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THE U.S.-CHINA ECONOMIC RELATIONSHIP: A NEW APPROACH FOR A NEW CHINA

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THE U.S.-CHINA ECONOMIC RELATIONSHIP: A NEW APPROACH FOR A NEW CHINA

THURSDAY, JUNE 10, 2010

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:07 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Bingaman, Kerry, Wyden, Schumer, Stabenow, Grassley, Hatch, Snowe, Bunning, Enzi, and Cornyn.

Also present: Democratic Staff: Bill Dauster, Deputy Staff Director and General Counsel; Amber Cottle, Chief International Trade Counsel; and Ayesha Khanna, International Trade Counsel. Republican Staff: Stephen Schaefer, Chief International Trade Counsel; and David Ross, International Trade Counsel.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will come to order.

According to chaos theory, a butterfly beating its wings in America might start a hurricane in China. As we emerge from the chaos of the worst financial crisis since the Great Depression, the relationship between what happens in America and what happens in China is as important as ever.

The United States' and China's economies are increasingly interconnected. As consumer demand in the United States declined, China's exports fell dramatically; and, as the United States fell into a deep recession, China's economic growth slowed significantly.

Now, both the United States and China must recover and rebuild, but we cannot do so in isolation. China has failed to recognize this fact.

For too long, China's economic policies have focused on unsustainable export-oriented growth at the expense of American ranchers, farmers, and workers. For too long, China has permitted the theft of U.S. intellectual property at the expense of American innovators. And for too long, China has protected its domestic industry at the expense of American businesses and exporters.

America can no longer afford to be complacent. We no longer have the luxury of pursuing failed approaches. We must rethink the U.S.-China economic relationship. We must act, not just talk.

China is the world's fastest-growing economy. In 2009, China's gross domestic product grew by almost 9 percent. China's per capita GDP nearly doubled from 2005 to 2009. Consumer spending in nearly a quarter of Chinese cities is expected to double over the next 10 years.

China is fueling global economic growth, and, as China develops a new role in the global economy and global institutions, we must develop a new approach to a new China.

Last month's Strategic and Economic Dialogue reinforced the need to rethink and revitalize. We entered the S&ED with expectations that China would take concrete action to address its currency and so-called indigenous innovation policies. We walked away with promises to engage in further discussions. Dialogue is important, but discussion does not equal action.

By seeking a new approach, we do not seek to start a hurricane. We do not seek to succeed at China's expense. Rather, we seek to foster long-term mutual cooperation, recognizing that, in the short term, we may need to take strong unilateral and multilateral action. We seek to ensure the long-term economic progress of America, as well as China.

But we must address a long-standing issue in our relationship. For example, a prominent CEO of a U.S. software company recently noted that many Chinese companies will legally purchase only 25 percent or less of their software needs. They illegally pirate the rest. We must take new steps to address persistent problems: that is, the fact that many Chinese companies illegally pirate the rest means that piracy of this magnitude reflects a policy choice in China.

I propose four ways to define America's approach to U.S.-China economic relations. First, the United States must formulate a comprehensive strategy to better manage our bilateral U.S.-China economic relationship. Different agencies are pursuing different, uncoordinated strategies.

When we talk to different agencies in the U.S. Executive Branch, (A) they do not have a China policy and, (B) the policy they do have is different from another agency. It is not coordinated. There is not a country policy. We can no longer approach our economic relationship in this piecemeal way.

We must craft a holistic strategy, orchestrated and led by the White House, to develop a strong, mutually beneficial U.S.-China economic relationship. In doing so, we must recognize that our bilateral economic relationship is an equal complement to our bilateral strategic relationship. Our economic relationship has, in my judgment, taken a back seat to our strategic relationship for too long.

In fact, I would go farther. I read a book a long time ago by Paul Kennedy, who basically said that in the sweep of history, in the rise and fall of countries, those that decline are not defeated generally by armies from afar, but rather are defeated by internal decay from within.

Strong economic policy is more important, because then we could project more political and strategic power.

Second, we must approach China's economic policies as a global concern, not just an American concern. China's currency misalignment, ineffective protection and enforcement of intellectual property rights, and industrial policies, such as indigenous innovation, hurt businesses around the world, not just U.S. businesses.

We must work multilaterally with key trading partners, such as the European Union, Korea, and India, to make it clear to China that the world is watching and is united in its concern, and we must effectively address these concerns through key multilateral fora, such as the G–8 and the G–20.

Third, we must look carefully at the tools offered by the international institutions, such as the International Monetary Fund and the World Trade Organization. Where these tools provide effective recourse, we must be willing to aggressively pursue it. Where these tools are not adequate, we must work to strengthen them.

Fourth, we must be willing to take strong unilateral action. In April, the Treasury Department postponed publication of its biannual currency report until after the S&ED and G–20 meetings. As I noted, we must work multilaterally to resolve the currency issue, but we cannot expect our trading partners to take strong action if we are unwilling to do so.

America must be willing to take the lead, even as we ask others to join. As part of a coordinated strategy, America must take steps now to address the U.S.-China economic relationship.

The Treasury Department must negotiate effective solutions to address China's currency manipulation. The Commerce Department must apply a rigorous analysis when investigating antidumping and countervailing duty petitions regarding Chinese imports.

The Office of the U.S. Trade Representative must take all necessary steps to improve China's protection and enforcement of U.S. intellectual property rights and to suspend China's discriminatory indigenous innovation policy. And Congress must assess whether the administration needs stronger enforcement tools to address the U.S.-China economic relationship.

With these efforts, I am confident we will build an effective new approach for this new China policy. We can recast the U.S.-China economic dialogue, and, by doing so, both the United States and China can recover from the global hurricane, to build interconnected economies that are stronger than ever before.

Senator Grassley?

OPENING STATEMENT OF HON. CHUCK GRASSLEY, A U.S. SENATOR FROM IOWA

Senator GRASSLEY. Thank you, Mr. Chairman. And, Mr. Secretary, I will be in and out this morning, because down the hall here, we have some important votes on in Judiciary.

Thank you, Mr. Chairman, for this very important hearing.

Mr. Secretary, some things I may say about you and this administration I have said about predecessors of yours in the Bush administration. So this is a long policy that this government—our government—has screwed up over a long period of time that has let China do whatever they want to do.

Today's hearing provides us an opportunity for the committee to engage you, Secretary Geithner, on the outcome of last month's Strategic and Economic Dialogue in Beijing. I have serious concerns about the direction that China's government is taking with respect to its economic and trade policies.

So I want to hear you speak specifically on what these meetings accomplished and what the Secretary sees in the way of next steps in our bilateral relationships.

For example, what are China's intentions with regard to its currency exchange? I emphatically disagree with the Treasury Department's decision in April to delay issuance of its currency report.

The time has long passed for the Treasury Department to admit publicly what everyone else already knows, namely, that China is manipulating the value of its currency in order to gain an unfair advantage in international trade.

I know every time that we mention that, they say we are interfering in their internal affairs. How many times have I heard them lecture us, in the right way, that we ought to get our budget deficit under control? And, if they are a 5,000-year-old society, they are members of the World Trade Organization, they are members of the U.N.—we are 400 years old on this side of the Pacific, and they are a mature nation—they need to grow up and be citizens of this world, mature citizens, and know that, in globalization, it is not just economics that is globalized. Politics is globalized. And we ought to be able to discuss these things without one country being incensed because the other one brings something up. We are all mature people.

Treasury, obviously, felt differently. I would like to hear what this delay in issuing the report has accomplished. I worry that, by delaying the report, Treasury raises expectations that will not be met.

Is the Chinese government going to make a significant adjustment in its exchange rate just because our Treasury Department held off issuing a report? I doubt it.

I also want to hear the Secretary's discussion regarding China's so-called indigenous innovation policy, which is a government policy that gives preferences in China's procurement market to products that contain intellectual property developed in China.

Our ambassador to the WTO has described this policy as one of several Chinese policies indicating, "a policy direction that seems designed to limit market access for imports and foreign investors, and pressure enterprises to localize research and development in China, as well as transfer technologies."

In other words, instead of doing everything it can to comply with the letter and spirit of its WTO obligations, the Chinese appear to be looking for ways to evade those rules and to find loopholes and gaps in the rules that it can exploit. This is a troubling development, and it calls for careful rethinking about our overall approach to China on trade matters.

For example, if China continues to refuse to make a serious offer to join the government procurement agreement in the WTO, we should take a harder look at our own procurement policies as they apply to procurement of goods and services from China.

Separately, if China chooses to apply what they call a national economic security test when it reviews foreign investment through mergers and acquisitions, perhaps we should do the same with respect to Chinese investment in the United States.

The point is, if one of the major beneficiaries of the world trading system engages in a pattern of refusing to play by the same rules as everyone else, then we should reconsider the rules that we apply to that country.

I look forward to hearing your testimony.

The CHAIRMAN. Thanks, Senator.

Now, I would like to introduce our guest, Treasury Secretary Geithner. Secretary Geithner, welcome back. We enjoy having you before our committee. You know the usual custom: prepared statement automatically included, and I ask you to summarize.

STATEMENT OF HON. TIMOTHY F. GEITHNER, SECRETARY, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Secretary GEITHNER. Thank you, Mr. Chairman, Ranking Member Grassley. It is a pleasure to be back here today to talk about China.

Our policy towards China is about protecting the interests of the United States, our national-security interests and our economic interests, and our strategy is to expand opportunities for American workers and American businesses.

We are seeing progress, but we still face many challenges. China is on its way to quickly becoming the world's second-largest economy and could soon become the largest foreign market for American goods and services. China is now consuming more and importing more from the United States. As a result, China's overall trade surplus has fallen sharply over the last 2 years, by roughly half as a share of its economy.

As we emerge from this global financial crisis, U.S. exports to China have rebounded much more rapidly than overall U.S. exports to the world and are now running 20 percent above pre-crisis levels. In fact, in the first quarter of 2010, U.S. exports of goods and services to China rose almost 50 percent compared to the same period in the previous year, which is about double the rate of growth in U.S. exports to the rest of the world.

We are seeing double-digit growth across the American economy in exports, from high-end manufactured goods to agricultural goods, like soybeans. This is important for American businesses, and it is good for American jobs. The strength in exports to China and to the world is one reason why we have seen 10 consecutive months of expansion in the manufacturing sector of the United States, and why, in April, manufacturing jobs grew faster than any month since August 1998.

Now, our economic relationship with China is not without challenges, and this morning I want to focus on three. The first is promoting a level playing field for American workers and businesses. This is a simple principle of fairness. When American workers have the chance to compete on fair terms, we do exceptionally well, and it is especially important to us that the policies China is considering putting in place to promote what they call indigenous innovation do not disadvantage American workers, businesses, and American technology.

Now, these policies, as I think you both said, include government procurement preferences, protections for intellectual property, the design of product standards, and other forms of government support for specific products the government designates.

Now, we have been very aggressive in pursuing the full remedies available under U.S. law and in the WTO to address unfair trade practices by China. Last year alone, we won two WTO cases against China and successfully settled another.

China has taken some steps to modify these innovation policies. It has committed, for example, to remove some of the most troubling elements of this initial proposal, such as the requirement that products eligible for government procurement in China have intellectual property that is owned by Chinese companies and developed in China.

China has pledged that its innovation policies—of course, we all promote innovation—but it has pledged that its innovation policies are consistent with the following principles of non-discrimination, of market competition, of open trade and investment, strong enforcement of intellectual property rights, and that the terms of technology transfer will be left to agreements between individual firms.

Now, these actions do not resolve our concerns, and they have committed to a high-level negotiation, led on our side by Ambassador Kirk and Secretary Locke, to move forward, find ways to address these concerns, and it is very important to us that we make further progress in this area.

Mr. Chairman, a second core challenge is about promoting more balanced economic growth. The United States and China recognized that the pattern of growth in both our countries and globally was simply unsustainable, so we have taken action.

In the United States, we are saving and investing more. China is moving to rely more on domestic demand, less on exports, to drive future growth. China has increased spending on infrastructure, on health and education. It is raising wage rates. It is removing restrictions on the service sector. It is promoting financial reforms, and these reforms have increased consumption and led to more rapid growth in imports than would otherwise have occurred.

As China unwinds its stimulus measures, this shift to domestic consumption has to be sustained through continued economic reform.

A third core challenge is about China's exchange rate policy. It is in China's interest to allow the exchange rate to reflect market forces, and it is critically important to the United States and to all of China's trading partners. We share the concerns of many members of this committee that China's exchange rate policy is both unfair and hurts the interests of American producers. China has committed to resume the process of reform, and we hope China takes advantage of the opportunity to move soon.

Mr. Chairman, I just want to conclude by emphasizing that our ability as a Nation to play a major role in China's future growth and our ability to deal effectively with the challenges we face in our relationship with China depends on our success in strengthening the fundamentals of the American economy.

That is why we are making substantial investments in innovation, in education, in research and development, in basic science, in new energy technologies, in public infrastructure, and in investment incentives.

These reforms and these investments, along with actions to restore fiscal sustainability as the economy recovers from crisis, are essential to the future growth of the United States. They are essential to strengthening the manufacturing base of the American economy and to providing greater opportunities for American workers.

The economic strengths of America and China are complementary. We in the United States are exceptionally good at making the goods and providing the services that the most rapidly growing parts of the world need to grow.

Right now, our job, our job in Washington, as the government, is to help the private sector do what it does best. Our job is to help American businesses expand and create more jobs. Our job is to make sure that, as China continues to develop and grow, it does so in ways that do not disadvantage our firms.

Now, we maybe have some different ideas on how best to achieve these objectives, but there is no difference between us—between us and the members of Congress, who care so much about this issue—in the basic view that our workers, our companies, our innovators have to have the chance to compete fairly in the global market. They have to have the chance to compete in China on a level playing field. When they have that opportunity, they do, as I said, exceptionally well.

I look forward to working closely with this committee to make sure that happens.

Thank you. I look forward to trying to answer your questions.

[The prepared statement of Secretary Geithner appears in the appendix.]

The CHAIRMAN. Thank you, Mr. Secretary.

My key concern, as I mentioned in my statement, though, is we do not have a strategic, coordinated United States economic policy, that I can determine, with respect to China. Different agencies have different non-policies. It is just not coordinated. There is not a plan.

It reminds me a little bit of—this is not original to me—the analogy of a football team. You have a quarterback, you have fullbacks, and the running backs and so forth, and if they do not all run according to the same plan, same play that is called, sometimes that team loses. So whoever is best-organized tends to do better.

I am not saying that we want to win at China's expense. I am just saying that we just do not want to lose.

What about that? Why can't there be a White House-led, standalone office somewhere that coordinates and develops the China economic policy? We have a similar problem with trade policy. I do not know what this administration's trade policy is. I have not seen it.

For months, we heard there is going to be a framework, a trade framework. We have never seen one. And I do not see an economic China framework. How are we going to solve this?

Do you not think it is a good idea for the administration to develop, in one location—I think it should be the White House. Sometimes there is the tension between Treasury and State and Commerce and all that, as to who is going to do all this. So I suggest it be in the White House. What is wrong with that?

Secretary GEITHNER. Mr. Chairman, let me just say that you have laid out four things that are important to the strategy moving forward, and I think that they are right.

We need to have a comprehensive strategy, we need to make sure we give our economic interests appropriate priority in the broader relationship, we need to make sure that we are using the tools we have multilaterally to protect our interests, and we need to make sure we use the tools we have in the United States effectively to promote those interests.

That makes sense. I like that basic framework. The White House is responsible now for coordinating policy on China. They do now play that role. They pull the Cabinet together on a regular basis to figure out what are priorities across agencies, to make sure that USTR, Commerce, the State Department, the Treasury Department, everybody else, are pursuing objectives with the right basic sense of priorities. That is the role they play now.

But I agree with you completely. If we are going to be effective, we have to come with common purpose, common objectives. And the three core things we are pursuing on the economic side are the ones I laid out in my statement, and I think you made in your statement: level playing field for American workers and producers, which means stronger protections for intellectual property, less discrimination against U.S. businesses in China; stronger growth in China that relies less on exports, so China is importing more from the United States as they grow; and reforms to their exchange rate mechanism, which, of course, is an important part of a level playing field.

Those are the three core objectives we are pursuing. They are what guide our strategy. And absolutely, you—we are about action, not about talk. You should measure us by what these results achieve. And we have a lot of concerns still about where we are.

But just for context, as I said in my opening statement, it is very important to point out that the U.S. economy is doing better today. Our manufacturing sector is getting stronger. Exports are growing, in part, because we are so competitive and doing such a good job of competing for a larger share of that rapidly growing economy in China; not just in China, of course, but around the world.

The CHAIRMAN. Well, I understand what you are saying, but just because it is better does not mean we should stop there.

Secretary GEITHNER. Absolutely. I completely agree.

The CHAIRMAN. It does not mean that China is not discriminating——

Secretary GEITHNER. Absolutely.

