual products—and successfully settled a third case in which we challenged what appeared to be prohibited export subsidies. China also repealed measures that discriminated against U.S. auto parts in order to come into compliance with a favorable WTO ruling obtained by the United States in another case.

We are in the process of reviewing carefully the evidence presented in the Section 301 petition filed by the United Steelworkers Union challenging a wide range of Chinese policies in the renewable energy sector.

And we are exploring ways to encourage a substantial improvement in intellectual property protection in China.

We are pursuing these important economic objectives at the highest levels of the U.S. Government, with a carefully coordinated assessment of priorities, led by the White House, and using all available tools, consistent with our WTO obligations.

Our commitment starts at the very top. President Obama has made clear to the highest levels of the Chinese government our economic priorities, including real progress on currency and indigenous innovation. He designated Secretary Clinton and me to lead the S&ED, through which we are pursuing an integrated and coordinated strategy to level the playing field; we do so together with our interagency colleagues as part of an Administration-wide effort.

We are making some progress. We welcome the recent assurances by the Chinese government, including Premier Wen's statements this week, to afford national treatment to U.S. companies operating in China. But we want to see that level playing field extended to U.S. exporters selling to China. This is the basic premise of the multilateral trading system from which China and the United States have benefited greatly.

Mr. Chairman, we welcome your attention to these issues. And we will work closely with this Committee and your colleagues in both houses of Congress to find ways to best advance and best protect our economic interests in this important strategic relationship.

China has a very substantial economic stake in access to the U.S. market, and China has benefited greatly from the rules and protections that underpin the multilateral trading system. And we have a very strong interest in a more level playing field in the Chinese market, so that U.S. businesses and U.S. workers do not face unfair trading practices.

I want to be clear: a strong and growing China benefits the United States, just as a strong and growing United States is good for China. The more level the playing field, the truer this is.

Fundamentally, our ability to benefit from the U.S.-China relationship depends more than anything else on our own actions to strengthen the American economy. To take advantage of the opportunities presented by a growing China, we have to educate our children, teach and advance basic science, invest in R&D, and foster innovation.

We are making very substantial investments to do just that—to develop our abilities in growing fields like new energy technologies and prepare our industry and workforce to remain global leaders.

And we are committed to restoring fiscal sustainability as the economy continues to recover so that our own economic conditions support strong and sustained growth, at home and globally. To achieve this, the Administration's Budget puts a 3-year freeze on non-security discretionary funding. Congress established its own pay-as-you-go budgeting rules in 2007 and the President proposed and signed legislation making PAYGO a legal requirement last February. PAYGO played an important role in restoring fiscal discipline in the 1990s. And the President has appointed a bipartisan Fiscal Commission which will make further recommendations by the end of the year.

Renminbi appreciation will not erase our global trade deficit, nor our deficit with China. Our bilateral trade deficit is likely to persist. But Chinese exchange rate adjustment is critical to removing a major distortion in the global economy, to rebalancing China's economy, and to ensuring strong, sustainable, and balanced global growth.

We need a more balanced economic relationship. This is imperative for us, but it is important to China as well.

I look forward to working closely with this Committee and your colleagues in Congress so that the American people get the full benefits of an open and fair economic relationship with China.

Thank you.

PREPARED STATEMENT OF C. FRED BERGSTEN

DIRECTOR, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS [1]
SEPTEMBER 16, 2010

A Proposed Strategy To Correct The Chinese Exchange Rate

Summary and Recommendations

1. *The U.S. and Chinese global trade imbalances are increasing sharply*. This makes it considerably harder to reduce unemployment and achieve a sustainable recovery in the United States.
2. *China's currency remains substantially undervalued,* importantly due to that country's massive intervention in the foreign exchange markets, and is a major cause of its large and growing trade surplus. *It has risen by less than 1 percent since the announcement of a "new policy" in June.*
3. China let its exchange rate rise by 20–25 percent during 2005–08. Our goal should be to persuade it to permit a similar increase over the next two to 3 years. *This would reduce China's global current account surplus by $350–$500 billion and the U.S. global current account deficit by $50–$120 billion.*
4. *Elimination of the Chinese misalignment would create about half a million U.S. jobs,* mainly in manufacturing and with above-average wages, over the next couple of years. The budget cost of this effective stimulus effort would be zero.
5. The United States should *seek to mobilize a multilateral coalition to press China to let its currency rise by the needed amount.* The European Union and a number of important emerging market economies, including all three of the other BRICs, have expressed deep concern over China's currency policy.
6. This currency realignment is an integral part of the global rebalancing strategy adopted by the G–20 and laid out in detail as part of its new Mutual Assessment Process. This strategy has been agreed by the Chinese (as well as all other) member governments. Further development and implementation of the program is to be discussed, and hopefully adopted, at the next G–20 summit in Korea in November.
7. To date, however, the efforts of the International Monetary Fund to persuade China to move sufficiently have largely failed. The Fund has no enforcement tools of its own. Hence the *United States and its allies should seek authorization from the World Trade Organization to impose restrictions on imports from China unless it allows its currency to adjust adequately*.
8. To lead this effort credibly, the *Administration must* of course *designate China as a "currency manipulator,"* as it has been for at least 7 years. We can hardly ask the world, through the IMF and WTO, to indict China if we are unwilling to do so ourselves. The Committee, and the Congress more broadly, should insist that the Administration do so—preferably at these hearings.
9. In addition, the *Administration should initiate a new strategy of "countervailing currency intervention" (CCI) against Chinese purchases of dollars* by making offsetting purchases of Chinese renminbi.[2] China has been intervening at an average of about $1 billion per day over the past several years, by purchasing dollars with RMB to keep the price of our currency up and the price of its currency down. This greatly enhances the price competitiveness of Chinese products in world trade. The United States should counter by buying corresponding amounts of RMB with dollars, which we can of course create without limit. This is technically challenging, since the RMB is not fully convertible, so our authorities will have to find and buy market proxies such as non-deliverable forward contracts for RMB and RMB-denominated bonds in Hong Kong.
10. The *United States should also henceforth treat currencies that are substantially and deliberately undervalued as constituting export subsidies for purposes of calculating and applying countervailing duties* (but not antidumping duties). They clearly represent a subsidy (and an equivalent import barrier)

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[1] Dr. Bergsten has been Director of the Peterson Institute for International Economics since its creation in 1981. He was previously Assistant Secretary of the Treasury for International Affairs (1977–81) and Assistant for International Economic Affairs to the National Security Council (1969–71). His 40 books include *The Long-Term International Economic Position of the United States* (2009), *China's Rise: Challenges and Opportunities* (2008), *China: The Balance Sheet—What the World Needs to Know Now about the Emerging Superpower* (2006), and *The Dilemmas of the Dollar: The Economics and Politics of United States International Monetary Policy* (2nd edition, 1996).

[2] I initially proposed this idea in testimony before this Committee on January 31, 2007. Senators Schumer and Graham have included a version of it in S. 1254 and S. 3134.

in economic terms and I believe the Department of Commerce erred in its recent determination that they are not countervailable under current U.S. law. As a result of Commerce's decision, however, I recommend that Congress pass that part of the Ryan-Murphy bill (H.R. 2378) that would clarify that currencies that are substantially and deliberately undervalued are to be treated as export subsidies subject to U.S. countervailing duties.

The Global Imbalances

The U.S. deficit and Chinese surplus have both moved substantially, first down and now back up, since the Committee last addressed these issues. Both declined sharply to 2009: our deficit fell from 6 percent of our GDP in 2006 to 3 percent, and China's surplus declined from an astounding 11 of its GDP in 2007 to 5 ½ percent.

There were two main causes for this improvement. The sharp decline in all world trade, due to the Great Recession, trimmed imbalances as well as overall trade levels because exports and imports both fell by roughly equivalent percentages. This meant that a country that started with an export surplus (China) experienced a drop in that surplus while a country that started with an import surplus (the United States) experienced a fall in its trade deficit.