The CHAIRMAN [continuing]. Or taking advantage of us——

Secretary GEITHNER. Absolutely.

The CHAIRMAN [continuing]. In many areas.

Secretary GEITHNER. Yes.

The CHAIRMAN. So I am asking what the White House is doing, what Treasury is doing to address those areas where we are being discriminated against.

As a general policy, too, I am a little concerned about your first goal, which is level playing field. Everybody espouses a level playing field. We all want that. Then you say that is a matter of fairness.

I think, to a significant degree, the United States is more process-oriented, and China is more results-oriented.

Secretary GEITHNER. Well, I do not agree with that, Mr. Chairman.

The CHAIRMAN. We love due process. We love fairness. We love that everybody has an equal chance to talk and so on and so forth, and rights are respected along the way.

I tend to think that in China, it is not quite the same. It is more results-oriented. It is more making sure that certain quotas are met, either issued by the central government or whatnot. It is much less concerned about, say, the rule of law than the United States, and that has to be recognized. That has to be dealt with, which means we have to get results, too.

They are just different systems. The United States is not China, and China is not the United States.

Secretary GEITHNER. I completely agree, and China is not going to become like the United States overnight. China still has a government that plays an overwhelmingly dominant role in economic activity. And as you said and as we all recognize, there is still a range, a broad range of practices that China pursues today that are designed to protect their workers and their firms at the expense——

The CHAIRMAN. At the expense——

Secretary GEITHNER [continuing]. Of China's trading partners, absolutely. And intellectual property is a very good example of that.

The CHAIRMAN. It is.

Secretary GEITHNER. There is still very widespread piracy.

The CHAIRMAN. How much do you think? How many American patents do you think are infringed? How much U.S. intellectual property do you think is pirated in China?

Secretary GEITHNER. Well, I think you had the right statistic, Mr. Chairman, which is to say that, if you look at the revenues American software producers get from sales to China, of things that include U.S. software, they are a tiny fraction of what they earn in other emerging-market economies, much less Europe or the United States, and that is a reflection of the fact that it is still easy in China, despite improvements in their laws, to steal and pirate those products. You are absolutely right.

There have been substantial improvements in protections in some manufacturing goods, in the medical technology and pharmaceuticals areas, in part, because it is harder to pirate, harder to copy, and in part because China perceived appropriately that they would be severely disadvantaged if they allowed piracy to erode the basic protections those provide.

But you are absolutely right, and intellectual property is one example. Indigenous innovation is another example. Again this policy is worth spending a few minutes on.

What China proposed to do was to say, this is a list of specific products, and to be on that list, initially, they suggested, the intellectual property and the products had to be owned by, developed in China. And, if you were not on that list, you would not be eligible for a whole range of preferences, government procurement, et cetera.

Now, that is fundamentally a problem for the United States, and it has raised huge concerns across the American business community and, frankly, China's other trading partners, as being fundamentally unfair.

So we have made a centerpiece of the—and the President has, too—of these concerns in our broader economic relationship. And as I said, China has made some movements in our direction, but not enough.

We are hoping, by getting them to agree to some basic principles of nondiscrimination, to make clear that government is not going to play a role in forcing technology transfer. By committing to those basic principles, we hope to get them to change that policy further in our direction, so it does not pose these risks to us. So that is just one example.

The CHAIRMAN. I hear you, Mr. Secretary. My time has way expired.

Not to be disrespectful: those are great words, great intentions, and great goals, but I am not yet persuaded that we and the administration have come up with enough of a framework here that is actually going to make a difference here.

We have heard a lot about piracy for years and years and years, and not a lot has been done, and we have heard a lot about the Chinese taking advantage of us, and not a lot has been done.

I do not disagree with your intent and your goal, but I, frankly, am not yet persuaded that the administration has come up with something sufficient to address these concerns.

Secretary GEITHNER. But, Mr. Chairman, I just want to say that, again, our test, too, like yours, is going to be about what happens in terms of U.S. exports to China. That is our test. Our test is not whether they agree to a principle. That is just a means of leverage to get improvements and results.

I completely agree with you that our test is not about whether we get some broad process commitments. Our test is about whether things change in ways that benefit American companies directly.

The CHAIRMAN. Senator Grassley?

Senator GRASSLEY. I want to talk currency. April 3, you cited two upcoming meetings of the G–20, as well as our bilateral Strategic and Economic Dialogue with the Chinese as reasons, back then, to delay issuance of the Department's exchange rate report.

You said your objective was to use those meetings as an opportunity to make material progress—"material progress," I think, are your words—on the currency issue in the coming months.

Now that two of these meetings are behind us, are we, in fact, making material progress in addressing the currency issues? And how do you envision that this issue will develop over the next month or two?

Secretary GEITHNER. Senator Grassley, I, to be honest, do not know whether we are at the point now where we are going to see meaningful progress in the short term. It is very important to us that we see that. China understands that.

China has made it clear, in public, that they have decided to resume the reform—that is the phrase they used—resume the reform of their exchange rate policy, meaning they have decided to resume the process of letting the market play a greater role in determining the rate of the currency.

But as you know, they clearly have not decided when and how they are going to act, and they are watching closely developments in the world economy as they make that basic decision.

As we said in April, and as I have said publicly, again, and as the chairman said, we want to make sure that we are using every effective means to encourage them to move, including taking advantage of the fact that the leaders of the G–20 meet in Canada later this month; in fact, in just 2 weeks, I believe.

I think that Chairman Baucus said that this is a global issue; it is not simply an American issue. This is an issue that all of China's trading partners have a stake in changing. And so we are trying to do everything we can to maximize the odds of them moving sooner in a more substantial way, and that is what is guiding our basic strategy.

Again, China has to make this move. It is China's choice. They are a sovereign country. And our hope is, of course, they are going to decide, as you heard the President, President Hu, say a few weeks ago, that it is in China's interest to move.

Senator GRASSLEY. Going back to your words, "I honestly don't know," my cynical view of the Chinese and my view of you and our government, both under Republicans and Democrats, being very, "diplomatic" towards the Chinese, is that they probably told you what they were going to do, but you promised not to discuss it, because somehow they do not want to think that they are doing something because we are pushing them to do it. That is my cynical view.

Secretary GEITHNER. That is not true in this case.

Senator GRASSLEY. Well, I will take your word for it. But I wanted to bring that out to you.

In your responses to the questions for the record that you submitted to the committee after your confirmation hearing, you wrote that, "President Obama, backed by the conclusions of a broad range of economists, believes that China is manipulating its currency."

Does President Obama still believe that?

Secretary GEITHNER. Senator, as you know, that is a judgment we make twice a year in this report, and we will make that judgment when we release this report.

Senator GRASSLEY. But I am not asking about your study of it and your Department's study of it. I am asking that President Obama said that he believes that China is manipulating its currency, and that is what you wrote to us when you were confirmed.

So what does President Obama believe? You have had discussions with him.

Secretary GEITHNER. I have.

Senator GRASSLEY. If you said in January of 2009 that he felt that China was manipulating its currency, has he changed his mind?

Secretary GEITHNER. We have issued two reports, two exchange reports since then, and, as you know, we delayed the issuance of our latest report. But when we release that report, we will provide the judgment of the Treasury. Of course it will reflect the broader views of the administration about that basic important question again.

But, Senator Grassley, our objective is to encourage China to move as quickly as possible. Everything we are doing is trying to maximize the chance that happens, and we will keep this committee closely informed of the progress we achieve and continue to underscore why this is important to the United States, of course, not just to China's other trading partners.

Senator GRASSLEY. The United States is not the only country affected by China's undervalued currency. Many of China's neighbors in Asia maintain similarly undervalued currencies in order to avoid losing their competitive position to China.

To what extent is Treasury working with other countries to form a united front on China's currency issue?

Secretary GEITHNER. We are working very closely with the countries in the G–20, which include countries that make up 85 percent of the world economy, including all of China's major trading partners, to help make sure there is a—well, how should I say—that China understands this is a global issue, not just an American issue, and we are doing it for exactly the reasons you implied, which is, again, and as the chairman said, it is important we use all the multilateral tools we have in institutions to reinforce these interests, not just do it on our own.

Senator GRASSLEY. Thank you, Mr. Chairman. Thank you, Mr. Secretary.

The CHAIRMAN. Thank you, Senator.

Senator Bingaman?

Senator BINGAMAN. Thank you for being here, Mr. Secretary. You cite these three areas of concern with the Chinese on trade issues. The first one, let me burrow down on a particular in that. You say the best way to limit China's use of government procurement preferences to promote its industrial policies is having China join the rules-based WTO agreement on government procurement, and then you say China has now committed to submit a revised offer by July of 2010.

I assume that that revised offer relates to this agreement?

Secretary GEITHNER. Exactly. It relates to the scope of commitments they would make, the range of government entities they would cover, and the types of commitments they make to the United States and other signatories to the government procurement agreement.

Senator BINGAMAN. Is there no remedy under the WTO when countries just choose not to pursue or not to adopt non-preferential procurement policies? Do we have no remedy under WTO on that?

Secretary GEITHNER. Senator, that is really a question for my colleagues on the trade side. But I think our only strategy we have in this area, consistent with the way the WTO works, is to get countries like China, who have not signed, to sign; and, when they sign, not just sign, but take on as broad a set of obligations to non-discrimination as possible.

That is the most effective way to make sure that these policies do not discriminate against American companies. Again, the Chinese government—this is very important to us, because the Chinese government plays a much larger role in its economy than, of course, the American government plays in this economy.

Senator BINGAMAN. You then go on in your testimony to say just before the S&ED—that is the Science and Economic Dialogue that we had. Is that the S&ED——

Secretary GEITHNER. It is called the Strategic and Economic Dialogue.

Senator BINGAMAN. Right. That is with secretaries—yourself and Secretary Clinton and others were involved.

Just before that, you say it issued a public comment draft regulation on the determination of domestic products, under government procurement law, containing a 50 percent local content provision.

Now, I think you are reporting that to us or putting that in your testimony as good news. Am I correctly interpreting that?

Secretary GEITHNER. Let me say it this way. They came out with a draft product accreditation scheme to promote Chinese technology and Chinese companies, I believe, back in the fall of 2009. There were a lot of troubling things in that proposal. That is like a draft legislation or draft rule.

But the basic concern was, again, that that would discriminate against American producers or American technology and would be another step towards a broad strategy that parts of the Chinese government have promoted over time to say, in effect, if you want to sell in China, you need to come produce here; if you want to come produce here, you have to transfer technology; and, ultimately, they say, and then we want you to serve your exports markets from China.

This was part of the policy strategy like that, and, as you can tell, this is troubling to us, as well as to the broad American business community.

Now, one of the most troubling aspects of this was the suggestion that, to be eligible for these preferences, the intellectual property in a product would have to be owned by Chinese companies, developed in China. That would be enormously consequential.

So we were very concerned, raised those concerns to the highest level, and they agreed, in the run-up to this meeting, to remove that explicit provision from that list, to submit to receive public comments and concerns from around the world on this proposal, and to delay implementation until those comments have been provided.

Then at the meetings themselves, as I said to Chairman Baucus, they agreed that these policies would be governed by a set of broad principles of discrimination going forward, and they would negotiate with us changes to those policies to address our concerns.

But we do not know yet how far they are going to go. They have only moved this much in our direction, and we need them to go substantially further.

Senator BINGAMAN. Would it not make sense—if they move far enough in our direction, to only require 50 percent local content for things that they procure, why should we not adopt that policy for everything we procure?

Secretary GEITHNER. I think, again, the way the system should work is that, in government procurement, we should not provide to China benefits, access to government procurement, that they do not provide in China. That is the basic—that is our policy. Now, that's not enough.

Senator BINGAMAN. Are we implementing that?

Secretary GEITHNER. We are implementing that policy. But that is not enough, because, again, that will still leave us in a position where we are forgoing lots of potential opportunities in China.

So our policy is to encourage China to submit to the disciplines and constraints and fairness provisions of the government procurement agreement so that the vast range of its companies, entities that are government-associated in China, would be eligible to buy goods from the United States.

So it is not enough just to say what we say now, which is to say that we are not going to give you rights to government procurement in the United States you do not give us in China—that is our current policy. It is that we want to get China to do better than that and expand opportunities to the Chinese market to American firms.

Senator BINGAMAN. My time is up, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Bunning?

Senator BUNNING. Thank you, Mr. Chairman.

Mr. Secretary, the 1988 omnibus trade law requires the Secretary of the Treasury to submit a report on exchange rate policy to Congress twice a year. That is the law. The report must be completed by October 15 each year and updated every 6 months. The statute says "the Secretary shall"—I think you are smart enough to know what "shall" means—not "the Secretary may" submit this report. It is now June 10, nearly 2 months after the deadline you missed.

What made you think that the deadline in this statute is optional? And do you understand that you are violating the law by not issuing this report?

Secretary GEITHNER. No, I would not say it that way, Senator. I would say you are right, though, as we announced, we were going to delay, for better or worse——

Senator BUNNING. Whoops, it does not say in the statute that you may delay. It is not optional.

Secretary GEITHNER. Senator, again, I am not sure this will reassure you, but there is a long tradition, unfortunately, over—since that report was—since that law was passed——

Senator BUNNING. Yes. The Bush administration also violated the law.

Secretary GEITHNER. Well, I would not say it that way. They did occasionally delay the report, for a broad range of factors, sometimes just because they were busy.

Senator BUNNING. But, see, we are not like the Communist Chinese government.

Secretary GEITHNER. I agree with you on that.

Senator BUNNING. We make the laws up here. You are supposed to be acting under our laws. The Communist Chinese government is a top-down government. That is why they negotiate with you rather than us, because they know that you cannot make a law, but we can.

So tell me why you are in violation of the law.

Secretary GEITHNER. Well, Senator, as we said publicly at that time, and as your colleagues have noted, we made a decision—we made a conscious decision in early April that delaying would improve the prospects that they would move.

Senator BUNNING. Well, but we did not say you could do that.

Secretary GEITHNER. No. We have the ability to do that. And as I said, my predecessors have done that many times before.

Senator BUNNING. Wrongly.

Secretary GEITHNER. Well, I do not know. I am not sure I would agree with that. But anyway, we made that judgment because we thought it was the best strategy for protecting our interests.

Senator BUNNING. Believe me, Mr. Secretary, from the chairman all the way over to the other end of the table, every time the Bush administration did this, they were criticized out the you-know-what.

Secretary GEITHNER. Well, I am not——

Senator BUNNING. And you are going to get criticized just like they did. You even got criticized by the chairman for not complying.

Secretary GEITHNER. Yes, and I recognize that, sir. I do, yes. And that is the privilege of my office. And I did not mean by saying that, just because my predecessors in the Bush administration had done it, it was the right thing to do.

I know in this case, it was the right thing to do, and I suspect it was—they had their reasons back then, too.

But, Senator, I understand your concerns on this. And everybody is concerned about whether there is a strategy in place that will induce China to move. That is an understandable concern, and I understand that concern.

Senator BUNNING. But you are talking my time away. Headline today in the *New York Daily News*: “Stop Trading Away American Jobs.” It specifically states 2.4 million jobs, mostly industrial and other types of jobs, have been traded away by our government’s policy; not only the last administration, but the current administration.

Now, we have spent approximately $4 trillion to stimulate this economy in different ways, either through Treasury or through the Fed, and we have also had a policy of change that was supposed to be implemented by this administration. And yet, there are 15.5 million people either part-time or full-time unemployed, in spite of all the stimulus.

Was Treasury afraid to issue the report on April 15? Can we assume the report would have finally cited China for currency manipulation, or would it have continued your practice that we saw in the last two reports of ignoring the fact that is obvious and pretending that China is not a currency manipulator?

Secretary GEITHNER. Mr. Chairman, may I proceed and answer?

The CHAIRMAN. Yes.

Secretary GEITHNER. Senator, you are absolutely right to point out that this crisis caused enormous damage to the American economy. It caused more than 8.5 million Americans to lose their job.

Senator BUNNING. Fifteen and a half, if you count part-time.

Secretary GEITHNER. Yes. But by every measure, the American economy is in a much stronger position today than when we took office, and because——

Senator BUNNING. Well, I do not agree with that one darn bit, no matter what you or the Chairman of the Federal Reserve says.

Secretary GEITHNER. Well, I am just saying if you look at the basic numbers everyone uses to measure——

Senator BUNNING. The basic number says the market is going the wrong way instead of the right way.

Secretary GEITHNER. Again, every measure of business confidence, employment growth, innovation, investment, broad confidence in the American economy is substantially stronger today than it was a year ago.

Senator BUNNING. Except in the housing and credit markets.

The CHAIRMAN. Senator Kerry?

Senator KERRY. Mr. Secretary, thank you. Thanks for being here, and thank you particularly for being willing to take on a tough task at a tough time in our country's history. We appreciate your leadership and the difficult decisions that you have had to make in the wake of months of losing 750,000 jobs a month and so forth.

I think the evidence is we have turned it around, but there are, obviously, tough issues ahead of us. I would like to ask you a little bit in terms of the China relationship.

American and Chinese workers and producers, obviously, ought to compete on fair terms, and we all understand that. I think there are two principal things.

I know currency has been brought up by a number of our colleagues, and that is one component of the relationship where a lot of Americans feel they are being put at a disadvantage. But, also, the Chinese government radically favors domestic producers, and it does it in the market through the government procurement practices and, also, through its industrial policy.

I was over there last year, and I remember meeting with a bunch of our companies that were deeply frustrated, because they would go through the bidding process, and there just was such a clarity to the fact that they were written out of any of the winning, even though they were bidding well and competitively and so forth.

I would like to ask you what—I know you just delivered a very frank message to our G–20 counterparts with respect to the global growth being slowed if China does not boost domestic demand and make up for the retrenchment of U.S. consumers.

Help me with both of these: what can China and should China do with respect to the fairness of the playing field; and, two, what should they do with respect to demand in order to—because I think the whole European-global community is going to be stalled, and I think you would agree with me, if China does not do its part with respect to the demand side.

Secretary GEITHNER. Senator, you are exactly right. I think I should start by noting, though, that it is very important what Europe does and what Japan does, too. It is very important to recognize, even with China's extraordinarily rapid growth, Europe and Japan are still much larger, have a much larger influence on the global economy. And, if Europe and Japan are not growing, with domestic demand leading growth, then the risk is that growth around the world will be slower than it could be, than it should be.

China is important to that, too, of course. And again, the most important things for China to do are to put in place reforms that will reduce reliance on exports, increase how much of future growth comes from consumption spending in China and, therefore, results in faster import growth for the United States and around the world. The exchange rate reform is a very important part of that.

On the trade and investment side, to remove/reduce the barriers to market access and to remove the preferences, reduce the preferences that they now provide their domestic companies.

Senator KERRY. Let me just stop you there for a minute, if I can, because I just want to follow-up on it. Obviously, members of this committee have been pursuing these questions with former secretaries for some period of time. This is not a new debate in our relationship.

What indications, if any, are there that you have that China is prepared to undertake these steps or respond to our continual complaints and raising of this issue?

Secretary GEITHNER. Well, on the growth strategy, reducing export reliance stage, you can just look at what they are actually doing in terms of policies and reforms and look at the effect that is having.

For the first time now, you are seeing domestic demand in China—not exports—domestic demand grow much faster than GDP, grow much faster than the overall economy. You are seeing consumption rise substantially as a share of growth. That is promising.

Those effects are exaggerated by the crisis, because exports fell so much in the crisis. But they are encouraging in the sense that, as the global economy recovers, you are seeing growth in China start to move in a way that is, again, promising.

But, of course, our job is to make sure that we reinforce—they reinforce that process.

Senator KERRY. Our exports have risen. Have they risen at a rate that you are satisfied with? And what is the impact of the falling euro on our effort to increase our exports?

Secretary GEITHNER. We are never satisfied on the export front, but U.S. export growth has been leading recovery in the United States. That is one reason why investment is strong in the United States and, as I said, why, even though the manufacturing sector is still operating at a fraction of its former level, that you are seeing the manufacturing sector start to come back.

U.S. export growth to China, as I said, in just, again, the first quarter of 2010, over the same 2009 quarter, is growing at about 50 percent, roughly double—I think more than double the rate of growth in our exports to the rest of the world.

So, again, that is a sign that is really important to recognize, because it shows that growth matters, how China grows matters. That can have powerful effects on how much the U.S. is able to produce and sell to China, and has direct effects on increasing manufacturing jobs, because a huge part of what we sell to China is real things you can see. It is not just high tech and technology and software. It is steel, airplanes, technology. It is, across the American economy, things that Americans are uniquely good at, and China needs desperately. And, because we are the best in the world at making it, we are likely to get a substantial share of that growth, as long as we can continue to make progress reducing these preferences for American producers.

The CHAIRMAN. Senator Wyden?

Senator WYDEN. Thank you, Mr. Chairman.

Mr. Secretary, I supported China's accession to the World Trade Organization. I thought it would be better to have the Chinese inside a rules-based trading system, and I thought it would be good for American exports, and especially Oregon exports.

But there is now a long trail of broken promises that can no longer be ignored. On the point that you have been asked about this morning, indigenous innovation, where 23 Senators joined Senator Hatch and I in a bipartisan effort to get it changed, the Chinese pledged to join the government procurement agreement 10 years ago.

So 10 years ago they promised to do what they are now offering, to use your words, a robust offer to go forward, a decade later.

So here is my question. By my calculation, at least five of your predecessors have been slow-danced by the Chinese. Secretary Rubin, Secretary Summers, Secretary O'Neill, Secretary Snow, and Secretary Paulson have all been part of this process where they push to try to get changes. And somehow robust offers are made, murky language is debated, but we constantly seem to be in this situation where someone in your position gets slow-danced off the dance floor.

My question is, what are you going to do to change that?

Secretary GEITHNER. Senator, again, I think that I would just offer two things as a context. China did move, in the period between 2005 and 2008, to allow a very substantial appreciation in the value of its currency against the U.S. dollar by more than 20 percent.

If you look at what has actually happened to U.S. exports to China over this period of time, there has been, by any measure, dramatic growth, and that growth is something that broad swaths of the American economy have participated in.

Now, I think you are exactly right to point out that, although I think we are better off because China is in the WTO, that there are a range of things that China did not commit to do and has not yet delivered on that are part of that agreement.

That is why we are going to continue to work to make sure that we expand the protections, rights, and obligations the WTO provides to cover things that are very important to our economy and their economy, like government procurement.

Again, China's government plays a much larger role in their economy than is true typically for major economies, and that is why opening up the government procurement market is such an important part of that. And we are going to pursue every effective means we have available to encourage them to do that more quickly than they have in the past.

Senator WYDEN. Mr. Secretary, I would only say, to cite an incremental step along the way, when we have a net loss, that is what our constituents are so angry about.

I mean, take this piracy issue. That has been a flagrant problem for years on end. We sought to change it. Your predecessors, again, the five that I mentioned, have sought to change it. It did not get done.

Now, we are fighting this question of indigenous innovations, flagrant protectionism, and we still have a piracy problem.

Secretary GEITHNER. We do. I agree with you.

Senator WYDEN. So the question is, given the fact that we have a piracy problem, given the fact that we have a protectionist policy with respect to getting our products of the future, the innovation goods, the technology goods into China, and we still are not there on currency, I still want to know at what point you are going to stop the slow dancing. At what point will we take stronger action?

Is there a point, for example, where we say so many jobs have been lost that we have to take stronger action? Because we have heard this before. That is what the chairman highlighted, Senator Grassley highlighted. And we still are being slow-danced.

Secretary GEITHNER. Senator, again, I do not think that I am going to disagree with you on the scale of the challenge ahead or the progress. And I agree completely with what you said. I think it is good to point out that—and you chose a good example—that on areas where they committed a long time ago to move, they still have not moved yet, and that is a problem for the United States of America.

Again, I am happy to work with this committee, but we will look for every effective way we can to try to——

Senator WYDEN. How long, Mr. Secretary——

Secretary GEITHNER [continuing]. Be more persuasive and get more progress.

Senator WYDEN. My time is almost up. How long are you going to give them to take what you cite as their robust offer on changing indigenous innovation, this protectionist policy, before you take stronger action?

Secretary GEITHNER. That is not quite the language I used. And that stuff is the responsibility of my colleagues on the trade side, the Secretary of Commerce and Ambassador Locke, and it is worth listening to their strategy in that case.

The CHAIRMAN. That is my point. It is not coordinated.

Secretary GEITHNER. No. It is coordinated.

The CHAIRMAN. You say you pass it off to Locke. You pass it off to USTR.

Secretary GEITHNER. No, no. I am just saying to be——

The CHAIRMAN. I mean, this is a basic problem that this country faces.

Secretary GEITHNER. No, Mr. Chairman. I am not doing that. I am saying that——

The CHAIRMAN. I do not want to take the time from my colleague, but that is the problem.

Secretary GEITHNER. I am being respectful of the fact that, as you said in your statement, those responsibilities, they negotiate them. They are charged under our system of government as part of a coordinated strategy for——

The CHAIRMAN. I understand that.

Secretary GEITHNER [continuing]. Those negotiations.

The CHAIRMAN. I understand that. I have already made my point. But I am not persuaded, frankly, that we have this coordinated the way it should be.

Senator Wyden?

Senator WYDEN. Thank you, Mr. Chairman. I believe I have made my point. Think about your predecessors. Go back and read their testimony. Literally, I have gone and done it, Mr. Secretary, in looking and preparing for this hearing.

You can take it out, and you can practically change the name of your predecessor, and they say the same things—we are making progress. They cite some modest step. And, after we make one modest step forward, we take three steps in the hole. Our constituents get angrier and angrier, and that is what is fueling, of course, this protectionist drive in this country that I think will be a great, great challenge for the innovators and the future of this country.

Secretary GEITHNER. I agree, and I share those concerns. But, again, what is different, though, what is different is, if you look at the best measure that we have about the benefits we get—and one of the measures we have is the scale of exports to China in things the U.S. creates and makes—those numbers are getting stronger at an accelerating rate, and that is very important.

Now, we have a long way to go. I completely agree with you. But it is not fair to say, Senator, that the results of these efforts over time have not translated into dramatically increased opportunities for American companies.

You talk to any company in the United States that is in a technology that is going to be important to our future, and they have a huge interest, not just in the market they have in China today, but a huge stake in being a larger part of that market, and we are committed to making sure that they are able to enjoy that basic privilege.

The CHAIRMAN. Senator Schumer?

Senator SCHUMER. Thank you, Mr. Chairman.

Thank you, Mr. Secretary.

Senator CORNYN. Mr. Chairman, may I ask? Are we going to be back and forth or just——

The CHAIRMAN. It is the early bird rule.

Senator CORNYN. Well, I have been here for the last hour, so that is why I asked.

The CHAIRMAN. Well, there are other Senators——

Senator SCHUMER. I was here at the beginning.

The CHAIRMAN [continuing]. Who preceded you. They came and they left. Senator Schumer was here at the beginning. I am sorry, Senator, you are down—there are two ahead of you.

Senator CORNYN. Every other committee I have ever been in, Mr. Chairman, we always had gone back and forth as opposed to go all on one side, but you are the chairman and you can——

The CHAIRMAN. No, no. Sorry, Senator, that is not——

Senator CORNYN [continuing]. You can do anything you want.

The CHAIRMAN. That is not a fair description. This committee has an early bird rule that pays no attention to parties.

Next, Senator Schumer?

Senator SCHUMER. And thank you for those bipartisan remarks, Mr. Chairman. [Laughter.]

Mr. Secretary, welcome. As you know, I share the frustration that my two colleagues have just talked about. And it is true, we do—America is gaining exports to China, but every one of us who visits our companies, we hear of China not playing by the rules in every way.

We could gain a lot more exports, and look at all the imports that come in from China. I know you are trying hard. I know you are doing the best you can. But I do not think anyone on either side of the aisle is satisfied with the results, and that is why we need to take stronger action than just diplomatic back-and-forth.

I want to talk about currency. As you know, it is something I have cared about, some might say been obsessed with, for the last several years, 5 years. China's policy of large-scale intervention in the exchange markets and the significant undervaluation of its currency subsidize Chinese exports to the United States and make U.S. exports more expensive.

Billions and billions of dollars, millions and millions of jobs flow to China simply because their currency is manipulated. There is no excuse for it—none. CEOs all over New York tell me they are able to compete with China based on labor cost differences, but a built-in cost advantage of 30 to 40 percent due to currency is difficult to overcome.

I have been talking about this issue, as you know, for more than 6 years. You are the third Treasury Secretary who has come to hear about it. First—and this relates to what Senator Wyden said—we waited for John Snow to make progress, and during his tenure, the Chinese did halt the dollar-yuan peg after Senator Graham and I threatened to push our initial tariff bill to a vote.

Then while Hank Paulson was Secretary, there was some very modest progress for about 2 years. But in mid-2008, China restored the peg, and there is no progress since, which means the level of undervaluation is back to where it was in 2005.

We have not made progress. We take a step forward and then take a step back. So, back in 1975, there was a huge hit on the Hit Parade. It was called "Right Back Where We Started From," by Maxine Nightingale.

Do you remember that one, Mr. Chairman? Jim Bunning does. [Laughter.]

If the current state of our China currency had a theme song, that is where it would be, "Right Back Where We Started From," and we are tired of it.

China's mercantilist policies continue to undermine the health of U.S. industry. So this is fair warning. My colleagues and I, bipartisan, despite the administration asking us not to do it, are going to move forward with our bipartisan legislation to provide specific consequences for countries that fail to adopt appropriate policies to eliminate China currency. And let me just say, we are going to do it soon. Be prepared.

The bill—Senator Stabenow, to my right, Senators Graham, Brown, Brownback, Snowe—Senator Snowe here, as well—bipartisan—will get the currency alignment corrected.

So here are my questions. First, where is the currency report? Why do we always shy away from telling the truth? That is question number one.

Second question, would it not be a good signal for the administration to support the bill that the six of us have, because it will do a lot more to create jobs than lots of the other things that we are doing?

Secretary GEITHNER. Senator, I would just say at the beginning that I believe that your efforts on this over the past 6 years—I would even go back before that—were effective, have been effective at decisive moments.

I recognize, and I think it is very important for China to understand, that your current legislation or the legislation that you helped create in cooperation with Senator Stabenow and others has very broad support, not just on your side of the aisle, but very broad bipartisan support.

I think the strength and the sentiment in the Congress on this is overwhelmingly strong. It is bipartisan, and it reflects, again, how important this is to the United States. So I understand that. I think it is important that China understands that. And you have been very consistent, not just in private with us, but in public, in saying that you believe that it is important for China to understand that Congress will act if China does not act.

Senator SCHUMER. And for the administration to understand and put it in its calculations.

Secretary GEITHNER. Of course, I understand that, and I understand exactly what you are trying to do and what you have tried in the past in this case, and I understand why you think it would be effective.

Senator SCHUMER. Do you disagree?

Secretary GEITHNER. With what?

Senator SCHUMER. That it would be effective?

Secretary GEITHNER. I think it is very important, again, for China to understand not just that other countries care a lot about this, not just that we care about it and the President cares about this, but that there is very broad support, on a bipartisan basis, in the Congress for them moving on this issue, absolutely.

The CHAIRMAN. Senator Stabenow?

Senator STABENOW. Thank you, Mr. Chairman, for this important meeting. And welcome, Mr. Secretary.

Just if I might add to what Senator Schumer has said. We have worked very hard. We have combined two approaches into one, into this bill, that deal with both countervailing duties and anti-dumping. And we have put together something that, as you know, addresses concerns about the WTO. We use the IMF definition as it relates to currency misalignment.

We both direct authority to Treasury and Commerce, and I think it is a very thoughtful approach that addresses concerns of the past. And I would share with Senator Schumer his analysis, as well as yours, that there is broad bipartisan support.

We are tired of losing jobs and losing American contracts as a result of an unfair advantage that gives a lower price on products coming in.

Let me also thank the administration and thank you for efforts that have been taken. The Chinese tire case, the efforts on raw materials, we are seeing efforts, and I appreciate that moving forward.

I do want to speak, though, also, to this indigenous innovations policy. And you and I have spoken about this. As you are hearing, again, from colleagues on both sides of the aisle, this needs to be addressed. And, in fact, Senator Graham and I are moving forward, and I expect strong bipartisan involvement and support on a bill that would address what is being talked about today.

We have given China 10 years to sign onto the government procurement agreement. They have chosen not to do that. And I believe that we need to strengthen your hand in terms of making sure that taxpayer money, Federal dollars, do not go to Chinese companies or the Chinese for products or services until they sign this.

Even though you have indicated that is the current policy, the reality is there are holes in that right now. We know, unfortunately, around the Census, we had two things brought to our attention—key chains and baseball caps, both of which were made in China, bought by the Federal Government for the Census.

So we want to close that, in working with the chairman, working with the committee, and, basically, we will be offering legislation I am hopeful that you will be supportive of, and will work with us on.

It will simply say that, until they sign that agreement, we will not waive provisions in law that relate to Buy America or other provisions that would allow Federal tax money to be used to purchase goods or services from China.

I wonder if you might respond to that.

Secretary GEITHNER. Well, Senator, again, you are absolutely right that this is a very important issue, and I would be happy to take a careful look at that legislation and work with you on how best to promote this interest in opening up that market in China. And I agree, I think it is not enough just to say we are not going to give China rights to our market because they do not give rights in their market. We want them to expand the rights that they offer in China.