The sizable currency adjustments of previous years also had major positive effects. The dollar fell, in a gradual and orderly manner, by a trade-weighted average of about 25 percent from 2002 until early 2007. The RMB, as already noted, was permitted by the Chinese authorities to rise by 20–25 percent from the middle of 2005 to the middle of 2008 (before they re-pegged it to the dollar). With the usual lags of 2 to 3 years, these currency corrections made important contributions to the subsequent adjustments in trade imbalances.

Over the past 6 months or so, however, both countries' external imbalances have again been climbing sharply. The U.S. deficit in goods and services, which fell to $25 billion in May 2009, climbed back to $50 billion this June and remained above $40 billion in July, the latest months for which data are available. China's surplus, after almost disappearing earlier this year (for peculiar statistical reasons), has now soared to monthly averages of about $25 billion during the last 4 months (to August) for which data are available. These reversals are due partly to the recovery of international trade, in response to renewed economic expansion around the world. They are also due partly to the renewed rise in the dollar during the crisis period, as safe-haven investments into the United States, and to the Chinese authorities' termination of appreciation of the RMB.

The outlook unfortunately is for more of the same. The IMF projects that China's surplus will rise back to 8 percent of its GDP by 2015 (after foreseeing even higher levels in some of the earlier drafts of its latest forecast). In light of China's continued rapid economic growth, this number would reach almost $800 billion and far surpass its previous record high in absolute terms. It could also mean that China's global surplus would exceed the U.S. global deficit in dollar terms.[3]

Exchange Rate Developments

This renewed growth of the current account imbalances, under normal market conditions, would produce a renewed rise of the RMB and decline of the dollar. The dollar has indeed weakened a bit lately against most currencies, after strengthening earlier this year due to the flight from risk surrounding the European public debt crisis (as it did for similar reasons during 2008–early 2009 at the depth of the Great Recession), but not by enough to make much difference. The Chinese authorities apparently set the stage for an upward move of the RMB when they announced on June 19 a return to a more flexible and more market-based exchange rate regime like that they had pursued during 2005–08.

The results to date have been very meager, however. As of September 10, the RMB had risen by less than 1 percent. If maintained over the coming year, this would amount to an annual rate of only 4 percent. Such appreciation would barely be enough to reflect the annual rise in productivity growth in China, compared with that of its trading partners, let alone reduce the large undervaluation accumulated over the last half decade.[4]

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[3] I refer throughout this statement solely to the *global* trade and current account positions of the two countries. The bilateral imbalance between them is analytically irrelevant in a multilateral world economy. As China's global surplus approaches the U.S. global deficit in absolute terms and as its share of the U.S. global deficit continues to rise, however, the bilateral number will be an increasingly accurate proxy for the global totals.

[4] William R. Cline. 2010. *Renminbi Undervaluation, China's Surplus, and the U.S. Trade Deficit.* Peterson Institute for International Economics Policy Brief 10–20, estimates that the RMB

Continued

Our Peterson Institute's latest calculations suggest that China would have to let the RMB appreciate by about 15 percent on a trade-weighted basis and about 25 percent against the dollar to achieve equilibrium, defined as cutting the Chinese surplus to 3 percent of GDP.[5] These numbers are less than the "25–40 percent" undervaluation that I and others have cited until recently[6] because the IMF and most other projections of China's future current account surpluses, though still very high as noted above, have been reduced considerably from their earlier levels so less currency appreciation would be required to reach the current account target. If one believes that China should totally eliminate its surpluses, however, the required adjustment would still be on the order of those earlier numbers. *A reasonable goal would be a rise of 20 percent in the trade-weighted average of the RMB even the next couple of years, about the same amount the currency rose during its earlier period of appreciation in 2005–08.*

It is obvious that China continues to intervene heavily in the currency markets to keep the RMB from rising much more rapidly. It does not publish intervention numbers and the latest data on its foreign exchange reserves cover only the second quarter, including only the first 10 days of the "new policy." Through that period, however, the data on reserves suggest that intervention has averaged at least $1 billion daily since 2005.[7] This official buying of dollars keeps the price of the dollar artificially high and the price of the RMB artificially low, generating the currency undervaluation that adds substantially to China's international competitive strength. *It is hugely ironic that China complains about the international role of the dollar but does far more than anyone else on the planet to further increase that role by adding such massive amounts to its, and thus global, dollar reserves.*

Hence it *remains obvious that China is "manipulating" the value of its currency.* This clearly violates both the international monetary rules of the IMF Articles of Agreement and the global trading rules of the WTO Charter. The latest report of the Treasury, while stating clearly that "the RMB is undervalued," nevertheless again fails to label China a "manipulator." One can understand Treasury's tactical desire to avoid further antagonizing China on the issue, even if disagreeing that doing so would reduce the prospect of its adopting more constructive policies, but it is violating both the letter and spirit of existing legislation as well as common sense by refusing to designate.[8]

Some critics still argue that currency adjustments would be ineffective in correcting the imbalances. To be sure, such adjustments must be considered in the context of complementary economic policies. This notably includes decisive U.S. action to correct our budget deficit over the next several years and expansion of domestic demand in China, as already undertaken via their huge fiscal and monetary stimulus programs, to offset the negative impact on growth of a declining external surplus. But this proviso is well understood and is imbedded in the G–20's rebalancing strategy. Moreover, the process demonstrably works: the earlier rise of the RMB during 2005–08 contributed importantly to the subsequent sharp fall in China's surplus, as noted above, without denting China's rapid overall growth during the period.

On the current accounts themselves, our latest studies show that every rise of 1 percent in the trade-weighted average of the RMB will cut China's global surplus by $17–$25 billion over the succeeding 2–3 years and will cut the U.S. global deficit by $2 ½–$6 billion over a like period. Hence the *proposed RMB appreciation of 20 percent could be expected to reduce China's global surplus by $350–$500 billion and the U.S. global deficit by $50–$120 billion.*[9]

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needs to rise by about 2 ½ percent annually to prevent China's rapid productivity growth from generating steady increases in its external surpluses.

[5] William R. Cline and John Williamson. 2010. *Estimates of Fundamental Equilibrium Exchange Rates, May 2010.* Peterson Institute for International Economics Policy Brief 10–15.

[6] See my testimony on that topic to the House Ways and Means Committee on March 24, 2010.

[7] China's total foreign exchange reserves have now reached about $2.5 trillion. The next largest holder is Japan, at about $1 trillion. No one else exceeds $500 billion. The headline number for China's reserve increase in the second quarter was only $10 billion but this included a markdown of $70 billion in the dollar value of their euro holdings so intervention must have approximated $80 billion—more than $1 billion per working day.

[8] See C. Randall Henning. 2008. *Accountability and Oversight of U.S. Exchange Rate Policy.* Washington: Peterson Institute for International Economics, especially pp. 44–52 on the report's treatment of manipulation in the case of China.

[9] See William R. Cline. 2010. *Renminbi Undervaluation, China's Surplus, and the U.S. Trade Deficit.* Washington, Peterson Institute for International Economics Policy Brief 10–20.

A Proposed Action Plan

Under current conditions of high unemployment, an improvement of $50–$120 billion in the U.S. trade balance would generate 300,000–700,000 new U.S. jobs. About half of these would occur in manufacturing and pay wages well above the national average. The initiatives proposed here to achieve this outcome would have virtually zero budget cost. Hence RMB correction (and exchange rate adjustment more broadly) must be one of the most cost-effective stimulus measures now available to the U.S. Government.

The cardinal issue remains what initiatives should be undertaken to promote the needed Chinese actions. Some of these steps range well beyond the currency issue itself. Most importantly, the United States' case would be much more credible, and much more effective in achieving its goals, if it would take tangible steps to address the imbalances from its own deficit side of the equation. The key step would of course be an effective program to reduce, and preferably eliminate, the budget deficit over the next three to 5 years. President Obama's National Export Initiative, to double exports over the next 5 years, is a laudable goal in this context but has yet to encompass any meaningful content—and will be impossible to achieve without substantial appreciation of the RMB and some other important currencies against the dollar. But it "takes two to tango" so China (and the other large surplus countries, notably Germany and Japan) must also adopt corrective policies to enable the needed adjustment to take place even if the United States were to do everything right.