I just want to underscore, again, what I have said and compliment you on this, too, which is that, again, an effective strategy in protecting our interests in this area requires not just that we be effective and forceful on the trade side with China, not just that we enforce our laws and our protections, as we are doing very forcefully, but it requires, again, as you have recognized, that we invest in innovation and strengthening the U.S. manufacturing base.

It is important for people to recognize that our fate on these basic questions lies in our hands. It lies in the hands of people in Washington, in the Congress, who have to make decisions about the scale of investments we make in innovation in the United States, and we need to continue to work with you on how best to make sure we are designing those incentives in a way that can have the most effect in strengthening our manufacturing base.

Senator STABENOW. Well, Mr. Secretary, I do agree with your comments that we are seeing at least the last 5 months an uptick in manufacturing. We are seeing some changes.

We know that China is a huge market for us. I had the opportunity to speak at the Global Auto Leaders Summit in Beijing and attend the Beijing auto show not long ago, saw American companies there selling automobiles. The interesting part is the fact that 80 percent of the people who are buying automobiles in China have never owned an automobile, even in their family. So it raises interesting challenges about auto maintenance and driving and a whole series of things that we do not usually see at an auto show.

But I raise this because the good news is, actually, they want to buy American automobiles. The bad news is I saw a vehicle made not very far from my home in Lansing, the Cadillac CTS—great car. It has a 25-percent tariff coming into China, and they do not have a tariff coming into the U.S.

So I support the President's effort to double exports, and I am pleased to be a part of his export council to make that happen. But all of these issues go back to what we are all saying today, which is, we have to have fair trade. We have to have a level playing field if we are going to make sure that the Chinese who want to buy our products are able to do that and we are able to sell to them.

So thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Enzi?

Senator ENZI. Go ahead. Senator Cornyn was here before I was.

The CHAIRMAN. Just to explain things here so there is full transparency. You were here first in the anteroom. That is why the clerk indicated you were next.

If Mr. Cornyn wants to go ahead of you, that is fine, but according to the rules of the committee——

Senator CORNYN. Mr. Chairman, you are in charge. I will defer to Senator Enzi.

The CHAIRMAN. Nobody is in charge here. That is just the rules. So you two can figure out——

Senator ENZI. Thank you, Mr. Chairman.

The CHAIRMAN. You two figure out between yourselves who wants to go first.

Senator ENZI. Thank you, Mr. Chairman. I did not realize that the anteroom counted.

The CHAIRMAN. Yes, it counts.

Senator ENZI. I was getting some additional instructions on the questions.

The CHAIRMAN. Yes, you were here.

Senator ENZI. And I am going to shift gears a little bit, because I have already asked about China's soda ash policy, which could increase exports from the United States if we took care of the VAT tax, and I am interested in what is happening on that.

But I am also interested in what the IRS is doing in a number of instances that I think would make a difference in the economy, not necessarily with China. And I have asked for an appeals officer to be in every State, and I have not gotten a response on that.

But I want to talk a little bit about what is happening on the floor of the Senate right now, which is that we have a tax extender package, and it has some provisions that I do not think have been vetted by congressional tax-writers either in the House Ways and Means Committee or necessarily here, and it disturbs me greatly.

It is mostly dealing with applying the self-employment taxes to the distribution of subchapter S corporations. That tax would apply when the principal asset of the S corporation is the reputation and skill of three or fewer professionals in a professional services corporation.

I know this is fairly technical, but I think it is very important for what we are doing now. And I need to know why that provision is necessary. I think the IRS already has an audit procedure in place to prevent tax evasion. And I have copies of the Internal Revenue Service rulings that address the tax treatment of dividends in lieu of compensation.

I also have pages of case law that the IRS has successfully litigated in the issue of dividend in lieu of compensation and the applicability of employment taxes.

Plus, Congress just codified the economic substance doctrine, which says a transaction must have an economic purpose aside from the reduction of tax liability in order to be considered valid. So my real question is, why can the IRS not do its job with the volumes of legislative, regulatory, and judicial tools it already has?

Secretary GEITHNER. Senator, again, I would be happy to come and talk to you and walk through the merits of this proposal and listen to your concerns about it. As always, of course, we are trying to figure out how to make sure that we provide greater clarity in how companies meet their obligations, to meet their obligations on the tax side, and this is part of that. But I would be happy to come spend some time with you and talk through the details of it.

Senator ENZI. Well, I would appreciate that, because I am concerned about how we are going to define this principal asset. If I am a small accounting firm, but my S corporation owns the building in which the tax practice is located, is the principal asset the accounting practice or would it be the real estate that it held? The current IRS standards for determining the application of the taxes for S corporations is the payment of a reasonable wage. And this new standard, I think, is going to get in the way of these people being able to reinvest. And it is the small businesses that are keeping this country going, and they are the ones that will pick up the unemployment first and make a difference.

But if we start taxing what they could reinvest and doing it differently than we have been doing it in the past, I think we are going to have some real repercussions. And I do not think that the policy really covers the situation where, if three children are shareholders and they do not have anything to do with the services, they are just receiving dividends, which would be the same with any major corporation. But under this proposal, their dividends would be subject to self-employment tax.

So I will look forward to sitting down and visiting with you about this. I do not know if you have any other comments you would like to make.

Secretary GEITHNER. Well, just that I know that members of this committee have spent a lot of time and care on this question in the past, and we will be very careful in making sure we apply the law, and that the IRS designs regulations to apply this law in a way that is careful and sensitive to the complexity involved.

But, again, I'd be happy to come spend some time to listen to your concerns about it.

Senator ENZI. I would like that, because it looks to me like we are doing some things that are already covered by law and have been—that have been established over a long period of time, and I would hate to see that change. And I will look forward to the answers that I have requested on China economic policy, as well as the appeals process.

I would yield back the rest of my time, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Enzi.

Senator Cornyn, here you are.

Senator CORNYN. Good morning, Mr. Secretary.

Secretary GEITHNER. I thought you were here first, by the way, I just want to point out. [Laughter.]

Senator CORNYN. Thank you. I think your eyesight is better than the chairman's. [Laughter.]

Secretary GEITHNER. No. I fully support the chairman and the rules of the anteroom, but I thought you did take your seat first.

The CHAIRMAN [continuing]. I do not like gratuitous comments, Mr. Secretary.

Secretary GEITHNER. I said I fully support the view of the chairman on the anteroom.

Senator CORNYN. Mr. Secretary, I have a question about our debt and who owns our debt. Senator Obama, at the time, in 2006, spoke in opposition to an increase in the statutory debt limit, and he said increasing America's debt weakens us internationally and domestically.

As you know, since that time, the debt has actually increased. Would you agree with that statement by then-Senator Obama that continued growth of U.S. debt will weaken the United States' international standing?

Secretary GEITHNER. Senator, I would say it this way. It is critically important to the economic future of our country, to our economic security, our financial security, to the basic prosperity of Americans that we work together to bring down these fiscal deficits to a sustainable level as the economy recovers. It is absolutely imperative, and we need to work together to make sure that the world has confidence that we are going to be able to do that over time. Absolutely.

Senator CORNYN. So you would agree with that statement.

Secretary GEITHNER. I would agree, again, that the fiscal position of the United States is unsustainable. I mean, again, as you know, just to go back a little bit, when I left the Treasury in 2001, we were paying down the debt. Projected surpluses were in the $5.6-trillion range over the next 10 years. There was a dramatic swing to deficits and huge increasing debt burdens in the ensuing 8 years.

When we came into office, we had a deficit of $1.3 trillion, I think. But we recognize, as you do, I think, that we need to bring restored gravity to our fiscal position, bring down those deficits, and we look forward to working with you on how best to do that.

Senator CORNYN. Secretary of State Clinton has urged Congress to address the Federal budget deficit as a matter of national security. Do you believe there are national security implications associated with our growing national debt, and who owns that debt?

Secretary GEITHNER. Senator, I believe that our national security depends significantly on our economic strength at home. And part of making this country stronger economically in the future, as we are doing, is making sure, again, the world has confidence, as I believe they do, that we are going to be able to find the political will to bring these deficits down over time.

So absolutely, our economic strength is critically important to our national security, and a critical part of our economic strength is, again, making sure that the world has confidence in Washington's ability to bring down these deficits.

Senator CORNYN. Are you familiar with the reported statement of a retired Chinese People's Liberation Army 2-star general, who currently remains working as a civilian at the People's Liberation Army, who was quoted in the news articles as saying that, because of American policy of selling defensive weapons to Taiwan, that the Chinese government could choose to retaliate by dumping American bonds and destabilizing our economy, and using that as leverage? Are you familiar with that report?

Secretary GEITHNER. I am certainly familiar with that concern, but I am not familiar with that specific statement. But, again, Senator, I would say this. Our economic fate and our financial fate as a country lies in our hands. It rests in our capacity to continue to convince the world—not just Americans, but the world—that we have the political will to deal with these things.

Again, it is just important to point out, and this is very important, in the last 18 months, when the world was going through, again, the worst financial crisis in generations, you saw investors around the world seek the basic safety and security of U.S. financial assets, because they had confidence in this country and our ability to act to fix our problems.

We are going to do everything we can to make sure we continue to earn that confidence, because it is so important to our economic strength. And again, a lot of it depends on our capacity together—people in Washington, in this room, and in this body of Congress—to demonstrate that we have the political will to fix what we got wrong, fix what is broken, and bring down these deficits over time.

Senator CORNYN. Mr. Secretary, last night, the Senate passed an amendment called Transparency Requirement for Foreign-Held Debt. The title is "The Foreign-Held Debt Transparency and Threat Assessment Act." And in the findings in the bill, and I would commend it to you and your staff, if you have not had a chance to read it—it only passed last night—it cites the potential economic and national security risks of foreign ownership of our debt, and, of course, China is the number-one owner of U.S. debt.

It asks for transparency and periodic reports from the President and others so that not only the administration, but Congress, can make objective assessments about the risks involved and inform our decisions on how to deal with either reducing the debt or otherwise addressing the matter.

Do you support the basic concept of transparency and periodic reports to Congress and other policymakers so we can deal with this in a realistic way, and in a way that protects both our economic and national security interests?

Secretary GEITHNER. Senator, I am very concerned about—although I understand your concerns, I say this with respect. I am very concerned about the language in your legislation and the signal it sends about the United States. But I very much support the basic objectives of making sure there is broad transparency, information available, not just about our budget deficits and their expected path and our debt burden, but about the level of ownership of those investments.

I am committed to doing whatever we can to improve transparency in that area and, again, happy to make sure that we are responsive to the concerns of this committee and making sure we are reporting regularly on those foreign holdings.

Senator CORNYN. Well, I would be happy to hear of your specific concerns. Of course, this bill passed with a strong bipartisan support, the amendment did and, I think, represents a concern of the Senate that increasing debt and the lack of transparency as far as who owns it and the concentration of that debt in the hands of people on whom we have to depend for their tender mercies, that that is not an optimal situation for the U.S. Government.

So I would be happy to visit with you and your staff about any specific concerns you might have.

Secretary GEITHNER. Again, Senator, I just emphasize what we have in common on this. I think it is very encouraging and very important—and important for the world to see this—that there is broad bipartisan concern about our future fiscal position and broad bipartisan interest, and it is very encouraging to see it.

We have to see it translate into action to make sure that we are working to bring these deficits down as the economy recovers. That is very important to the future of this country, to the future strength of our economy. And, again, we look forward to working with you on how best to achieve that.

The CHAIRMAN. Senator Snowe?

Senator CORNYN. Mr. Chairman, thank you.

Senator SNOWE. Thank you, Mr. Chairman. And welcome, Mr. Secretary.

It is, obviously, an enormous frustration because of the lack of action on the part of our government, frankly, for years. We have been sitting in this committee, I certainly have, for the better part of this last decade, and we are talking about the very same issue, precisely, the same dimensions of our problems with China, the same problems with respect to the manipulation of currency, and actually we have the status quo.

I understand about all of these meetings that you have had in China, but I do not see it reflected in any concrete, specific actions or a timetable that would suggest that they will be revising their currency any time soon.

So beyond soothing words, what can we expect? Frankly, because I represent a manufacturing State—and we have seen the withering of our manufacturing base since 2001 when China joined the WTO—we have lost 10,000 jobs just directly related to China. Nationally, we have lost 2.4 million jobs.

We can expect, according to leading economists, to lose another 1.4 million over the next few years as a result of the manipulation of the currency and, also, subsidy. So I do not exactly know what course of action, what road map we have that is going to make any profound change.

Then, today, on the revised estimates for May, with respect to China's imports, those to the United States climbed 44 percent, up from 19 percent, between April and May, compared to April and May of last year.

So we went from 19 to 44 percent over the same period of time compared to last year. So, obviously, we are moving entirely in the wrong direction.

So I would like to ask you, first of all, what were you encouraged about as a result of the Strategic and Economic Dialogue meeting? You said afterwards that—you were quoted as saying that you were very, very encouraged by the meeting.

Was there anything specific that developed at the meeting that we could be encouraged about?

Secretary GEITHNER. Well, absolutely. In the run-up to these meetings, again, China committed to resume its process of exchange rate reform to allow its currency to begin to reflect market forces. Although, as you have seen, of course, they have not decided when they are going to do that, how quickly, and we want them do it quickly.

They committed to change and modify aspects of this indigenous innovation policy to remove some of the most discriminatory aspects of it and to a process of negotiation to try to resolve our remaining concerns. They agreed to a range of specific commitments to increase opportunities for U.S. investors in China in a range of sectors.

But I agree with your concerns, Senator, and, again, the test of these things is not what people say, and it is not how many meetings you have. The test is what actually happens to the terms and conditions in which U.S. companies compete on and what the results are in terms of increased exports to China.

Again, I think that it is important to note that U.S. exports to China are growing much more rapidly than they are to the rest of the world. Now, we think they can do better than that. They are growing at roughly double the pace of U.S. exports to the rest of the world, in part, because China is just growing so fast. But we do not feel like we face a level playing field now in China, and we need to work together to make that better.

Again, we are willing to work closely with this committee to figure out how we can strengthen the tools we have to get more rapid progress in these questions.

Senator SNOWE. Well, according to today's report, their exports overall are up 48 percent.

Secretary GEITHNER. Yes. You are right. Their exports were up almost 50 percent, and their imports were up almost 50 percent, too. Now, they export more than they import, which is something that is important we change over time, which is why we want to see future growth in China come more from domestic spending, less from exports.

Senator SNOWE. Following the 2 days of the Strategic and Economic Dialogue talks, China's Assistant Finance Minister said the U.S. clearly understands China's stance on the yuan and went on to say that the U.S. understands that China will decide on the exchange rate reforms by taking into account world economic conditions and China's own development trends.

Do you agree that the United States clearly understands China's stance on its currency? What do we understand about it?

Secretary GEITHNER. Well, I do not know what actually he said or what he meant. But what China has said publicly—and I think that is the best measure—is that they are going to resume the process of reform to let the exchange rate reflect market forces.

That will, over time, allow the exchange rate, as it has done in the past, to move up against the dollar. They have said in making that decision about how they move, when they move, they are going to look at what is happening around the world, as in China, but you would expect them to say that. I do not think there is anything particularly interesting in that observation.

So, again, this is something that we think is in China's interest. It is, obviously, in our interest. We think it is in the world's interest. And we hope they recognize how important it is to us that they move.

Senator SNOWE. Well, I mean, what can you suggest to this committee or to the Congress or, more importantly, to the country about where do we go from here? What exactly can we expect from China?

I mean, we are seeing a bleeding of manufacturing jobs. That is the only picture that I know, regrettably, right now. We are not creating jobs in this economy. We have shown no capacity to create jobs, and we are losing manufacturing jobs.

There is just no definitive certainty of policy that is coming out of Washington right now to give anybody confidence, and then you add that in conjunction with what we are dealing with in China.

So what direction can we expect from you in coordination with the other agencies to get this done? I mean, because we clearly are bleeding jobs. It is true frustration, and I just keep hearing, "Well, we are doing great."

I know you do not want to call China a currency manipulator. You can call them misaligned currency, whatever the case may be. But we expect some definitive action. I mean, we are losing thousands of jobs, and that is not going to abate any time soon.

Secretary GEITHNER. Senator, it is absolutely true that the U.S. economy is still showing devastating effects of this crisis in this recession, not just in manufacturing, but across the American economy. We have lost millions and millions of jobs.

But it is important to note that the U.S. economy has now been growing for 4 quarters. We have seen positive job growth across the economy now for almost 6 months. You are seeing income start to increase again, hours worked increase again, and that is happening, importantly, in manufacturing, and this is very important.

We are seeing the beginnings of the recovery. And we have a long way to go, and it is still very, very difficult, very, very hard out there. But you are seeing private investment increase, and the recovery is being led by private investment and by exports.

Now, the best strategy for the United States is to make sure we focus on continuing to provide greater incentives for investment, for innovation in this country, to strengthen our manufacturing base. As part of that, of course, we want to expand opportunities for American exporters around the world, make sure we are using the U.S. trade laws to protect Americans from unfair trade practices, and we are doing that very aggressively.

But you have to do both these things. You have to make sure that we are making this economy stronger at home, which we are making a lot of progress on doing, and we have to make sure we are aggressively protecting Americans from unfair trade practices and opening up foreign markets.

Again, if you look at the best measure of results in this area, which is what is happening to American exports for what is the most rapidly growing market for American exports in the world, they are growing very rapidly because Americans are so good at and so productive and so competitive in producing the things that so much of the rest of the world needs, and that is true across manufacturing.

It is true in high tech, it is true in software, and it is true in agriculture. It is true in all the basic strengths of the American economy. So we are, obviously, going to continue to work, are happy to work with this committee still and figure out how we can make sure that you can reinforce, give us more leverage, more traction in our efforts. But that has to be the basic strategy.

The CHAIRMAN. Do you have other questions, Senator?

Senator SNOWE. Well, can I just make a comment?

The CHAIRMAN. Sure.

Senator SNOWE. Yes. Mr. Secretary, I still do not believe, and I think the evidence is abundantly clear with respect to job creation, that it is just simply not happening. And I just hope that we can get together on a policy, certainly on small business, on trade, because there is no demonstrative change. Job creation is simply not happening, by any measurable standard.

Secretary GEITHNER. Well, I do not think it is strong enough yet.

Senator SNOWE. It is not evident. And I am just telling you, and I hope everybody on the other end of Pennsylvania Avenue understands, we are not creating jobs. It is as simple as that, and it is horrific. So jobless recovery is not a true recovery, and we have to create jobs.

I just do not understand why we have lost the focus. It is very frustrating, and I am expressing all my constituents' frustration and probably Americans' frustration, and I just want it to be heard: we are not creating any jobs.

Secretary GEITHNER. Again, the Senate is in the process of considering a range of targeted measures to help ensure that, as we grow, we see more job creation. Now, you mention, and I think it is very important, not just the trade export agenda, but also small businesses, and we hope that Congress will move quickly, including the Senate, to pass a package of measures to help small businesses not just through the SBA, but though things to support small business lending as a complement to the tax incentives the Senate is now considering.

I think that would be very important, but, again, that is something the Senate has to do. We have proposed it. The Senate has to act, along with the House.

Senator SNOWE. Well, we require leadership on both ends of Pennsylvania Avenue, frankly, and I have been working for 6 months on that small business package, and I have not seen it. And people are suffering, and I just want you to understand, and I think the administration better understand, the President needs to understand, Congress needs to understand. You had better wake up to it.

Secretary GEITHNER. Senator, we understand. That is why——

Senator SNOWE. Because we are just dithering, and I think it is regrettable.

Secretary GEITHNER. That is why we proposed this, as you said, more than 7 months ago.

Senator SNOWE. Yes. Well, and where is the action?

Secretary GEITHNER. Again, we, under the Constitution——

Senator SNOWE. I would be glad to work here day and night. I am dead serious. We better take charge, because a lot of people are suffering, and I think we better understand that and get focused on job creation. And that is just simply not happening here, and it requires leadership on both ends, both in Congress and the White House, to get this done.

Secretary GEITHNER. On that I completely agree.

Senator SNOWE. It is in everybody's interest.

Secretary GEITHNER. And I completely agree with you. And it is something we cannot do alone.

Senator SNOWE. It is in our national interest.

Secretary GEITHNER. And I think, Senator, there will be broad—I hope there will be broad support for the small business package on both sides, not just because of your commitment to it, but there are a lot of colleagues on your side of the aisle who want to be supportive of this.

Senator SNOWE. Thank you.

The CHAIRMAN. Thank you, Senator.

Mr. Secretary, why is it in China's own self-interest to let the currency appreciate? Could you just outline why it is in China's best interest, as well as the U.S.'s best interest?

Secretary GEITHNER. I would put it this way, Mr. Chairman. China, by tying its currency to the dollar, does not have the capacity to run an independent monetary policy. You cannot run an independent monetary policy, meaning set interest rates, set the overall level of conditions so that you do things sensible for growth and inflation in China, if you tie your currency to somebody else's currency. So that is one reason.

A natural part of development is to make sure you have the independence to pursue an independent policy to make sure you are supporting growth and price stability in your country.

A second very important objective is to make sure that, by letting the exchange rate reflect market forces, they are more likely to do a more effective job in encouraging this shift to greater reliance on domestic demand, domestic consumption, and reduce incentives for export, reduce the excess dependence on exports that has characterized China's growth for the last 3 decades.

They recognize that they are getting too big for that to be an effective strategy, and they need to recognize, as we change how we grow, as we save more as a country, that the world is going to be able to rely less on spending by U.S. consumers fueled by borrowing in the United States. So that is the second reason for doing it.

A third reason is that, again, it is very important to China's trading partners. It is very important to the basic sense of fairness and balance that China's trading partners expect. So those are three reasons why I think it is in their interest.

The CHAIRMAN. Well, will it help address the asset bubble?

Secretary GEITHNER. It will give China more—part of flexibility to run an independent monetary policy is the flexibility to act to contain the risk of inflation or asset price inflation in China, and, again, you have heard many Chinese officials speak to that imperative as one rationale for moving on the exchange rate.

The CHAIRMAN. Now, when you talk to them, do they indicate they understand in some degree and might agree with those reasons?

Secretary GEITHNER. Absolutely.

The CHAIRMAN. What are your thoughts on delinking the strategic policy of the United States from economic components of our bilateral relationship?

Secretary GEITHNER. Well, Mr. Chairman, I think——

The CHAIRMAN. There are many who think that economic issues are not adequately pursued because they are linked too much with U.S. strategic concerns. For example, making progress on economic issues is linked with trying to influence China to vote appropriately in the U.N. Security Council with respect to Iran sanctions or to encourage China to act appropriately with respect to North Korea.

Some think, and I tend to agree with this, that economic policy is a stepchild, a second cousin. It takes a back seat to larger strategic interests.

Why not just de-link? Why not just pursue our economic policies, because they are so important and, as I mentioned earlier, I think, in some ways, are more important, because the more important we are as a country economically, the stronger we are as a country economically, the more we project power, the more we project results that we want overseas.

Why not de-link?

Secretary GEITHNER. Senator, I completely agree with you on this. We cannot pursue our national security interests with China without pursuing our economic interests with China. It is very important for people to recognize that.

It may have been a concern. People may have concerns about U.S. policy in the past, getting that balance right, but it is not true now. The President believes very strongly that we have to pursue these two things together, and that is what he is doing. And I can tell you from direct experience these last 18 months that we have put these economic issues at the center of our concerns in the relationship with China.

Now, of course, countries have broader interests, too. We have to recognize all those interests, too. But I completely agree with you that we cannot pursue our national security objectives effectively with China without also pursuing our economic interests.

The CHAIRMAN. Now, as you pursue our economic interests, do you have deadlines? For example, with the Strategic and Economic Dialogue, you indicated, I think, that China committed to address its indigenous innovation practices, and to address some procurement issues.

Do you have a deadline for addressing these issues?

Secretary GEITHNER. Our basic deadline is always the sooner, the better, and yesterday would be better.

The CHAIRMAN. We all know that.

Secretary GEITHNER. But in the agreements reached as part of this dialogue, there are, in a number of areas, very specific deadlines, time-tables for actions, objectives for actions for follow-through, as you would expect.

Now, it is not true everywhere, but in a variety of important areas, there are specific objectives for progress, and there are specific time-frames identified for next steps.

The CHAIRMAN. All right. Now what happens? What is the backup plan if they are not met?

Secretary GEITHNER. We try to be as persuasive as we can.

The CHAIRMAN. That is more talk.

Secretary GEITHNER. No, not necessarily.

The CHAIRMAN. If it is not necessarily, what is it?

Secretary GEITHNER. As I said, we have a variety of basic tools and instruments and protections under U.S. trade law and in the WTO. Those are some forms of leverage. We use those where we think they are going to be effective, and we will continue to do that.

Again, we try to use all means available that we think are going to be effective in convincing them to move on things that are important to the United States, as you would expect us to do, and we are going to continue to do that.

Again, I am happy to work with you on how best to make sure that those tools are as effective as possible.

The CHAIRMAN. What about on patents? That is one of the most glaring areas of discrimination.

Secretary GEITHNER. I could not agree with you more. I could not agree with you more. It is, for so many people, in some ways, like the exchange rate: it is a basic symbol of commitment by the government to play by a basic set of rules that we all play by.

I completely agree with you. And it is completely unacceptable to the United States that you continue to see, despite improvements in the laws, such inadequate enforcement, such inadequate deterrence of basic piracy and theft of intellectual property in the United States.

Again, I am happy to work with you and this committee on how to make sure we can strengthen the tools available to——

The CHAIRMAN. But does the administration have a plan to address it?

Secretary GEITHNER. Again, my colleagues at U.S. Chamber of Commerce are working very hard on how to improve this, and I am sure they would welcome a chance to come brief the committee on where they think they are and what is ahead.

The CHAIRMAN. Are you aware of that plan?

Secretary GEITHNER. Senator, I do not think it would be fair for them for me to speak to their strategy on this stuff, but again, they completely agree with the objectives. It is important to the President. The President sets these priorities, and he has made it clear to them that he wants to see progress in these areas, and they have a very detailed, extensive, intensive negotiating process in the Joint Committee on Commerce and Trade to try to work through these things.

Now, what we try to use at these higher level meetings, we try to make sure that, when the President meets with the head of the country and we meet as Secretary of the Treasury and Secretary of State, we are reinforcing that and making it clear that they understand it is important to us, too.

Again, we are happy to work with you on how best to make sure that we——

The CHAIRMAN. China agreed to the benchmarks in the Joint Committee on Commerce and Trade plan? As I hear it, there is a plan with other agencies. Commerce, for example, has a plan.

Secretary GEITHNER. In some areas, again, they have—you should ask them to come up and talk to you about it, but they have a set of detailed objectives for making progress, and they have a bunch of negotiations ongoing in specific areas to try to get more progress in this area.

But, again, you are right to underscore this, and this is the way I approach life, too. What matters is not whether you meet, agree to have a meeting, sit down and talk. What matters is whether that results in changes in policies that matter to us.

Again, you can measure very directly whether this is getting better, and, in the intellectual property area, particularly in software or in entertainment products of the United States, it is still terrible.

The CHAIRMAN. Yes.

Secretary GEITHNER. It has gotten better in some areas, but in these areas, it is still, based on all measures, it is still terrible.

The CHAIRMAN. Yes, it is. In prior trade laws, such as Special 301, countries were put on watch lists and, if certain actions were not taken, USTR would begin enforcement actions against those countries.

As I recall, that worked very well. It got countries' attention.

I would just encourage you to be thinking of ways to come up with a similar procedure,

Secretary GEITHNER. I agree with you about that history. And one of the WTO cases against China that we recently won was a copyright case, and U.S. companies seem to be having a little success in China in winning cases in Chinese courts, which would be helpful, too.

But, again, we are looking for ways to try to make sure that we can use these tools we have in the WTO to be as effective as possible in getting better progress in these areas.

The CHAIRMAN. When does Treasury plan to issue its report on the currency?

Secretary GEITHNER. At the right moment.

The CHAIRMAN. When is that?

Secretary GEITHNER. It will be at that time that we decide is the right moment.

The CHAIRMAN. Can you help us out a little more?

Secretary GEITHNER. Do we need what?

The CHAIRMAN. Can you help us out a little bit more and be a little more precise?

Secretary GEITHNER. Well, I have not decided yet. As we said when we announced in April that we were going to delay, as, of course, has been done many times in the past, we made it clear we wanted to take advantage of this window between then and the G–20 meeting to see if we could make some progress in the area.

So once we get through the G–20 meeting, we will take some stock.

The CHAIRMAN. Is delay in part to try to encourage China to take action we want in the U.N. on sanctions, because we want China to take other action with North Korea, for example?

Secretary GEITHNER. I would say it this way, Mr. Chairman.

The CHAIRMAN. But we have not de-linked.

Secretary GEITHNER. Everything we are doing in this area is designed to improve the chance that China moves on things that are important to the United States. And our strategy is going to be guided, again, by what is going to improve the chances that they move on things that matter to the United States.

Now, again, we may disagree occasionally on what is the best path to get there, and you are going to judge us by what happens. I completely agree with that. And we will have to see. But after the G–20, we will take stock a little bit and see what makes sense.

The CHAIRMAN. It sounds like you are not de-linking. It sounds like these are all linked.

Secretary GEITHNER. Linked to what?

The CHAIRMAN. The currency reports are linked to——

Secretary GEITHNER. No, no. I did not mean to imply that. I am saying, look, we are a Nation with interests. We have interests on the national security side. We have interests on the economic side. We are pursuing those together, as we should, as a country, and I think you would do that in our shoes, too.

We are going to figure out, again, the most effective way to make sure we can get as much progress in those things as we can. China is a sovereign nation. It has interests, too. Our job is to try to make sure how—how we can make sure that we are getting them to be responsible on things that are essential to the United States.

The CHAIRMAN. Well, I understand all that. I, frankly, I hate to use the phrase—"lead the effort"—but we did need that kind of leadership to end the annual conditional MFN status for China. It needed to be eliminated, and we finally, finally—I have a lot of scars to show how hard that was—eliminated that and then replaced it with PNTR.

I pushed hard for PNTR for China, very hard. I thought it was the right thing to do. I remember talking personally to President Clinton about it, because I thought it made good sense for China to be much more part of the world community, a member of WTO, et cetera.

But China now has to live up to its obligations. It has to be a responsible stakeholder; not just a stakeholder, but a responsible stakeholder. And I believe that, generally, no country altruistically, out of the goodness of its heart, ever lowers a trade barrier. They do not do that. It requires leverage.

It is up to you, the administration, to find that leverage to show that we will undertake certain actions if China does not do what it should do. So I just urge you very much to find that leverage. It is not going to happen without leverage. No country altruistically, out of the goodness of its heart, ever lowers a trade barrier; they just do not.

We have to find ways to encourage them to do the right thing in our mutual self interests.

Senator Enzi?

Senator ENZI. Thank you, Mr. Chairman. And I want to thank you for the comments that you have made and the questions that you have just asked. I think they are very, very pertinent and things that we need an answer to.

I want to thank the Secretary for all of the times that he has appeared before us and your tremendous ability to both answer questions and to deflect questions. [Laughter.]

Secretary GEITHNER. I am sorry. I will not respond to that, but——

Senator ENZI. And I understand that sometimes the deflection has to do with a national strategy and the need to keep that strategy private rather than public until the appropriate time, and I appreciate that.

I will have some questions that I will submit in writing that probably fall more into that category, but they are something that I would like to have a little bit more direction on as we go into some of these things.

I also want to thank the Senator from Maine, Senator Snowe, for her emphasis on small business and would hope that you would encourage the administration to bring that to the forefront. We have a lot of issues that we are talking about out there that I think are long-term issues that probably will not result in a lot of action or resolve, but that small business package has potential, and it is bipartisan, and that is where the jobs are created in this country.

One of those small businesses is the soda ash business that I keep bringing up, and I would ask if you would kind of elevate that in these strategic and economic development talks, the dialogues, so that it could actually be emphasized a little bit. I think with some emphasis, that that might be a place that we could make a huge difference in the economy.

As a final comment, I hope that our discussions on the small business, the S corporation tax can happen soon, because that tax extenders package could really be a detriment to the small businesses, not just in figuring out what it means, which is a major problem, but in the way that it will affect their ability to reinvest in new jobs.

Secretary GEITHNER. Mr. Chairman, can I just say that I very much appreciate your support on the small business side and Senator Snowe's support. This package of small business measures includes a very powerful package of tax incentives for small businesses. It includes a substantial increased expansion, carefully designed, of the Small Business Association credit programs. And it includes a new lending facility designed to make sure that community banks across the country are able to expand lending to small businesses and, as part of that, includes a targeted set of programs that go directly to States to also help support small business lending.

So it is very carefully designed, it is very well-designed. It is not expensive, and we think it has the highest return on use of scarce resources of almost any of the programs we have looked at. So we hope we can move on it, and I agree with you that it is a critical priority.

Senator ENZI. Well, the incentives for small business, of course, will help, but that package seems to be way off in the future, whereas this detriment to the small business, this tax that we will be undoubtedly voting on next week——

Secretary GEITHNER. Well, Senator, I think the intention of the leadership in both houses is to move on this small business package very quickly.

The CHAIRMAN. If the Senator will yield. This is exactly—the only thing that is holding it up, frankly, is the extenders bill. When that is out of the way, we are going to jump into the small business and get that passed, because it is so important for the reasons you both indicated.

Senator ENZI. Well, I am concerned that the tax extenders package, with the taxes on the S corporations, is going to offset any gains that we might get by doing the small business bill.