It is also essential to embed the exchange rate issue in the broader context of rebalancing the world economy, with the United States consuming less and exporting more while China consumes more and exports less. The G–20 has adopted such a strategy, the IMF has laid out the implementation details in its Mutual Assessment Process, and the U.S. and Chinese leaders have committed their countries to pursue it.

Most fundamentally, China will of course allow its currency to rise only if its authorities believe that doing so makes sense in terms of the country's own economic and international objectives. There is much debate around that issue but most analysts agree that it does. A stronger currency and smaller trade surplus, offset in growth terms by expansion of domestic demand, will rebalance the Chinese economy from capital-intensive investment and exports toward consumption and services. This in turn will promote a more rational allocation of capital, create more jobs, help check inflation, sharply reduce the country's need for energy and other raw materials, and cut pollution.[10] Such adjustment will of course also reduce the risk of international conflict, caused by China's surpluses, and thus promote its broad foreign policy interests along with its economic goal of maintaining open markets for its exports.

But the top Chinese authorities have clearly not accepted that diagnosis to date. Hence direct action on the exchange rate will be needed. One clear lesson of the recent past is that China is likely to respond more constructively to multilateral pressure than to bilateral pressure from the United States alone. The timing of its announced policy change in June, albeit of limited practical effort so far, was apparently motivated by the upcoming G–20 summit in Toronto and the need to comply at least nominally with the MAP being presented there by the IMF. The sharp criticism it had recently received from fellow emerging economies, notably Brazil and India, may have had some impact as well. Hence the United States should seek to mobilize as broad a coalition as possible, in terms of both the number and development level of countries, to support its efforts to achieve effective adjustment by China.

There are two multilateral instruments for pursuing adjustment by China (or any surplus country), the IMF and the WTO, neither of which has been very effective historically.[11] The IMF has been seized of the currency issue at least since 2005, with very modest results. When the Executive Board finally discussed the Fund staff's latest report on the country's economy (including the exchange rate), after China had delayed that conversation for 3 years, it could not even muster a majority to agree that the currency was "substantially undervalued"—as the IMF's Managing

[10] Nicholas R. Lardy. 2008. Sustaining Economic Growth in *China in China's Rise: Challenges and Opportunities,* C. Fred Bergsten *et al.* Washington: Peterson Institute for International Economics, and Nicholas R. Lardy. 2007. China: Rebalancing Economic Growth in *The China Balance Sheet 2007 and Beyond,* C. Fred Bergsten *et al.* Washington: Center for Strategic and International Studies and the Peterson Institute for International Economics.

[11] John Williamson. Forthcoming 2010. *Encouraging Adjustment by Surplus Countries.* Peterson Institute for International Economics Policy Brief. Washington: Peterson Institute for International Economics.

Director and staff have been saying repeatedly on the basis of their own in-depth analyses for some time. Close observers believe that only five or six of the Fund's 24 Directors, presumably a few (but not even all) of the Europeans as well as the United States and no developing countries, were willing to criticize China even to this very modest (and obvious) extent. Even if the IMF Board were willing to indict China, it has no power of enforcement and could only "name and shame"—which would be helpful, particularly in promulgating a WTO case (see below), but would certainly not guarantee a constructive response.

Hence attention has turned toward the WTO, which can authorize member countries to erect barriers against imports from other members that violate its rules. The issue is whether current WTO rules do in fact effectively prohibit currency manipulation a la China at present. There are two routes to such action:[12]

- A general indictment of China under Article XV, which proscribes countries from "frustrating the intent of the provisions of this Agreement by exchange action," prosecution under which would authorize members to retaliate against China; and
- Approval of case-by-action action by individual countries that chose to regard China's currency undervaluation as an export subsidy under the Code on Subsidies and Countervailing Duties, which *China* would have to challenge to overturn.

I recommend that the United States pursue both courses of action if China continues to resist adequate appreciation of the RMB. In both cases, it should seek to move in concert with as many other WTO members as possible. In both cases, it should be noted that the WTO will be guided on the exchange rate issue itself (as opposed to the trade policy responses) by the IMF.

The Article XV action is preferable in principle because it would apply to Chinese exports of all products to all countries. However, the language and legislative history of the provision make it difficult to apply to the current Chinese case (or any other foreseeable currency case). Some observers therefore oppose invoking the article because they fear that a negative ruling would make it harder to challenge currency undervaluations in the future and might also undermine very valuable dispute settlement mechanism of the WTO. I would nevertheless urge its pursuit, including via a push from the Congress if necessary to convince the Administration, because doing so (1) would represent an impressive multilateral effort that (2) would publicize the need for Chinese action much more widely than at present and (3) highlight the desirability of reform of the WTO itself to handle such cases if the present language does in fact prove to be impotent. All this would play out over at least a couple of years, because WTO cases take that long to run their course, and would thus desirably keep the spotlight on the issue as long as it remained unresolved.

In the meanwhile, the United States and as many allies as possible should act on their own to treat the RMB undervaluation as an export subsidy—as Fed Chairman Ben Bernanke has noted publicly that it is—that must be included in calculating countervailing duties against Chinese products. The Department of Commerce has recently concluded that currency undervaluation is not actionable as a subsidy under current U.S. law so Congress should pass legislation, along the lines of H.R. 2378 (The Currency Reform for Fair Trade Act of 2009), to reverse that ruling.[13] It is not clear whether this approach will pass WTO muster either but in this case, unlike the Article XV option under which the United States would take China to the WTO and seek authorization for action, the action would already be taken by the United States (and hopefully others) and China would have to take the United States to the WTO in an effort to remove the countervailing duties. This too would take a considerable period of time, during which the CVDs would be in place, and—again depending importantly on how many countries joined the U.S. initiative—would provide a powerful "shot across the bow" to help induce China to let the exchange rate move substantially.

[12] Gary C. Hufbauer, Yee Wong and Ketki Sheth. 2006. *U.S.-China Trade Disputes: Rising Tide, Rising Stakes.* Peterson Institute for International Economics Policy Analysis in International Economics 78. Washington: Peterson Institute for International Economics.

[13] There are a number of technical problems with H.R. 2378 as currently drafted, however. For example, its threshold level of 5 percent for an "actionable undervaluation" is far too low in light of the imprecision of all misalignment calculations; the number should be at least 10 percent. It muddies the waters by calling for parallel treatment of currency *over*valuations, which do not require similar policy action. And it erroneously treats undervalued currencies, which reflect *government* export subsidies, as a source of discriminatory pricing of exports by *private* parties for antidumping purposes.

Mobilization of an international coalition should be particularly feasible under the countervailing duty option. Other major importers would fear diversion of subsidized Chinese goods to their markets if the United States acted alone against its products. Hence they would almost certainly emulate the U.S. action very quickly and should be willing to act simultaneously with it. Chinese awareness of potential action by a large number of its key markets, especially the United States and the European Union as by far the two largest, would presumably provide maximum inducement for China to prevent the planned action by letting its exchange rate move substantially. Other countries might also be willing to join the Article XV, however, because only the plaintiffs in the case would be authorized under WTO rules to retaliate against the offensive Chinese practice.

A New Option

There is one, directly monetary, measure that the United Stated should contemplate taking against China: direct purchases of RMB to counter China's direct purchases of dollars. It is absurd, especially from a U.S. national perspective but also from the standpoint of global financial stability, that other countries set the exchange rate of the dollar. This is a consequence of the international role of the dollar, one of several of which lead me to question whether that role remains in the national interest of the United States.[14]

In principle there could be little objection to such "countervailing currency intervention" against manipulation by another country that was keeping its exchange rate substantially undervalued as a result. In practice, the United States could easily adopt such a policy against any currency that is generally convertible, such as the euro if it too became substantially undervalued (as appeared to be occurring several months ago).

The United States has of course bought foreign currencies on many past occasions, most recently the euro in 2000 and the Japanese yen in 1998. Those interventions were taken in close coordination, and via joint market operations, with the issuer of the other currency at its request because they believed (and the United States agreed) that it had become too weak. It would be very different for the United States to intervene *against* the desires of another country, especially to *counter* its intervention, but the market techniques would be identical. Moreover, the objective would be to push a specific exchange rate toward equilibrium levels and thus to reverse a misalignment that was distorting global trade and the world economy.