The CHAIRMAN. On that, too, Senator, if I might just say, I deeply understand and appreciate the concerns you raised about that provision. It came over from the House to us. It needs some work to address some of the concerns you mentioned.

The whole purpose of it, though, is to prevent an abuse that very significantly occurs among some professional, some S corporations, where the management will give itself just a very small salary, then pay itself large dividends, to avoid payroll taxes, to avoid FICA, as well as the Medicare payroll tax. And we are just trying to correct an abuse there, but in a way that is not burdensome.

Senator ENZI. Well, I think I brought a number of documents that are designed to make sure that people are getting a reasonable compensation, which will eliminate—I think everything is in place to eliminate the fraud part of it. I think that the tax extender package is more designed to provide offsets and add liability to those corporations and actually violates the economic substance document, the doctrine that we mentioned earlier.

The CHAIRMAN. I am very sensitive to your concerns.

Senator ENZI. Thank you. Thank you, Mr. Geithner—Mr. Secretary.

The CHAIRMAN. Well, thank you, Mr. Secretary, for spending a couple of hours with us. And we have a lot of work ahead of us, and let us make history. Let us get some results here.

Secretary GEITHNER. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. The hearing is adjourned.

[Whereupon, at 12:02 p.m., the committee was adjourned.]

APPENDIX

Additional Material Submitted for the Record

Hearing Statement of Senator Max Baucus (D-Mont.)
Regarding the U.S.-China Economic Relationship

According to chaos theory, a butterfly beating its wings in America might start a hurricane in China.

As we emerge from the chaos of the worst financial crisis since the Great Depression, the relationship between what happens in America and what happens in China is as important as ever.

The U.S. and Chinese economies are increasingly interconnected. As consumer demand in the United States declined, China's exports fell dramatically. And as the United States fell into a deep recession, China's economic growth slowed significantly.

Now both the United States and China must recover and rebuild. But we cannot do so in isolation. China has failed to recognize this fact.

For too long, China's economic policies have focused on unsustainable export-oriented growth at the expense of American ranchers, farmers and workers. For too long, China has permitted the theft of U.S. intellectual property at the expense of American innovators. And for too long, China has protected its domestic industry at the expense of American businesses and exporters.

America can no longer afford to be complacent. We no longer have the luxury of pursuing failed approaches. We must rethink the U.S.–China economic relationship. We must act, not just talk.

China is the world's fastest growing economy. In 2009, China's Gross Domestic Product grew by almost nine percent. China's per capita GDP nearly doubled from 2005 to 2009. Consumer spending in nearly a quarter of Chinese cities is expected to double over the next ten years.

China is fueling global economic growth. And as China develops a new role in the global economy and global institutions, we must develop a new approach to a new China.

Last month's Strategic and Economic Dialogue (S&ED) meeting reinforced the need to rethink and revitalize. We entered the S&ED with expectations that China would take concrete action to address its currency and so-called "indigenous innovation" policies. We walked away with promises to engage in further discussions. Dialogue is important. But discussion does not equal action.

By seeking a new approach, we do not seek to start a hurricane. We do not seek to succeed at China's expense. Rather, we seek to foster long-term mutual cooperation, recognizing that in the short term we may need to take strong unilateral and multilateral action. We seek to ensure the long-term economic progress of America as well as China.

But we must address long-standing issues in our relationship. For example, a prominent CEO of a U.S. software company recently noted that many Chinese companies will legally purchase only 25 percent or less of their software needs. They illegally pirate the rest. We must take new steps to address persistent problems.

I propose four ways to redefine America's approach to U.S.–China economic relations.

First, the United States must formulate a comprehensive strategy to better manage our bilateral U.S.–China economic relationship. Different U.S. agencies are pursuing different, uncoordinated strategies. We can no longer approach our economic relationship in this piecemeal way.

We must craft a holistic strategy, orchestrated and led by the White House, to develop a strong, mutually beneficial U.S.–China economic relationship. In doing so, we must recognize that our bilateral economic relationship is an equal complement to our bilateral strategic relationship. Our economic relationship has taken a back seat to our strategic relationship for too long.

Second, we must approach China's economic policies as a global concern, not just an American concern. China's currency misalignment, ineffective protection and enforcement of intellectual property rights and industrial policies such as indigenous innovation hurt businesses around the world, not just U.S. businesses.

We must work multilaterally with key trading partners such as the European Union, Korea, and India to make it clear to China that the world is watching and is united in its concern. And we must effectively address these concerns through key multilateral fora such as the G-8 and G-20.

Third, we must look carefully at the tools offered by international institutions such as the International Monetary Fund and World Trade Organization. Where these tools provide effective recourse, we must be willing to aggressively pursue it. Where these tools are not adequate, we must work to strengthen them.

Fourth, we must be willing to take strong unilateral action. In April, the Treasury Department postponed publication of its biannual currency report until after the S&ED and G-20 meetings. As I noted, we must work multilaterally to resolve the currency issue. But we cannot expect our trading partners to take strong action if we are unwilling to do so.

America must be willing to take the lead, even as we ask others to join. As part of a coordinated strategy, America must take steps now to address the U.S.–China economic relationship.

The Treasury Department must negotiate effective solutions to address China's currency manipulation. The Commerce Department must apply a rigorous analysis when investigating antidumping and countervailing duty petitions regarding Chinese imports. The Office of the United States Trade Representative must take all necessary steps to improve China's protection and enforcement of U.S. intellectual property rights and to suspend China's discriminatory indigenous innovation policy. And Congress must assess whether the administration needs stronger enforcement tools to address the U.S.–China economic relationship.

With these efforts, I am confident we will build an effective new approach for this new China. We can recast the U.S.–China economic dialogue. And by doing so, both the United States and China can recover from the global hurricane to build interconnected economies that are stronger than ever before.

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TESTIMONY OF TREASURY SECRETARY TIMOTHY F. GEITHNER

June 10, 2010

Chairman Baucus, Ranking Member Grassley, Members of the Committee, thank you for the opportunity to testify about China.

I want to talk today about the opportunities, and challenges, in this important relationship.

Our policy is to expand the opportunities provided to Americans from a growing China. We want future growth in China to result in more exports from the United States and more jobs in the United States. We want China to change those policies that disadvantage American companies and to provide greater protections for American intellectual property. We want China to provide a level playing field for the products of American workers and investments by American companies. And we want China to change its growth strategy to rely less on exports and more on consumption.

The President is committed to these objectives. We are seeing some progress, but we still face many challenges.

China is fast on its way to becoming the world's second largest economy and could potentially become the largest foreign market for U.S. exports of goods and services. China is consuming and importing more – including from the United States. As a result, China's overall trade surplus has fallen sharply, by roughly half as a share of its economy, over the last two years. A substantial part of this change is the result of China's strong stimulus policies and broader policy actions to strengthen domestic sources of growth.

As we emerge from the global financial crisis, U.S. exports to China have rebounded much more rapidly than overall U.S. exports, and are now running 20 percent above their pre-crisis levels. U.S. exports to China are growing much more rapidly than exports to the rest of the world. China is already the third largest destination for U.S. merchandise exports, up from 11th place in 2000.

In fact, in the first quarter of 2010, U.S. goods exports to China rose almost 50 percent compared to the same period the year before, while U.S. exports to the rest of the world have risen by less than 20 percent. During this period, we have seen double digit growth in a variety of export sectors, ranging from high-end manufactured goods and chemical products to agricultural goods like soybeans.

China is an important market not only for large U.S. firms, but also for small- and medium-sized enterprises (SMEs). The latest data show that small businesses directly account for roughly a third of the value of U.S. exports to China and they contribute a substantial part of the value of exports by our large companies as well.

This is good for American business and good for American jobs. China is a key source of export-based jobs around the country, from Washington and Oregon on the Pacific coast, to

Texas and Louisiana on the Gulf, to New York and Pennsylvania on the East coast. And the potential is there for much more growth going forward.

The broad strength in U.S. exports to China and the world is one reason why we are seeing strong growth in manufacturing. The manufacturing sector has expanded now for ten consecutive months. In April, manufacturing employment growth was faster than in any month since August 1998. Manufacturing employment has increased by 126,000 jobs this year.

Over time, U.S. imports from China have increased very rapidly, but much of this growth is the result of China replacing other foreign producers. China's exports to the United States have gradually replaced those of other countries, particularly in Asia. At the same time, a substantial share of the value added in the products we import from China comes from components manufactured in other countries in Asia.

China has to be a key part of any strategy to increase U.S. exports and jobs. Our strategy to improve the balance of benefits for Americans in this relationship focuses on change in three important areas: trade and investment policies, including China's policies to favor domestic producers and domestic technology; economic reforms to reduce China's reliance on exports and encourage more import growth; and exchange rate reform.

Promoting a Level Playing Field

One of the most important objectives of the S&ED and our broader engagement is to expand economic opportunities for American workers and firms through trade and investment with China. That is why we have urged China to take action to provide a more level playing field for American firms that export to China, that operate in China, and that compete with Chinese producers in our markets and around the world. We have asked China to make meaningful market access contributions in the WTO Doha Round negotiations that will result in new trade flows for U.S. manufacturers, farmers, ranchers, and service suppliers. We are working to improve protections for U.S. intellectual property and to reduce piracy affecting the U.S. software and entertainment industries. At every opportunity, the Administration will continue to push these important trade issues in various forums, including the Joint Commission on Commerce and Trade (JCCT).

It is especially important to the United States that the large number of policies China has put in place to promote what it calls "indigenous innovation" – including government procurement preferences, enforcement of intellectual property rights, design of product standards, and proposed new preferences and other forms of government support for specific products designated by the Chinese government – do not disadvantage American workers, firms, and technology. American firms operating in China should have the same rights enjoyed by Chinese companies, just as Chinese firms have in the United States. This is a simple principle of fairness.

In response to some of our concerns, China has acted to modify its policies to promote innovation and technological advancement. China published a draft measure proposing revisions to some of the troubling elements of its product accreditation system, and we will continue to work with China to address our concerns. At our strong urging, China has also pledged that its innovation policies would be consistent with the principles of non-discrimination, market competition, open trade and investment, strong enforcement of intellectual property rights, and leaving the terms of technology transfer, production processes, and other proprietary information to agreement between individual enterprises. Sharing the concerns of U.S. companies about China's innovation policies, we secured agreement from the Chinese to establish a high level process over the coming weeks and months, led by my colleagues Ambassador Kirk, Secretary Locke, and Science and Technology Director Holdren, to find ways to address the unresolved issues, and to take into account the results of these discussions in formulating and implementing their innovation measures. While we still have more work ahead, we now have agreed to a broad set of common principles and a framework on which to move forward and resolve our differences.

The best way to limit China's use of government procurement preferences to promote its industrial policies is having China join the rules-based WTO Agreement on Government Procurement. China has now committed to submit a revised offer by July 2010, and just before the S&ED, it issued for public comment draft regulations on the determination of "domestic products" under its government procurement law containing a 50 percent local content provision.

China has also committed to revising its investment catalog and to encourage and expand areas that are open to foreign investment, including certain services, high-technology goods, high-end manufacturing, and energy saving products. Finally, China also agreed to facilitate foreign investment by narrowing the scope of its investment review and approval processes.

The Administration will apply forcefully the full remedies available under U.S. law to address unfair trade practices, such as injurious dumping and subsidies. The Department of Commerce has been investigating antidumping and countervailing duty complaints against Chinese goods, consistent with U.S. law.

We will continue to apply the full arsenal of tools available to ensure that China meet its international trading obligations, including in the WTO. Last year, we reached a favorable settlement in a WTO dispute in which we challenged what appeared to be prohibited export subsidies. We also 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. 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. The United States is also now pursuing another dispute on raw material export restraints.

Economic Reforms to Reduce Export Reliance and Promote More Balanced Growth

The United States and China recognized two years ago that the pattern of growth in both countries and globally was unsustainable. While we both acted aggressively to stimulate our economies and stave off the worst of the financial crisis, we also both took actions to create a more balanced, sustainable base for strong growth in the future.

In the United States, we are saving and investing more, and it is important that future growth is less reliant on consumption financed by excess borrowing.

As we make this shift here, China and other large economies that have traditionally run large trade surpluses need to shift their growth model to rely more on domestic demand, rather than exports, to drive growth. Without this shift, China and the world economy will grow below the potential rate of growth.

Recognizing this imperative, at the first Strategic and Economic Dialogue in July 2009, China and the United States agreed to promote fundamental rebalancing of the drivers of global economic growth. And that agreement paved the way for the G-20 to embrace this goal, and launch a new global initiative.

For its part, China has begun to make progress. It used its sizable stimulus package to reinforce the start of this transition to consumption-led growth. Rather than focusing on expanding manufacturing capacity, which would create further pressure on firms to increase their exports, China has instead concentrated its stimulus funds in measures to increase household income and in infrastructure projects, particularly in its less prosperous interior regions.

Other features of China's stimulus and reform that will support consumption-based growth are:

- *Increased public spending on health and education and strengthening of the safety net.*
- *Higher wages and real income for ordinary people.* This includes recent increases in provincial minimum wages of 20 percent or more.
- *Greater transfer of the substantial corporate sector savings to households*, through higher wages and interest rates, along with corporate governance and dividend reform.
- *Gradual liberalization and opening of important service sectors,* such as health, education, telecommunications, and logistics.
- *Financial sector reforms* to promote a greater share of lending to consumers and small businesses, and a greater variety of financial products for households to save for education and retirement and insure against risks.

As a result of these ongoing efforts, over time Chinese households will be able to earn more and buy more, including American goods and services.

In part because of these policies, domestic demand has been growing much faster than overall GDP growth, consumption growth is contributing a much larger share of overall growth than in the past, and imports, including from the United States, have been growing faster than overall growth in global trade.

This shift has been exaggerated by the effects of the crisis on exports, and it is important that this shift be sustained through continued reforms as the global economy recovers and as China moves to withdraw its various stimulus programs.

Exchange Rate Reform

Reform of China's exchange rate is critically important to the United States and to the global economy. And it is in China's own interest to allow the exchange rate to reflect market forces.

President Hu stated in public this month that China is committed to the reform of the exchange rate, and stated that reform is a key part of China's strategy to produce more balanced growth, growth that relies more on domestic demand.

A stronger renminbi (RMB) would benefit China because it would boost the purchasing power of households and encourage firms to shift to production for domestic demand, rather than for export. A more market-determined exchange rate also means that China will be able to pursue a more effective, independent monetary policy, which is particularly important now, with China's economy facing a risk of inflation in goods and in asset prices.

In July 2005, China shifted its exchange rate regime from a fixed rate pegged to the U.S. dollar to a gradual appreciation. Over the three years from 2005-2008, the RMB appreciated by about 20 percent against the U.S. dollar, and by about nine percent on an average trade weighted basis.

However, as the global financial crisis deepened in the summer of 2008, the Chinese authorities decided to re-peg the RMB to the U.S. dollar, and the RMB-dollar exchange rate has remained essentially unchanged over the past two years. During the early months of the crisis, most emerging market currencies depreciated against the dollar, and many remain lower than their pre-crisis values. And the dollar overall rose in value against most currencies as investors sought the safety of U.S. financial assets.

As a consequence, even though the RMB was held essentially fixed to the dollar over the past two years, China's currency appreciated by about nine percent against the weighted average of the currencies of its trading partners. Europe is China's largest export market, and 45 percent of China's appreciation on a trade-weighted basis, since July 2008, has occurred in the last seven weeks, due primarily to the sharp appreciation of the U.S. dollar against the euro in May.

China's exchange rate policy affects all of China's trading partners. Because of concern about the impact on their competitiveness, many emerging markets have been intervening in foreign exchange markets in order to resist upward pressure on their exchange rate. Intervention in the rest of emerging Asia outside China has been at record levels over the last nine months. The distortions caused by China's exchange rate spread far beyond China's borders and are an impediment to the global rebalancing we need. A more flexible RMB will allow market forces to play a more active role over time in facilitating strong, balanced and sustainable growth globally.

Conclusion

Chairman Baucus and Ranking Member Grassley, we will continue to engage forcefully with China to expand the economic benefits of the relationship for American workers and companies.

The Administration is committed to use any and all effective means of expanding opportunities for U.S. workers and firms and promote U.S. interests in our bilateral economic relations.

The United States and the American people have benefitted, and must continue to benefit, from strengthening our economic relationship. We cannot afford to miss the opportunity that China's growth presents, not to shrink from the challenges it poses.

Our ability to gain these benefits will depend significantly on the policies we pursue to strengthen our economic fundamentals at home. We are making very substantial investments in innovation, in education, in research and development, in basic science, in new energy technologies and in investment incentives. These investments, along with actions to restore fiscal sustainability as the economy recovers from crisis, are critical to the future to growth in the United States. They are essential to strengthen the manufacturing base of the American economy and to provide greater opportunities for American workers.