There is a practical problem in the Chinese case. The absence of full convertibility for the RMB, and the existence of widespread Chinese capital controls, make it impossible for the U.S. authorities to enter well-functioning currency markets (as for the euro or yen) to buy RMB because no such markets exist. Hence the United States would have to identify proxy assets and buy them instead. Candidates would include non-deliverable forward (NDF) contracts for RMB and RMB-denominated securities in Hong Kong. The magnitude of such interventions by the United States would be limited by the size of the relevant markets and thus to far less than the daily purchases of dollars by the Chinese authorities. But such an initiative by the United States would clearly indicate the seriousness of its concern over the misalignment of the RMB, provide an unmistakable and indeed dramatic signal to the markets themselves, and add further to the pressure on China to cooperate.

There is nothing in U.S. law or the IMF Articles of Agreement that would prohibit the United States from undertaking such "countervailing currency intervention" today. However, the Congress might want to consider amending the relevant portion (Section 3004) of the Omnibus Trade and Competitiveness Act of 1988 to authorize Treasury to conduct countervailing currency intervention operations whenever it determines that a country is manipulating its exchange rate to gain an unfair competitive advantage. Such an authority would greatly strengthen the hand of the Treasury in conducting the negotiations to remedy an unfair currency practice as called for under the Act. A version of the idea is included in S. 1254 and S. 3134, proposed by Senators Schumer and Graham.

The exchange rate is of course an inherently international issue because it involves at least the two countries between whose currencies it provides a price. Hence the use of countervailing currency intervention by the United States, or by any other country, should be subject to review by the International Monetary Fund. Any country that believed it was being unfairly challenged by such a policy should be able to appeal to the Fund, and the countervailing country should be required to desist if its justification for the action was found to be inconsistent with the objectives and rules of that institution. This would parallel the treatment of counter-

[14] C. Fred Bergsten. November/December 2009. "The Dollar and the Deficits," *Foreign Affairs.*

vailing duties by the WTO, described above, under which target countries can win disapproval of the countervailing action if they can demonstrate that their alleged subsidies are in fact not actionable under the rules of the institution.

The United States would be in a strong position to defend itself against any such protest from China, however. The IMF Guidelines for Exchange Rate Policies call on member countries to "take into account in their intervention policies the interests of other members, *including those of the countries in whose currencies they intervene"* (italics added). There is no evidence that China has done so *vis-a-vis* the United States despite its massive intervention in dollars. Japan has interestingly just posed a similar question concerning China, complaining that the Chinese are driving up the exchange rate of the yen by buying Japanese bonds while blocking Japanese purchases of Chinese bonds that might have a counteracting effect.

Countervailing currency intervention would be decidedly superior to countervailing duties to deal with the problem of manipulated exchange rates. Undervalued currencies subsidize all of the exports of the country in question and pose a barrier of equivalent magnitude to all of its imports. Countervailing duties, however, address only exports of individual products from such a country on a case-by-case basis and do not apply to its imports at all. The currency approach is monetary and comprehensive whereas the trade tool, useful as it is for its intended purpose, involves cross-retaliation and is very selective in its application.

Conclusion

The time has clearly come, indeed has long since passed, to devise effective strategies to achieve adjustment of the world's largest international imbalances: the U.S. deficit and the Chinese surplus. Continued failure to do so will generate increasing risks of renewed financial crisis, encourage new outbreaks of restrictive trade measures as countries respond to China's blatantly protectionist currency policy, trigger renewed transpacific tensions, and make it more difficult to reduce the U.S. unemployment rate as China exploits demand in other countries to create jobs at home.

The proposed action program entails risks as well. The designation of China as a "currency manipulator" could increase its intransigence rather than promote constructive action. Appealing to the WTO on "exchange action" enters new territory and could jeopardize that valuable institution. Expanding the scope for countervailing duty actions could lead to protectionist abuse of that safeguard device. "Countervailing currency intervention" could trigger temporary instability in financial markets.

But the risks of inaction, including to the open system of international trade and finance, are much greater than these and other possible costs of the measures proposed. I strongly recommend that the Congress work closely with the Administration to advance them and, if necessary, insist that the Administration do so.

PREPARED STATEMENT OF LYNN BROWN

SENIOR VICE PRESIDENT FOR SALES AND MARKETING,
HYDRO ALUMINUM NORTH AMERICA
SEPTEMBER 16, 2010

Mr. Chairman, Mr. Shelby, and Members of the Committee:

My name is Lynn Brown and I am the Senior Vice President of Sales and Marketing of Hydro Aluminum North America ("Hydro"). I have 14 years of experience in the aluminum extrusion industry. I appreciate the opportunity to appear on this panel to discuss the Treasury Department's Report on International Economic and Exchange Rate Policies and its failure to name China as a currency manipulator. The U.S. aluminum extrusion industry has been adversely impacted by China's exports of aluminum extrusions, and in particular, by the large and distortive subsidy that Chinese aluminum extrusion producers benefit from as a result of China's undervalued currency.

Hydro is a wholly owned subsidiary of Norsk Hydro, a leading global integrated aluminum company. We are one of the largest U.S. manufacturers of soft alloy aluminum extrusions. Hydro operates six extrusion facilities across the United States, including in Kalamazoo, Michigan; North Liberty, Indiana; Monett, Missouri; Belton, South Carolina; St. Augustine, Florida; and Phoenix, Arizona. We also have a stand-alone fabrication, or component manufacturing, facility in Sidney, Ohio. With our geographic scope, we have close to national market coverage.

Approximately fifty percent of our facilities are unionized, with workers represented by the United Steelworkers, the Teamsters, and the United Autoworkers.

Currently we employ about 1,800 workers, which is a significant reduction from the 2,300 workers that were on the payroll 3 years ago. In 2006, we shipped approximately 250 million pounds of aluminum extrusions. In 2010, we expect to ship approximately 35 percent less.

Imports of Chinese extrusions have created havoc in our industry, growing from a negligible factor a few years ago to a market share of almost 25 percent. During a time when U.S. consumption of aluminum extrusions has fallen substantially due to the recession, Chinese imports have more than doubled. Earlier I mentioned our six extrusion facilities—it used to be seven. We have already closed one of our plants in Ellenville, New York, with 150 jobs lost. In addition, we idled press lines at three of our plants in 2009. This, along with reductions in employees, work shifts, and work weeks, have made it very difficult for my company and our workers. There are similar stories throughout our industry.

The flood of low-priced Chinese imports caused Hydro, along with other members of the domestic industry and the United Steelworkers, to file antidumping and countervailing duty petitions covering aluminum extrusions from China. We filed these petitions on March 31, 2010. In the countervailing duty petition covering Chinese subsidies, we listed a host of subsidy programs that benefit Chinese aluminum extrusion producers, including an allegation covering China's undervalued currency.

Our currency allegation provided information demonstrating that all three legal requirements for finding the existence of a countervailable subsidy were met: 1) that the Chinese government had provided a *financial contribution,* which 2) resulted in a *benefit,* and 3) which was *specific* to a particular industry or group of industries in China. With respect to the financial contribution, we explained that by requiring foreign exchange that is earned from export activities to be converted into Chinese yuan at a rate that is set by the Government, a rate which is universally recognized to be about 40 percent below its true value, Chinese exporters reap an enormous windfall. Specifically, Chinese exporters get 40 percent more yuan for every dollar that they exchange than they otherwise would absent Chinese government intervention in the foreign currency markets. This provides an enormous, continuing benefit to those exporters, and allows them to significantly under-price U.S. producers. We also alleged and documented that this subsidy was specific to exporters in China, because it is directly linked with exports and creates a powerful incentive for Chinese producers to export their products to the United States, rather than sell them at home.

The Chinese currency is clearly undervalued. A January 2010 policy brief by the Peterson Institute estimated that China's currency is undervalued by 41 percent on a bilateral basis against the dollar. Other estimates are within this range.

Petitioners in twelve different investigations have alleged that China's manipulation of its currency results in a countervailable subsidy. However, in each instance the Commerce Department has refused to initiate an investigation into these allegations. Commerce has claimed that domestic industries have failed to sufficiently allege that the receipt of the excess yuan is contingent on export or export performance—in other words that the subsidy was specific. But I am aware that the paper industry submitted a revised allegation in January of this year, this time providing an expert report from an independent economist which demonstrates that based on the Chinese government's own data, 70 percent of China's foreign exchange earnings from Current Account transactions and from long-term Capital and Financial account transactions were derived from the export of goods. The study concluded that no other category of foreign exchange inflows comes close to matching the $1.4 trillion foreign exchange earnings of Chinese exporters. Because Chinese exporters garner the overwhelming share of benefits from the undervaluation of the yuan, the subsidy benefit is *de facto* specific to exporters as a group.

Our allegation was based on this revised methodology. And yet much to our disappointment, the Commerce Department did not initiate an investigation into our allegation, claiming that we did not sufficiently allege that China's currency undervaluation does benefits a specific group, enterprise, or industry in China. One of the more troubling aspects of the Commerce Department's determination was that it did not even give us the opportunity to remedy the deficiencies in our currency allegation, which would be normal procedure in most cases. It is our hope that Commerce will investigate and offset this unfair trade practice in the future, but we are unsure what more can be done to demonstrate that currency undervaluation, at a minimum, merits a comprehensive investigation.

The Treasury Department's July 2010 report also was disappointing. The Treasury Report acknowledges that the Chinese Government purchases foreign exchange to limit the yuan's appreciation against the dollar and the yuan remains undervalued. And, despite a major Chinese Government announcement of allowing the yuan to float between a narrow band, the yuan has appreciated by less than 1 percent since July. As a businessperson whose company is trying to survive against import competition that benefits from a host of government subsidies—of which currency undervaluation may be the most significant—the Chinese government's assurances do not offer much solace.

I think many people not involved in the extrusion industry would ask us, "Why don't you just become more efficient and lower your prices so you can compete?" It is not that simple, and that is why the extremely low Chinese prices are all the more unfair.

The starting point for all pricing is the cost of aluminum, which, as you may know, is a globally traded commodity. In the markets that I work with the most, North and South America and Europe, aluminum is priced according to the London Metal Exchange (the "LME") in U.S. dollars and is publicly reported and known throughout the industry. In additional to the LME price, we have to pay delivery and handling, which, in the U.S. is referred to as the Midwest premium. But, anywhere you go, you have to pay delivery and handling.

Once we get the aluminum, there are additional processes that must be done to cast the ingot into aluminum billet or aluminum log to create the feed stock for our extrusion process. Depending on the specific alloy, the price for this conversion varies. These commodity metal purchases and additional processes can account for over 70 percent of our total cost of manufacture. Because these costs are virtually fixed, there is very little opportunity to negotiate or affect any of those metal costs.

China's import prices are so low that we end up with extremely little room to negotiate on price—even though theoretically we should be paying roughly the same global commodity prices for the raw materials. We do have some advantages: We are within a day's drive of most of the continental U.S., which is a significant geographical advantage over imports from China; we participate in a wide variety of market segments, including solar energy, transportation, electrical, consumer goods, industrial, building and construction; and we offer excellent customer service. But we continue to lose sales to Chinese imports in every one of those markets. Why? Despite the absence of any comparative advantage, imports from China are able to undersell us by significant margins.

Chinese extrusion producers have been able to lower prices, increase exports, and gain market share in the United States, in large part because of the undervalued Chinese currency. It is widely recognized that, despite the recent so-called "revaluations" of the yuan, China's currency is still undervalued by approximately 40 percent on a bilateral basis against the dollar. Chinese exporters get as much as 40 percent more yuan for every dollar they exchange than they otherwise would absent the Chinese government's intervention in the foreign currency markets. Along with other significant subsidies, the currency advantage provides an enormous, continuing benefit to those exporters, and allows them to significantly undersell U.S. producers.

This has cost good, manufacturing jobs in the United States, and the profit necessary to justify the reinvestment in and upgrading of our facilities. Without the establishment of a level playing field, the U.S. extrusion industry faces major long-term problems. Not only does this injure our business at home, the severe undervaluation of China's currency effectively imposes a 40 percent tax on any potential exports from our U.S. facilities. This affects not only exports to China but also exports to other third markets where we compete with the Chinese.

The best outcome would be for China to allow its currency to float freely and reflect market forces. Past efforts, however, to negotiate with China on its currency revaluation both bilaterally and multilaterally have not met with success. Therefore, we believe that the best approach is, at a minimum, for the Commerce Department to investigate China's undervalued currency as a countervailable subsidy, which it has thus far refused to do. We are hopeful that this issue can be resolved soon, and we would welcome any assistance the Congress can provide.

On behalf of Hydro and the other companies in the U.S. aluminum extrusion industry, we appreciate the Committee's attention to this important issue.

PREPARED STATEMENT OF CHARLES W. FREEMAN, III

FREEMAN CHAIR IN CHINA STUDIES,
CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES (CSIS)

SEPTEMBER 16, 2010

Mr. Chairman, esteemed members of the Committee, it is my honor to testify today on the factors in China that contribute to the undervaluation of the renminbi

(RMB) and other economic policies that may act to disadvantage American businesses and their workers.

Much has been written about the RMB and its value relative to the dollar and other major currencies. China has largely maintained a fixed exchange rate for the entire history of the People's Republic of China (PRC) since its foundation in 1949. For the first three decades of the PRC, the RMB was pegged at an absurdly overvalued rate of between 2.5 to 1.5 RMB to the U.S. dollar. In the early 1980s, as China began to open to the outside world and the country became focused on export-driven growth, the RMB was devalued to improve export competitiveness such that, by 1994, the RMB was valued at 8.62 to the dollar. Following the Asian financial crisis of the late 1990s, China maintained a peg of 8.27 to the dollar from 1997 until 2005 when, in the midst of vocal international criticism (led in no small part by Congress), China announced an intent to gradually relax the peg.

The decision in 2005 to loosen it exchange rate policy to allow appreciation certainly came in the midst of extraordinary international outcry, but it also followed a lengthy period of heated external debate within China. Many of China's financial regulatory officials had long argued that the peg was undermining China's efforts to create a modern financial system; that it misallocated investments domestically; and that it contributed to what was then just becoming a chronic global current account surplus. These financial mandarins have faced a recalcitrant and powerful set of interests committed to maintaining export competitiveness as a key pillar in China's economic policy. When the financial crisis took the world by storm in 2007, those Chinese officials determined to prop up exports put the brakes on additional appreciation so that global economic uncertainty would not undercut China's perceived export advantage conveyed by a competitively valued currency. For all the wringing of hands within China about a loss of competitiveness that significant RMB appreciation would yield, China's enormously impressive economic performance suggests that fears of RMB appreciation are misplaced.

Despite the dramatic levels of economic and export growth behind China's frustrating refusal to meaningfully appreciate the RMB lays an almost stunning insecurity about China's political and economic stability. The PRC's leadership is deeply concerned about its ability to maintain domestic economic stability, given the challenges (many of which are admittedly staggering) of income and development disparity, and other factors. Since many in China's leadership consider economic growth and stability to be a sine qua non of political stability, maintaining any competitive advantage to drive economic growth is a political necessity: without growth, the Communist Party is out of power, or so the thinking goes. While many of China's economic policymakers are seeking to reduce the country's reliance on exports for economic growth, there remains much skepticism that alternative pathways—particularly through increasing the share of consumption in GDP—are available in the near term to export growth. Accordingly, maintaining an export advantage is part and parcel of maintaining political control. Small wonder that Chinese officials are loath to answer the entreaties of Treasury and Congress to remove the RMB's peg to the dollar. They fear the domestic consequences: a loss of jobs and competitiveness that will stir public antipathy and, ultimately, cost them their political authority.

These concerns will no doubt be familiar to many in this body. To the extent concern in the United States public over Chinese economic policies can be said to reduce competitiveness, and lead to the loss of jobs and business opportunities, the Administration and Congress have a solemn responsibility to the American public to confront those policies. So in many respects Chinese officials are pursuing the same fundamental political goals we are. Their motivations, however, should not excuse policymaking behavior that undermines U.S. and global confidence in the fairness of the world's trade and financial architecture. More recently, this behavior has increasingly been bolstered by an increasing confidence among Chinese policymakers that their policies are right, and our concerns are misplaced.