The economic strengths of America and China are complementary. Just as America benefits from China's growth, China benefits from ours. American companies are leaders in innovation. We are exceptionally good at making the goods and providing the services that the rapidly growing parts of the world – including China – need.

Right now our job is to help the private sector do what it does best. Our job is to help American businesses expand. Our job is to make sure that as China continues to develop, it does so in a way that does not disadvantage our firms.

We will work closely with this committee and your colleagues in Congress to support these goals. We may sometimes have different ideas on how to achieve that aim. But where there is no difference is in the belief that our workers, our companies and our innovators must have the chance to compete fairly on the global market, especially in China, and that, given a level playing field, we will compete and thrive.

Questions for the Record
Treasury Secretary Timothy F. Geithner
June 10, 2010

Questions from Chairman Max Baucus (D-MT)

1. **The U.S. Government maintains various dialogues with China, including the S&ED and JCCT. And these dialogues are led by different agencies. But the Obama Administration has not developed a comprehensive strategy to deal with China's emergence as an economic powerhouse. I think the Obama Administration should pursue a new White House-led strategy to deal with U.S. – China economic relations and to identify U.S. leverage to persuade China to resolve our outstanding concerns. What is the Obama Administration's plan for developing a comprehensive strategy to address the U.S. – China economic relationship? How should we measure progress in the U.S. – China economic relationship?**

The White House currently plays an active role in overseeing a comprehensive strategy for China. It regularly convenes meetings to ensure that USTR, Commerce, the State Department, the Treasury Department, and other relevant agencies are coordinated in pursuit of common objectives and are pursuing the agreed upon objectives with the right basic sense of priorities.

In all our economic engagement with China, whether in the S&ED, the JCCT, the G-20 or other multilateral fora in which China participates, the key objective of this Administration is to maximize the benefits of our bilateral economic relationship for U.S. firms and workers. We do this by reducing Chinese trade and investment barriers so that U.S. firms have the same access in China as Chinese firms, and ensuring strong, sustainable and balanced global growth in which major surplus economies like China consume more, providing greater opportunities for U.S. exports.

Progress in the U.S.-China economic relationship hinges on the success we achieve in making sure U.S. firms and workers share fully in the benefits of our bilateral relationship. Using that metric, and due in large part to coordinated action across agencies, concrete progress can be seen in:

- China's decision to increase the flexibility of its exchange rate, although the true test now is how far and how fast the Chinese will move;

- Getting China to begin to make changes to some of the troubling elements of its indigenous innovation policies, including by committing to a set of principles to guide its innovation policies that, if implemented, will help us address the concerns that we and other trading partners have about the direction of China's policies in this area, as well as to launch an expert- and senior-level dialogue on innovation policy; and

- China's submission of a revised offer to join the WTO's Agreement on Government Procurement (GPA) earlier this month, although we will need to continue to work with the Chinese to ensure that they provide coverage that is in line with that of other GPA members.

2. **I am worried that the United States has been subsuming U.S. –China economic priorities, such as currency and indigenous innovation, to diplomatic concerns. And I am concerned that we have not made progress on key issues in our economic relationship as a result. What are your thoughts on delinking the strategic and economic components of our bilateral relationship? Will this help prevent China from trading progress on economic issues for progress on strategic issues?**

   Progress on economic and strategic/security issues are complements, not substitutes for one another. A strong, productive, and mutually-beneficial U.S.-China economic relationship provides an important foundation for making progress in other areas of the broader relationship.

   The S&ED provides an important means for signaling our policy priorities to the Chinese, both on economic and security issues. While every forum can always be made stronger, the S&ED has demonstrated that it can produce tangible results on these priorities.

   On June 19, 2010, China announced that it was returning to an exchange rate regime that would be more flexible and more market-based. China's policy shift is a significant development, but what matters is how far and how fast the renminbi appreciates. And the progress that we made in getting China to begin to make changes to its indigenous innovation policies, under the leadership of Secretary Locke and Ambassador Kirk, constitutes another example of concrete progress.

3. **Recent reports indicate that China is uncertain about the role it should play in the international economy and international institutions. What have you been doing to ensure China becomes a responsible stakeholder in the international community? What are three steps China should take to cement its role as a stakeholder? How can the United States convince China that it is in both countries' interests for China to assume this role?**

   China is already an important voice in the international economic system, as the world's third largest economy, largest trader, largest developing country, and as a member of key multilateral institutions and fora including the World Trade Organization, international financial institutions, the G-20, and the Financial Stability Board.

   We will continue to urge China to play an active and constructive role in these bodies, which are critical to promoting more open and rules-based global trade and investment, strengthening the stability and transparency of the global financial system and tackling critical global development challenges, including financing climate change and food security.

   However, China is still not a member of several multilateral arrangements and institutions that are important for promoting U.S. interests, such as the WTO Agreement on Government Procurement (GPA). And China is too big to remain an outsider. In line with its S&ED commitment, China submitted a revised offer to join the GPA before the

July 12, 2010, GPA Committee meeting. Becoming a member of the GPA will dramatically limit China's ability to use government procurement to advance unfair trade policies. We will continue to encourage China to participate more actively in important fora and organizations in which it is not yet a member, and to accede to the GPA expeditiously by providing coverage that is comparable to that of other GPA members.

4. **China recently announced that it would allow its currency to appreciate, but signaled that appreciation would be gradual. In the meantime, misalignment persists. Some economists estimate that China's currency is undervalued by up to 40 percent against the dollar. What are your plans for addressing China's currency manipulation? When can we expect to see meaningful movement from China on currency?**

We welcome China's announcement that it is resuming its prior policy of moving towards a more market determined exchange rate. China's policy shift is a significant development, but of course the true test is how far and how fast the renminbi appreciates.

I continue to believe that exchange rate reform is in the interests of both China and the global economy. And as I have noted, we are using every opportunity to fully engage with China on achieving stronger domestic demand growth, a rebalancing of the Chinese economy, and pursuing a more autonomous monetary policy with greater exchange rate flexibility.

5. **I am concerned that China's indigenous innovation policies are just one more example of rising protectionism. I understand China committed to additional dialogue on indigenous innovation during May's U.S.–China Strategic and Economic Dialogue meeting (S&ED). Dialogue is important, but it is not enough. China needs to suspend these discriminatory practices. Will you commit to me that indigenous innovation will remain a priority issue in your discussions with China? What is your plan for seeking suspension of these practices?**

The Administration shares your concerns about China's indigenous innovation policies, which are and will remain a priority issue in our discussions with the Chinese, with whom we will continue to engage vigorously at the highest levels. We have made some progress to date. For example, in response to some of our concerns, in April, China published a draft measure proposing revisions to some of the troubling elements of its product accreditation system, and, in May, Chinese authorities delayed implementation of the product accreditation system to review the comments submitted during this period. Moreover, at the Strategic and Economic Dialogue (S&ED), we secured a commitment from the Chinese that their innovation policies would be consistent with an agreed upon core set of innovation principles and to participate in expert- and senior-level discussions on innovation to find ways to address unresolved issues. There is no doubt, however, that we still have more work ahead. Working off of this broad set of shared principles, we intend to use these new discussions, the Joint Commission on Commerce and Trade, and the S&ED to continue pressing China to implement innovation policies that are nondiscriminatory, that are in line with internationally-accepted practices, and that do not unfairly disadvantage U.S. workers and firms.

The administration also is pressing China to join the rules-based WTO Agreement on Government Procurement (GPA). China's GPA accession would help to limit its ability to use government procurement to advance unfair trade policies, including the product accreditation system. In line with its S&ED commitment, China submitted a revised offer to join the GPA before the July 12, 2010, GPA Committee meeting, and we will continue to work with China to ensure that it provides broad coverage consistent with that of other GPA members.

6. **Other U.S. trading partners, including Korea and the European Union, are also harmed by China's discriminatory economic and trade practices. Yet these countries have historically been hesitant to oppose China's currency, indigenous innovation, and IP policies. What is your plan for convincing other key trading partners to work with us to address China's protectionist economic and trade policies? Do you think the United States alone can continue to exert meaningful leverage on these issues?**

I believe our key trading partners recognize the importance of China adhering to its international obligations and avoiding discriminatory policies and this has resulted in increasing multilateral cooperation on issues of shared concern. We coordinate with those trading partners regularly, especially in international fora such as the G-20 and the WTO. For example, the EU and Mexico are co-complainants in the current WTO case challenging China's restraints on certain raw materials exports. And multilateral pressure was a key factor in China proposing new draft criteria that change some of the troubling provisions of its indigenous innovation product accreditation system, and in the continued delay of that system's implementation. Obviously, U.S. Trade Representative, Ambassador Kirk, takes the lead for the United States in coordinating on trade policies and, in particular, WTO disputes.

While multilateral pressure is important, the United States also continues to assert meaningful leverage on China through bilateral engagement mechanisms, such as the S&ED, the JCCT, and others, and through WTO dispute settlement where appropriate.

7. **I believe that the United States should work through international institutions, such as the International Monetary Fund, to address China's currency practices. But the IMF has been hesitant to designate China as a currency manipulator. And China has refused to allow the IMF to publish its so-called "Article IV" report that many believe may raise concerns about China's currency practices. What are you doing to secure publication of this report? And what are you doing to ensure the IMF takes a more active and public role in assessing China's currency practices?**

Treasury strongly supports a more ambitious publication policy for IMF documents. The IMF cannot publish its Article IV Reports without the member's consent, except under certain specific circumstances. Under the IMF's current transparency policy, publication of Article IV staff reports is "voluntary, but presumed."

Treasury has consistently advocated that IMF members consent to universal publication of Article IV staff reports. However, support among the IMF membership for universal publication has been disappointing. In 2009, three members of the G-20 declined to publish their Article IV staff report (Brazil, China, and Saudi Arabia) while two other members (Argentina and Turkey) did not conduct Article IV consultations with the IMF at all.

Regarding China, IMF Managing Director Strauss-Kahn and other senior IMF officials have said repeatedly and publicly that the renminbi is substantially undervalued and that greater flexibility is needed. While China declined to publish the IMF staff report for its 2009 Article IV consultation, the Executive Board Assessment, which was made public, noted that "some Directors supported the view that the renminbi remains substantially undervalued" while "many Directors considered that a further strengthening of the renminbi would be part of a comprehensive strategy to rebalance the economy…"

IMF Article IV Reports on China, when they have been published, have provided valuable information about assessments of macroeconomic and exchange rate policy. We have encouraged China to resume publication of its Article IV Reports.

<u>Ranking Member Charles Grassley (R-IA)</u>

1. **Chinese currency and the IMF.**

   In 2005, a Treasury Department official said the International Monetary Fund (IMF) was "asleep at the wheel" when it came to overseeing currency exchange rates. Do you think that that perception is still valid? What should our expectations of the IMF be with respect to monitoring and oversight of currency exchange rates? What is the status of the IMF's implementation of its 2007 Decision on Bilateral Surveillance, specifically with respect to the identification of currencies in "fundamental misalignment"? I understand that China is exercising its right to block the release of an IMF report that finds China's currency is substantially undervalued, is that correct? If so, what is the Obama Administration prepared to do in response to this failure of the Chinese government to acknowledge publicly the consequences of its deliberate policy decisions regarding its currency exchange?

   While IMF exchange rate surveillance has improved in recent years, the Fund still has ample progress to make in better fulfilling this important task. Since the IMF's 2007 Decision on Bilateral Surveillance, for which Treasury was a leading advocate, IMF exchange rate analysis has improved in both breadth and quality. Virtually all Article IV reports now include a clear assessment of the exchange rate's value in relation to economic fundamentals, and the sophistication of IMF exchange rate assessments has improved.

   We continue to have questions about the candor of IMF exchange rate assessments, which generally are overly ready to accommodate external imbalances. The IMF must not shy away from the job of making tough judgments, especially when these policies are undertaken by large countries and have systemic implications.

   With respect to China, while the IMF has not labeled the renminbi as fundamentally misaligned, Managing Director Strauss-Kahn and other senior IMF officials have said repeatedly that the renminbi is substantially undervalued. The Chinese authorities consented to the publication of China's annual IMF Article IV staff report from 2004 to 2006 and the staff report for the 2006 Article IV consultation identified the renminbi as undervalued. China did not conclude an Article IV consultation with the IMF in 2007 and 2008 and did not consent to publication of the IMF staff report for its 2009 Article IV consultation. The Chinese authorities did consent to publication of a Public Information Notice that summarized the IMF Executive Board discussion of the 2009 Article IV consultation. This document noted that "some Directors supported the view that the renminbi remains substantially undervalued" and "many Directors considered that a further strengthening of the renminbi would be part of a comprehensive strategy to rebalance the economy..."

   Treasury has and will continue to advocate universal publication of IMF Article IV staff reports as well as stronger requirements for IMF members to meet their obligations to consult with the Fund regularly. However, support among the IMF membership for universal publication has been disappointing. In 2009, three members of the G-20 declined to publish their Article IV staff report (Brazil, China, and Saudi Arabia) while two other members (Argentina and Turkey) did not conduct Article IV consultations with the IMF at all.

IMF Article IV Reports on China, when they have been published, have provided valuable information about assessments of macroeconomic and exchange rate policy. We have encouraged China to resume publication of its Article IV Reports.

2. **Chinese currency and impact on U.S. jobs.**

The unemployment rate in the United States is unacceptably high and we need to keep working to encourage job creation. Earlier this year, Fred Bergsten of the Peterson Institute testified to the House Ways and Means Committee that every $1 billion in exports supports around 6,000 to 8,000 jobs in the United States. In his view, correcting China's currency misalignment should be the most important component of the President's new National Export Initiative. He described it as "by far the most cost-effective step that can be taken to reduce the unemployment rate in the United States." Do you agree with his views? How do you respond?

President Obama has underscored the link between trade and U.S. job creation and set a goal of doubling our exports in five years, to support several million American jobs. Combating barriers that prevent U.S. workers and companies from getting free and fair access to foreign markets, and ensuring that large surplus countries, including China, depend more on their own domestic demand for growth, are key components of our efforts to achieve this goal.

As the world's third largest economy, and the fastest growing major economy, China presents enormous opportunities for U.S. workers and firms, but also some of our biggest challenges. That is why we have urged China to take action to provide a level playing field for American firms that export to China, that operate in China, and that compete with Chinese producers in our markets and around the world.

As part of the effort to rebalance global demand and sustain growth at a high level, China and other large surplus economies need to shift their growth model to rely more on domestic demand, rather than exports, to drive growth. A stronger, more market-based renminbi (RMB) is one tool, but an important one, in boosting the purchasing power of Chinese households and encouraging firms in China to shift to production for domestic demand, rather than for export. As a result of this and other efforts, over time Chinese households would be able to earn more and buy more, including American goods and services.

We welcome China's recent announcement that it is resuming its prior policy of moving towards a more market determined exchange rate. China's policy shift is a significant development, but we will be monitoring closely because the true test is how far and how fast the renminbi appreciates.

3. Export promotion and our pending trade agreements.

With respect to the President's National Export Initiative, what is your opinion regarding the Administration's failure to implement our pending trade agreements with Colombia, Panama, and South Korea? I don't understand why the Administration is refusing to implement these three trade agreements. Every day we wait is a lost opportunity for our exporters.

Do you agree that implementing these trade agreements would be good for U.S. exporters and the U.S. economy as a whole? Why doesn't the President make it a priority to resolve the issues that his Administration has identified as impediments to sending implementing legislation for each of these three pending trade agreements to Congress?

The Administration is focused on keeping world markets open in this time of economic crisis and creating more opportunities for our goods and services providers. The Administration remains committed to the three pending free trade agreements (FTAs) with Colombia, Panama, and Korea, and Treasury will work closely with USTR and others in this process.

With regard to the Korea-U.S. FTA, the President announced in June that he was launching an initiative to complete the agreement. In that regard, the President asked USTR to initiate new discussions with the Korean Minister of Trade to resolve outstanding issues related to the agreement by the time of the President's November visit to South Korea in a way that levels the playing field for U.S. workers and producers. With the resolution of the outstanding issues, the President intends to submit the agreement to Congress for approval in the months following his November meeting with President Lee.

Our FTAs with Colombia and Panama continue to be important trade priorities for the Administration. The Administration is working with the Panamanian and Colombian governments, Congress, and stakeholders to address outstanding issues relating to the agreements.

4. China's policy of "indigenous innovation".

I was glad to see the indigenous innovation issue treated as a priority during the recent meetings of the Strategic and Economic Dialogue with the Chinese. But, I was disappointed that the Chinese government continues to resist addressing U.S. concerns. I understand, for example, that the Chinese attitude is that they have no obligations under the Government Procurement Agreement (GPA) of the World Trade Organization, so they can do whatever they want in this area. We, of course,

could say the same given that we do not have any GPA obligations with respect to China. So, if China refuses to suspend its policy, should Congress consider further restricting the ability of federal agencies to procure goods and services from China?