Not all is bad news in the U.S.-China trade and economic relationship. In 1979, total trade between the United States and China was $2.4 billion. 30 years later, by 2009, that trade had grown to $365 billion. During this period China became the fastest growing export market in U.S. history; Chinese exports to the United States (which to an overwhelming degree did not compete directly with American production) enhanced the buying power of Americans, particularly those at lower income levels; and China became one of the most profitable and fastest-growing markets for the operations of American businesses. Not insignificantly, the commercial relationship between the United States and China has been an important area of common interest that has reduced bilateral tensions between two countries that are not, to say the least, natural political partners.

Yet, more broadly, Chinese economic policymaking, whether acts of commission like industrial policies that disadvantage U.S. competitiveness in its market; or acts of omission like China's completely ineffectual system of intellectual property rights protection and enforcement, is unquestionably undercutting Americans' faith in the fundamental fairness of trade between the United States and China. On one hand, the fact that China, by the introduction to the global labor market of twenty percent of the world's potential workers, has come into conflict with other countries, is far from surprising. That the rise of China from less than a percentage point of global GDP to around 8 percent has created concerns among industrialized nations should further create challenges is hardly shocking either. However, in spite of all the misplaced outrage, the impact of China's rise in the global trading order has still created valid challenges that need to be confronted. Indeed, China presents a fundamental challenge to the nature of the global trading order and the U.S. role in that order going forward.

The Rise of the Beijing Consensus

This most recent global economic crisis has left many Chinese feeling triumphant. China's economy, after a brief pause, is once again roaring at double-digit growth. China's financial system was underexposed to many of the "toxic" assets that were the bane of so many other countries', and its stimulus package was targeted and relatively efficient. Chinese media and internet chatting has been full of commentary that the United States was down and out as a result of the crisis and China is scaling new heights. There is a palpable sense among many Chinese that China's economic and political system has distinct advantages over that of the United States. Despite a long-time view that the U.S. model of development—based on the so-called "Washington Consensus"—had much to be admired, many Chinese now perceive that there is a distinct Chinese model of growth—based on "state-directed capitalism"—that has little to be learned from the American experience favoring open markets and a preference for private activity. As Chinese Vice Premier Wang Qishan said, tongue clearly in cheek, to a forum of American business and government leaders as the extent of the financial crisis became clear: "We have learned that our teacher has some problems."

China's widespread perception that the U.S. economic model is inferior to that of the newer Chinese version has profound implications for both China and the United States. To begin with, it is based on a faulty supposition. China's twenty-five year run of breakneck growth is not the result of effective state-owned firms or savvy industrial policies. Rather, China's economy has largely grown by the government getting out of the way of entrepreneurial individuals and companies; by allowing the ambitions of Chinese private individuals to substitute for the will of the state. Rather than clever planning by Chinese government agencies, as many Chinese now seem to suppose, twenty years of intensive market reform policies that removed the Chinese government from active intervention in market activity have been the primary source of Chinese growth. Chinese state-owned enterprises are largely a drag on growth, consuming 70 percent of Chinese resources and producing only 30 percent of Chinese output. China's industrial planners, those ministries that are heirs to the disastrous economic policies of China's Maoist past such as the Great Leap Forward and other tragic missteps, were largely sidelined during much of the two decades leading up to the beginning of this century as China's leadership sought to replace bureaucratic decisionmaking with market principles. Fifteen years of painful negotiations with the United States and other economies leading up to Chinese entry into the World Trade Organization in 2001 was intended by those steering the Chinese economy during this period to force reform on an otherwise recalcitrant bureaucracy. The wisdom of Chinese leaders in developing China's economies has not been to construct careful economic plans, but to eschew constructing those plans and drastically reduce state control over the economy. Unfortunately for those in China counting on unabated and efficient economic growth, the new generation of Chinese policymakers seems to have forgotten this important lesson.

The second problematic impact of a newfound Chinese economic triumphalism is on the ability of U.S. trade and economic officials to convince Chinese counterparts to revise or reverse policies that impact U.S. economic interests. In the past, examples from the U.S. economic experience were important teaching tools that our officials and businesspeople could deploy to demonstrate alternative policies that Chinese officials might choose as alternatives to problematic policies. In an era in which the U.S. model was a powerful case in point of how to get economic development right, Chinese officials were at least willing to provide some deference to these examples. Newly convinced of the superiority of the Chinese system, Chinese policymakers are less easily converted to replace offensive policies and practices by examples from the "failed" U.S. model. As a result, when attempting to "fix" problems in U.S.-China trade relations, U.S. trade officials are left with few alternatives and must seek Chinese concessions during high-level summitry like the Strategic and Economic Dialogue or the Joint Commission on Commerce and Trade; by seeking WTO dispute resolution; or through unilateral trade actions. Unfortunately, high-level summitry isn't an efficient process by which to resolve multiple complex trade issues. WTO dispute resolution is slow and unwieldy, and few problems in the relationship are clear violations of China's WTO commitments. Finally, unilateral trade actions can run afoul of our own multilateral trade commitments.

The final challenge placed by China's newfound sense of economic superiority has been to dramatically suppress the forces of reform in China. In 2001, with the goal of Chinese WTO accession realized, the forces of reform were relieved of their primacy in economic policymaking. The planning-oriented ministries and agencies that had been suppressed in the fifteen years of reform found overnight that they no longer were easily coerced by reform oriented ministries like Commerce and Foreign Affairs. The planning forces not only began to flex their muscles in ways that challenged U.S. economic interests, they did so with no small amount of resentment at the perceived heavy-handedness of the forces of reform during the period of their dormancy. Paradoxically, much of the decentralization of power and authority throughout the bureaucratic system that was a hallmark of WTO reform effectively empowered bureaus and offices throughout the Chinese ministerial to come up with creative plans that challenged the spirit of reform that embodied China's WTO push. When these plans challenged U.S. economic interests, however, U.S. officials have been forced to take up their concerns with different ministries, namely Commerce and Foreign Affairs, that may be most sympathetic to our concerns, but without the power and authority that they enjoyed in previous years.[1] Given the unique, stove-piped nature of the Chinese bureaucracy, the effectiveness of those agencies in over-turning policies generated in other ministries is highly limited, absent external intervention from a higher-level authority. In short, the United States has difficulty finding an official audience in China that is both sympathetic and has political capital sufficient to do something about our concerns.

In order for you to approach challenges holistically I believe that it is also critical to address some of the economic and trade challenges not under the purview of the Banking Committee.

Intellectual Property Rights Protection and Enforcement

Not all challenges in the U.S.-China trade relationship are a result of newfound Chinese self-confidence or date from the resurgence of Chinese economic planning. The most costly of China's trade policies to U.S. economic interests has been the same for nearly as long as the relationship began. The counterfeiting and piracy of U.S. intellectual property from software to celluloid to switching technologies has been rampant and virtually unchecked in China for over two decades. This despite China's implementation of a basically WTO-consistent legal framework of intellectual property rights (IPR) protection and enforcement. One of the primary challenges to those seeking to prevent the unopposed theft of their IPR is that China's extreme geographic and political decentralization makes it very difficult for rights-holders to pursue legal protection and enforcement of their rights without having to run a gamut of local and provincial officials and courts that are more likely to side with local violators with more local political clout. When rights-holders are successful at seeking legal redress for their grievances in court, they are frequently awarded damages that are *de minimis*—barely adequate to cover legal costs let alone serve as a deterrent of future IPR theft. For many recidivist IPR pirates and counterfeiters, legal fines are an unfortunate but bearable cost of doing business: the rewards for piracy far outweigh the risks.

U.S. officials have, for years, attempted to establish with Chinese counterparts an understanding on the utility of an effective IPR regime for Chinese economic development. A primary complaint of Chinese economic policy officials is that China's economy, while it has grown exponentially in the past 30 years, remains on the low-end of industrial input values. Searching for a means to bring Chinese industry up the value chain, some of these policymakers have seized on an effective IPR regime as an important means to an end. If China can better protect IPR, so the theory goes, China's domestic inventors and entrepreneurs will have a greater incentive to build Chinese technology companies and brands. There is thus a highly energized cadre of Chinese officials that understand the importance of IPR to an innovative economy and are seeking to establish a more effective system of IPR protection and

[1] Neither the Ministry of Commerce nor Foreign Affairs has a direct representative on the Politburo, unlike previous years. Experience managing international affairs among China's most senior leadership is therefore in short supply.

enforcement not because of an interest in protecting foreign business interests, but promoting domestic Chinese innovation.

This cadre of officials is bolstered somewhat by the increasing attention of China's most senior leadership to the importance of innovation to China's future growth plans. China's desire for technological advancement is a longstanding obsession. As early as the mid-1970s, China's Premier Zhou Enlai espoused the goal of "Four Modernizations", among which technological modernization was prominent. In the 1980s and 1990s, China sought to increase its technology base through technology transfer, attempting through incentives to encourage Western companies to incorporate higher technology platforms into their production bases.

But China's effort to seek technology transfer, through incentives or (occasional) coercion, has been less-than successful. Some Chinese individuals and firms, not necessarily with state sponsorship, have on occasion attempted to access higher technologies from the United States and other Western economies through industrial espionage. But in most cases, U.S. companies have largely abstained from large scale transfers of technology to China. Chinese officials in many cases suggest that the reason for such abstention is U.S. export control laws. In practice however, the reason for China's lack of success in encouraging technology transfer is not U.S. policy [2] but rather a rational U.S. company approach to risks associated with exposure of technology to the Chinese market: intellectual property theft is so rampant that few, if any, companies are likely to expose their technologies to the Chinese marketplace.

Part of the problem with China's approach to IPR is, as most Chinese officials will tell you, that Chinese society is undereducated about the role of IPR in a modern economy. A prevailing Chinese attitude with respect to IPR is that China's development requires the free transfer of Western technologies in order for China to "catch up" with the West. It is not uncommon for Chinese of varying sophistication to demand that the China-based development of gunpowder and paper, which was freely adopted by Western sources, is adequate justification for Chinese citizens' commandeering of such products as Microsoft Windows or other such products. This cultural reality is no excuse for China's failure to effectively enforce the laws on its books, but it does present a significant enforcement challenge. That China has yet to allocate the resources necessary to begin to overcome this reality suggests that the lack of appreciation for the importance of an effective IPR regime is not merely a problem with China's populace, but is a challenge that runs deep within China's officialdom as well. Perhaps, given the apparent fetish within the leadership for policies that encourage innovation, IPR protection may gain increasing acceptance as a necessary part of the equation. That remains, however, to be seen. Simply challenging the WTO consistency of China's IPR regime, however, is unlikely to achieve satisfactory results.

Industrial Policy

As I discussed earlier, the return of industrial planning to the fore of Chinese economic policymaking is a major challenge to market-oriented businesses in China, including U.S. businesses. Policies that encourage the development of one business sector to the disadvantage of another have long been a factor in Chinese economic policy. Each year, China's central government has published an "investment catalogue" that lists businesses that qualify for "encouraged," "accepted" and "discouraged" status. This catalogue has been a guide for local and provincial officials in seeking foreign direct investment. "Encouraged" investments (typically in high technology, high-employment businesses) have had preferences showered upon them. Subsidies in the form of tax, land and labor breaks as well as dramatically simplified regulatory processes and the easing of other legal burdens have made the process of favoring some businesses over others a fact of life in China's economic landscape. The process of encouraging and discouraging different businesses has developed into a high art in recent years. Various national and sub-national official groups within China, especially those charged with working with various domestic constituency industries, have increasingly sought to develop new industrial groups in China. On a number of occasions, these groups have developed individual policies, not necessarily with the broad consensus of the Chinese government, that aim to encourage the development of industries in China in ways that challenge or disadvantage American companies and their workers:

- Promotion of National Champions

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[2] Statistics from the Department of Commerce suggest that only about $6 million in U.S. export licenses to China are denied each year, significantly undercutting Chinese official's insistence that export controls are a significant factor in both the lack of significant technology transfer and the U.S. trade imbalance with China as a whole.

Certain Chinese companies, not necessarily state-owned companies, have in recent years found special favor as firms that may develop into distinctly Chinese multinational companies. The advantages conferred on these "national champions" vary, but the rationale for their promotion by parts of the Chinese government is straightforward. Chinese government officials, largely for reasons of national pride, favor the existence of Chinese national companies that operate on a world stage with a stature comparable to U.S., Japanese and European multinationals. When the interests of these companies compete with those of American companies, the Chinese companies are generally accorded a "patriotic" advantage. An area of particular concern at this point is in green technology, which many Chinese officials perceive to be a competitive international commercial battleground that, given the dramatic scale of China's domestic market for wind and solar power in particular, Chinese companies will be uniquely poised to capture.

- Technology Certification for Procurement (the "Indigenous Innovation") Challenge

As discussed earlier, China's desire to move up the industrial value chain by improving its technology base is based on largely benign motivations. Whether intended to fulfill the Technology leg of the Four Modernizations, or to cope with the demographic challenge of China's aging workforce because of the "one child policy", a desire to build a more technologically advanced industrial base is not necessarily threatening to U.S. interests. The push in recent years, led by Chinese Premier Wen Jiabao, to develop a Chinese "indigenous innovation" capacity, on its face, is hardly something about which the United States has license to object.

However, since China's leadership opined on the broad parameters of an "indigenous innovation" push, Chinese industrial planners have actively developed operational policies that contradict the spirit of Chinese reform policies that led to China's accession to the WTO. These decisions unquestionably impact the ability of U.S. and other foreign companies to operate in the Chinese marketplace. In November 2009, a group of Chinese ministries collaborated on the development of a policy designed to provide advantages in China's procurement market to those companies that developed "indigenous innovations." The resulting policy circular set off a firestorm of criticism among the foreign business community in China, who argued variously that the policy would shut them out of the market, command their transfer of technology into the market, or require their collaboration with domestic Chinese players in the market. Although Chinese officials have been quick to suggest that the policy is not intended to disadvantage foreign players, the effect of the policy has, at a minimum, established confusion at the direction of China's attitude toward foreign business operations. More specifically, the effort, if allowed to stand, would have posed fundamental challenges to the ability of U.S. and other foreign businesses to operate on equal footing with Chinese counterparts.[3] The principle of "national treatment"—by which a WTO member accords no less advantageous a business environment to foreign businesses as it does its own—is, after all, a basic guarantee agreed to by China under its WTO accession agreement. The use of Chinese procurement laws to affect the policy was allowed by WTO rules because China is not a member of the WTO's Government Procurement Agreement, giving the country the ability to use its procurement market for the purposes set forth in the indigenous innovation policy. That China agreed on WTO accession to join the GPA "as soon as possible", yet used its lack of membership to adopt a policy counter to the GPA, suggests that the forces of reform that stood behind WTO accession are in full retreat.

- The Standards Trap

Technical standards are another area in which certain Chinese agencies have made an effort to carve out parts of the Chinese marketplace for domestic firms. In some cases citing security concerns, in some cases citing safety, Chinese agencies involved in commercial areas as diverse as agriculture to wireless encryption technology have been active in promoting China-only standards, frequently in collusion with domestic Chinese firms seeking market advantages. Some of these standards issues have become significant sources of friction in the relationship, such as the WLAN Authentication and Privacy Infrastructure (WAPI), a unique wireless encryption standard that Chinese regulators originally insisted be mandatory for all wireless equipment providers. That standard and its progeny, despite numerous

[3] At the meeting of the U.S.-China Strategic and Economic Dialogue this past May, China agreed to reduce the impact of the offending technology certification regulations. Whether those regulations or the spirit that motivated their creation are gone for good, or are just being held at bay, is uncertain.

high-level interventions at the Vice Premier and Secretary level, continue to percolate under the surface of international trade relations. Numerous other standards in various stages of development, some seemingly created purely to confound the ability of American and other companies to compete with Chinese rival firms in the marketplace, will almost certainly prove to be a major source of commercial friction in the years to come.

Beyond the Bilateral: China's International FTA Push

In addition to the ongoing bilateral trade considerations that serve to challenge U.S. companies and their workers, China's activist international trade liberalization agenda is of undoubted concern to America's long-term competitiveness. Chinese efforts to build free trade links with Southeast Asia and other parts of the world are increasingly developing as competitive challenges to longstanding U.S. commercial advantages in these regions. China is winning hearts and minds in these parts of the world through conferring trade advantages. While the United States is obviously of two minds at present on the question of free trade, the failure to use a liberalizing trade agenda with Southeast Asia is increasingly acting to cede that part of the world to Chinese economic dominance. Without a more assertive international trade policy posture, including the goal of promoting Free Trade Agreements, the United States risks alienating itself as a commercial power, and reducing its overall influence in the region.

Combating the Challenges

Contrary to some suggestions that the U.S. trade agenda with China is occasionally captive to broader strategic considerations, in my experience the commercial relationship is appropriately treated separate and distinct from security and other matters involving China. The U.S. Trade Representative and Department of Commerce are active in pursuing enforcement cases against Chinese interests. USTR is quick to pull the trigger on WTO cases when winnable cases are presented. DOC is unflinching in applying American trade laws to protect American businesses and their workers from unfair trade practices when the facts present a compelling reason to take legal action. The fact remains, however, that not every Chinese trade policy that disadvantages American businesses and their workers presents an actionable WTO or U.S. trade law case. Most often, the most difficult circumstances arise when a Chinese trade policy or practice is technically within the bounds of China's WTO commitments. Convincing Chinese officials to nonetheless reverse that policy or practice requires considerable skill. At a time when (a) Chinese officials are less-inclined to give credence to American arguments because of a perception that the American model is no longer appropriate to China's conditions; and (b) the ministries who favor market-oriented reform are short on political capital, the usual U.S. approach—that of engaging primarily with the Ministries of Commerce and Foreign Affairs to solve problems in the U.S. trade relationship—is unlikely to be particularly effective in solving the broadest range of challenges in the relationship.

In order to genuinely combat the challenges faced by American companies and their workers in the China market, the U.S. Government and our companies will need to increase the sophistication of their approach to the marketplace. Too often, we approach China as if it were a monolith; a government with a top-down hierarchy that is best approached from the top down. In fact, the Chinese society is home to diverse constituencies that rarely are in lock-step consensus. Relying on any one or several ministries to expend political capital in the Chinese system in order to fix "an American problem" is not a long-term recipe for success. One thing that Americans need to get better at in China is understanding the array of forces in China that are aligned in favor and against a particular trade proposition, and working more closely with those forces that support an American position. China has come far in 30 years. It is now a complex business and policy environment with multiple interest groups commanding attention. The United States would do well to understand the complexity and diversity of this environment and begin developing alternative means for resolving problems in the environment that are not solely reliant on the strategies and tactics of years past.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BROWN FROM TIMOTHY F. GEITHNER

Q.1. You delayed publication of Treasury's exchange-rate report in order to use the Strategic & Economic Dialogue and the G–20 summit to encourage China to move on its currency. You acknowledge in your testimony today that the pace of China's RMB appreciation as too slow and too limited. You said the Administration is "examining the important question of what mix of tools" are available to encourage China to move more quickly.

Will the currency report be issued October 15, as required by the law? As far as examining tools to encourage China, does this include taking a case to the WTO?

A.1. Did not respond by publication deadline.

Q.2. Section 310 of the Trade Act of 1974, referred to as "Super 301," requires the Administration to establish enforcement priorities for opening foreign markets for U.S. exporters. Super 301 was renewed in the Clinton Administration. It lapsed in the Bush Administration. I have a bill to revive it, which I see as key tool to doubling our exports in the next 5 years.

In the 1980s, when perhaps the Federal Government was more aggressive in combating unfair competition and pressing trade partners for market access, Super 301 I was one of the tools used to address currency manipulation with Korea and Taiwan.

Do you see trade tools, like 301, strengthening Treasury's bargaining position on exchange-rate matters?

A.2. Did not respond by publication deadline.

Q.3. The Commerce Department has delayed at best, and ignored at worst, consideration from the coated paper and aluminum extrusion producers that China's currency intervention is a countervailable subsidy.

The law on this is pretty straightforward—it requires that the Department initiate an investigation to determine whether a countervailable subsidy is provided if the domestic industry "alleges" and meets a relatively low threshold.

Why has the Administration not made the decision to initiate an investigation on currency in these cases?

A.3. Did not respond by publication deadline.

Q.4. The Japanese Government unilaterally intervened in international currency markets to the tune of reportedly $12 billion. in order to weaken the yen. And so far they succeeded. The yen moved from 82.8 on September 15 to over 85 on September 16, obviously due to this large intervention. Here's another case of classic currency manipulation whose purpose is to weaken a currency to make its exports more competitive, again to the detriment of American workers and American jobs.

What has the Treasury said about this latest blatant unilateral intervention? Did you put out a statement condemning this action? If not, why not? Is the absence of a strong U.S. statement going to be seen by the Japanese and the world as evidence that the United States is tacitly supporting this intervention?

In light of this intervention by Japan, can you reiterate for us what exactly is the U.S. policy toward large, unilateral currency interventions?

Can we expect to see Japan cited in the next Treasury report on foreign exchange as a currency manipulator, under terms of the current U.S. law?

A.4. Did not respond by publication deadline.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BUNNING FROM TIMOTHY F. GEITHNER

Q.1. Mr. Secretary, I want to ask about your role at the New York Fed because of new information about the AIG bailout. This summer the *New York Times* reported on the latest AIG outrage. As part of the agreement to cancel its derivatives deals and pay the counter-parties off at par, AIG also waived all legal rights to sue Goldman Sachs, Merrill Lynch, and others for fraud or other reasons on the mortgage-backed securities the big banks issued and AIG insured. Did you participate in this additional giveaway to the big banks at the taxpayers' expense while you were at the New York Fed, and do you believe this action was appropriate?

A.1. Did not respond by publication deadline.

Q.2. It is my understanding that in the past, when you were asked about elements of the AIG bailout, you claimed that you excused yourself from decisions about elements of the AIG deal and other major decisions in late 2008 because you were working with the Obama transition. During this time when you were not performing the major responsibilities of your job at the New York Fed, were still collecting your salary from the New York Fed?

A.2. Did not respond by publication deadline.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR VITTER FROM TIMOTHY F. GEITHNER

Q.1. Though this hearing has focused on our relationship with China and the valuation of our currency, I would be remiss if I did not address the recent decline in the value of the U.S. dollar. This week the dollar is trading near a 5-month low against the euro and consumer confidence has dropped to its lowest point since February. In the past you have said, "I believe deeply that it's very important for the United States and the economic health of the United States that we maintain a strong dollar."

What specifically are you doing, as Secretary of the Treasury, to support a strong dollar policy?

A.1. Did not respond by publication deadline.

Q.2. What impact do you think our nation's budget deficits play in the weakening dollar?

A.2. Did not respond by publication deadline.

Q.3. Do you think that our budget deficits are sustainable?

A.3. Did not respond by publication deadline.

Q.4. Do you believe the current state of the U.S. dollar on world currency markets is a cause for concern?

A.4. Did not respond by publication deadline.

Q.5. Do you believe that you should be doing or saying something to strengthen the dollar?

A.5. Did not respond by publication deadline.

Q.6. What role do you think the extraordinary debt issuance by the United States this year has played in the status of the U.S. dollar in world currency markets?

A.6. Did not respond by publication deadline.

Q.7. Some have described efforts to jawbone the Chinese to increase the value of their currencies to have the same result as a weak dollar policy—because their goods would become more expensive for U.S. consumers?

A.7. Did not respond by publication deadline.

Q.8. Who do you believe bears the responsibility for the dollar rests with, the Department of Treasury or the Federal Reserve?

A.8. Did not respond by publication deadline.

Q.9. What affect has the Federal Reserve's open checkbook, bailout response to the financial crisis had on the dollar?

A.9. Did not respond by publication deadline.

Q.10. How big of an impact would the Federal Reserve have on the strength of the dollar if it announced that it was closing its checkbook and ending plans for further quantitative easing?

A.10. Did not respond by publication deadline.