As a member of the WTO Agreement on Government Procurement (GPA), China will have to provide national treatment under transparent and non-discriminatory procedures for the goods and services of all GPA members in procurements covered by the GPA, and U.S. and Chinese producers will have comparable, reciprocal access to each other's procurement markets for covered goods and services. In line with its S&ED commitment, China submitted a revised offer to join the GPA before the July 12, 2010 GPA Committee meeting, and we will continue to work with China to ensure that it provides broad coverage consistent with that of other GPA members. A key benefit of China's GPA accession will be the discipline the agreement imposes on China's use of government procurement to advance unfair trade, including indigenous innovation, policies.

Due to current U.S. restrictions on federal procurements from countries that are not in the WTO Agreement on Government Procurement or with which we do not have a free trade agreement that provides reciprocal government procurement market access, except under certain exceptions, it is my understanding that the United States procures relatively little from China.

5. **Electronic Payments System.**

China restricts the access of U.S. credit card companies to the Chinese market because the government only allows the Chinese-owned "China Union Pay" company to provide electronic payment processing services for domestic credit card transactions. I understand that China's restrictions are inconsistent with its obligations as a member of the World Trade Organization (WTO). It seems to me that we should be aggressively challenging these restrictions at the WTO. Since this is a financial services issue, I imagine that Treasury has a say in the interagency deliberation over whether to file a case at the WTO. Can I count on you to support bringing a WTO case against China over this issue?

We and interested stakeholders have been concerned about China's restrictions on electronic payment services, and in particular Chinese measures that permit only a single Chinese supplier, China Union Pay (CUP), to process domestic currency payments transactions for credit and debit cards. We are looking at this issue closely.

With respect to possible future WTO cases, the Obama Administration continues to review a variety of issues. It would not be appropriate to make public statements about whether particular issues might be subject to WTO litigation.

As a general matter, Treasury is a strong supporter of a rules-based trading system and is committed to resolving our disputes with China through direct engagement, and, where appropriate, through the enforcement of our rights in the WTO. In that regard, Treasury is an active participant in the interagency process led by USTR, which determines whether to file a particular case.

<u>**Senator Orrin Hatch (R-UT)**</u>

1. **Mr. Secretary, I would like to know what part of our Chinese trade policy is working. Specifically, during last month's Strategic and Economic Dialogue talks with the Chinese, our nation had two vitally important objectives. The first objective was to have the Chinese suspend its indigenous innovation policy. This policy unfairly favors domestic Chinese industries and seeks the transfer of intellectual property from foreign companies looking to access China's market. So what was the result of these talks? According to Inside US Trade the Under Secretary of Commerce stated the Chinese did not provide "an affirmative answer" to the Administration's request to suspend the indigenous innovation policy. The Under Secretary went on to say, the Chinese agreed to "allow some time" for the US government and corporations "...to offer suggestions on what would be a more effective approach." Not a particularly beneficial outcome. The second objective was to have the Chinese stop artificially manipulating its currency. Did we achieve this critical second objective? According to your statement at the time "China's leaders have recognized that reform of the exchange rate is an important part of their broader reform agenda." Well, I am glad China's leaders have recognized there is a need to reform a system which gives their companies an artificial and unfair world-wide 25 to 40 percent price advantage over American companies. This brings us back to my question Mr. Secretary. What part of our Chinese trade policy is working?**

   The Administration shares your concerns about China's indigenous innovation policies, and continues to engage China vigorously on this important issue at the highest levels. We have made some progress to date. For example, in response to some of our concerns, in April, China published a draft measure proposing revisions to some of the troubling elements of its product accreditation system, and, in May, Chinese authorities delayed implementation of the product accreditation system to review the comments submitted during this period. Moreover, at the Strategic and Economic Dialogue (S&ED), we secured commitments from the Chinese that their innovation policies would be consistent with an agreed upon core set of innovation principles and to participate in expert and senior-level discussions on innovation to find ways to address unresolved issues.

   There is no doubt, however, that we still have more work ahead. Working off of this broad set of shared principles, we intend to use these new discussions, the Joint Commission on Commerce and Trade, and the S&ED to continue pressing China to implement innovation policies that are nondiscriminatory, that are in line with internationally-accepted practices, and that do not unfairly disadvantage U.S. workers and firms.

   On currency, we welcome China's recent announcement that it is resuming its prior policy of moving towards a more market-determined exchange rate. This is an important step, but the true test will be how far and how fast the Chinese authorities let the currency appreciate. Vigorous implementation would make a positive contribution to strong and balanced global growth. We will continue to engage intensively and monitor progress carefully.

2. **Mr. Secretary, in 2005 legislation was introduced in the Senate which was designed to combat China's currency manipulation by imposing tariffs on Chinese goods which was roughly equal to their artificial price advantage. Partially as a result, the Chinese agreed to the appreciation of the yuan from 2005 to 2008. During this period substantial progress was made. However, with the advent of the current financial crisis, China resumed the depreciation of its currency and many of these gains were lost. Therefore, Mr. Secretary since the most positive tangible accomplishments in addressing this issue were made the last time the Senate threatened legislative action, why should the Obama Administration not adopt a similar strategy now? If showing resolve and a will to act has worked in the past, why not declare China a currency manipulator?**

   We share the concern about China's exchange rate policies expressed by Congress, though we may pursue different approaches for achieving our mutually shared goal. We believe that our strategy of intense engagement and private pressure, by us and by other nations, is the most effective way of bringing about meaningful change in China's exchange rate policy.

   As noted in our most recent Report to Congress on International Economic and Exchange Rate Policies, no major trading partner of the United States met the standards identified in Section 3004 of the Omnibus Trade and Competitiveness Act of 1988 during the reporting period of manipulating the rate of exchange between its currency and the U.S. dollar for the purposes of preventing effective balance of payments adjustment or gaining an unfair competitive advantage in international trade.

   Treasury officials have spoken with Congressional members and staff and will continue to work with Congress to achieve our shared objective – that China implements its more market-determined exchange rate policy vigorously to make a positive contribution to strong and balanced global growth.

3. **Mr. Secretary, the G-20 meeting is next month. Preeminent economists such as C. Fred Bergsten of the Peterson Institute of International Economics have argued for a multilateral approach to convince the Chinese to appreciate the yuan. Specifically, Dr. Bergsten argues "the Chinese are much more likely to respond positively to a multilateral coalition rather than bilateral pressure from the United States, especially if that coalition contains a number of emerging market and developing countries whose causes the Chinese frequently claim to champion." Therefore, is the Administration taking steps to put together such an international coalition? What are those steps?**

It is important that we continue to take full advantage of multilateral opportunities to complement and reinforce our bilateral message to China on its exchange rate policies.

The G-20 has emerged as the preeminent forum for international cooperation on economic and financial issues, and one of our top priorities within the G-20 is to bring about policies that will help create a stronger, more sustainable, and more balanced global economy. There are many countries, including China, that recognize that China's move to a more market-oriented exchange rate will make an essential contribution to this global rebalancing effort.

We made sure that the G-20 is focused on these issues. As G-20 Leaders agreed at the Toronto Summit, "[s]urplus economies will undertake reforms to reduce their reliance on the external demand and focus more on domestic sources of growth," and in this context, "[m]arket-oriented exchange rates that reflect underlying economic fundamentals contribute to global economic stability."

In addition, we are working aggressively in multilateral fora such as APEC to secure support for our global rebalancing agenda from countries that are not G-20 members.

4. **Mr. Secretary, Dr. Peter Morici of the University of Maryland has written that our trade deficit with China is "reducing U.S. GDP by more than $400 billion or nearly three percent. Unemployment would be falling rapidly and the U.S. economy recovering more rapidly but for the trade deficit with China and Beijing's currency policies." What happens if the Obama Administration's policy of "quiet diplomacy" does not work? What timeline do you have for changing your policy if you do not see results? Will we see that reevaluation is a few months, a year, when?**

Our relationship with China is one of the most important in the world and the Administration is committed to making it more beneficial for the American people. President Obama has underscored the link between trade and U.S. job creation and set a goal of doubling our exports in five years, to support several million American jobs. Combating barriers that prevent U.S. workers and companies from getting free and fair access to foreign markets, and ensuring that China and other large surplus countries depend more on their own domestic demand for growth, are key components of our efforts to achieve this goal.

We welcomed China's recent announcement that it is resuming its prior policy of moving towards a more market-determined exchange rate. China's policy shift is a significant development, but what matters is how far and how fast the renminbi appreciates.

I believe that our policy of active bilateral and multilateral engagement on global rebalancing and the role China must play in that process continues to provide the best avenue for advancing U.S. interests at this time.

5. **What are the most important things that the U.S. side and the Chinese side can do to reduce the big trade imbalance?**

As part of the effort to rebalance global demand and sustain growth at a high level, policy adjustments are needed across the globe that measurably strengthen domestic demand in some countries and boost saving in others. In the United States, we are saving more, and it is important that future growth is less reliant on consumption financed by excess borrowing. As we make this shift here, China and other large economies that have traditionally run large trade surpluses need to rely more on domestic demand, rather than exports, to drive growth.

China has begun to make progress, using its sizable stimulus package, to reinforce consumption-led growth. China concentrated its stimulus funds on infrastructure projects, particularly in its less prosperous interior regions, and on measures to increase household income. Reforms that would support consumption-based growth in China and more balanced trade include: increased public spending on health, education, and the social safety net; higher wages and real income; greater transfer of the substantial corporate sector savings to households; liberalization and opening of important service sectors; and financial sector reforms. A stronger, more market-based renminbi (RMB) will also play an important role, boosting the purchasing power of households and encouraging firms to shift to production for domestic demand, rather than for export.

As a result of these efforts, over time, Chinese households will be able to earn more and spend more of what they earn, including on American goods and services. This shift to stronger domestic demand growth in China has started, but it is important that it be sustained through continued reforms as the global economy recovers and as China moves to withdraw its various stimulus programs.

The Administration has also urged China to take action to provide a more level playing field for American firms that export to China, that operate in China, and that compete with Chinese producers in our markets and around the world. We have asked key emerging markets, including China to make meaningful market access contributions in the WTO Doha Round negotiations that will result in new trade flows for U.S. manufacturers, farmers, ranchers, and service suppliers. The Obama Administration is also working to resolve priority trade issues with China through the Joint Commission on Commerce and Trade (JCCT) chaired by the U.S. Trade Representative and the Secretary of Commerce.

In the United States, our ability to contribute to and benefit from strong, balanced, and sustainable global growth will depend significantly on the policies we pursue to strengthen our economic fundamentals at home. We are making very substantial investments in innovation, education, research and development, basic science, and new energy technologies. These investments, along with actions to restore fiscal sustainability as the economy recovers from crisis, are critical to future growth in the United States and to providing greater opportunities for American workers.

6. **During this period of recovery from the global crisis, has China's growing international presence been a net minus or a net plus for U.S. economic interests, at home and globally?**

As the world's third-largest economy and largest developing country, China is a growing international economic presence and an important contributor to global economic growth. In 2009, when global output declined for the first time in sixty years, China's aggressive stimulus measures supported Chinese economic growth, contributing to a fall in China's trade surplus from 8.0 to 5.1 percent of GDP. At a time when the global economy needed it most, China's net imports increased by almost 3 percent of China's GDP.

International initiatives to promote and rebalance global growth cannot succeed without China's active and responsible participation. In 2009 and 2010, Treasury played a key role in decisions to increase China's ownership stake in both the International Monetary Fund and the World Bank, and to have the G-20, of which China is a member, become the premier forum for international economic cooperation.

These actions increase China's stake in the success of these multilateral institutions, and in turn strengthen the legitimacy of these institutions in tackling the most critical challenges in global economic governance.

We have already seen important benefits from this approach. China is participating actively in the G-20's Framework for Strong, Sustainable and Balanced Growth. Such an initiative would be largely irrelevant without the involvement of China, a key surplus economy that must make significant adjustments in its pattern of growth if the global economy will be able to achieve strong, sustainable, and balanced growth.

China is still not a member of several multilateral arrangements and institutions that are important for promoting U.S. interests, such as the WTO Agreement on Government Procurement (GPA). And China is too big to remain an outsider. In line with its S&ED commitment, China submitted a revised offer to join the GPA before the July 12, 2010 GPA Committee meeting. We will continue to encourage China to participate more actively in important international fora and organizations, and to accede to the GPA expeditiously by providing coverage that is comparable to that of other GPA members.

7. **How does the U.S. maintain its technological lead? Should we be worried that China is imitating or stealing our firms' best technologies?**

The United States will maintain its technological lead through the President's Innovation Strategy, which consists of three components: (1) investment in the building blocks of American innovation, which includes investments in research and development and the human, physical, and technological capital needed to perform that research and transfer those innovations; (2) promotion of competitive markets that spur productive entrepreneurship, which is imperative to create a national environment ripe for entrepreneurship and risk taking that allows U.S. companies to be internationally competitive in a global exchange of ideas and innovation; and (3) catalyzing breakthroughs for national priorities in certain sectors of exceptional national importance where the market is unlikely to produce the desirable outcomes on its own. These include developing alternative energy sources, reducing costs and improving lives with health information technology, and manufacturing advanced vehicles.

Protection for intellectual property rights is a critical innovation component, and Chinese protection and enforcement of intellectual property rights remains a major concern for U.S. industry and the Administration. We continue to push the Chinese very aggressively to improve their IPR protection and enforcement regime, through bilateral meetings and multilateral engagement, which will benefit not only U.S. firms, but will enhance China's own innovative capacity.

8. China's central bank is now the largest foreign holder of US treasuries. What risks does this create for us? How do you see China's reserve holdings evolving in the next few years?

China's holdings are 7 percent of total outstanding Treasuries and 11.8 percent of Treasuries that are publicly traded. U.S. private residents, however, hold $3.6 trillion of U.S. Treasury securities, more than four times China's holdings. China holds 1.3 percent of total U.S. financial assets. U.S. investors are far and away the largest holders of U.S. financial instruments.

The Treasury market is the deepest and most liquid market in the world. Daily transaction volumes total approximately 400 billion dollars. We have a very broad investor base for U.S. Treasuries and are not reliant on any particular investor. This has become even more evident throughout the financial crisis. Treasury's investor base has grown over the last two years as investors continue to seek the safety and liquidity of the Treasury market.

We have seen increased interest on behalf of domestic investors. As the U.S. savings rate has risen, so has domestic investors' appetite for Treasuries. Going forward, our federal government borrowing needs are expected to decline.

The Chinese have repeatedly stated publicly that their goal is to manage their reserves in a way that preserves their capital and maintains financial stability. Their actions to date have been consistent with that goal.

<u>Senator John Kerry (D-MA)</u>

General Administration and Information

1. **Since December 2009, Congress has been requesting an updated copy of Treasury's International Affairs Directory. The sharing of this basic information - as other executive branch departments and agencies routinely do both with Congress and in many cases, the general public - is a basic requirement for Congressional oversight. This enables Congress to understand how important departments are structured, including the identity of key officials who are managing those departments, and to better understand the job descriptions of those key officials - several of whom were confirmed by this Committee. This has been a practice that has been carried out on a bipartisan basis. Other agencies provide such information, including the State Department, which lists this information openly on its website. Even other offices within the Treasury Department, including the Office of Domestic Finance, publicly disclose the identity of key officials, their duties and organizational charts on Treasury's own website. When can Congress expect to receive an updated copy of Treasury's International Affairs Directory?**

   The International Affairs directory was provided on June 29, 2010.

Rebalancing

2. **What are the implications of the falling Euro for U.S. efforts to double our exports, what are its implications for other markets that we need to target, and what's the availability of credit for American firms exploring new export markets?**

   I make it a habit not to comment on currency market developments.

   Our ability to increase U.S. exports depends critically on having a healthy, vibrant global economy. To achieve that, we have focused considerably within the G-20 nations, which make up 85 percent of global output, on achieving a strong, sustainable, and balanced economic recovery. During the global recession, international trade fell by more than 35 percent in dollar value, and although trade has recovered significantly, it has yet to recover to its pre-crisis peak. Not only is it important that the global economy grow at a strong pace, it is equally important that the composition of growth be well balanced. That means that economies with external surpluses need to boost the share and pace of domestic demand growth within their economies. Strong demand growth abroad will mean strong growth of U.S. exports and increased job creation in the United States. At the recent Toronto Summit, Leaders of the G-20 reaffirmed that their highest priority is to safeguard and strengthen the recovery.

   Earlier this year, in March, the President announced a new National Export Initiative (NEI) designed to marshal the resources of the U.S government to ensure that U.S. businesses take full advantage of sales opportunities abroad. One key aspect of the

President's National Export Initiative (NEI), which set the goal of doubling exports within five years to support several million jobs, is increasing access to credit for small- and medium-sized businesses that want to export, including through a call from the President to the Export-Import Bank to increase its financing available for small- and medium-size businesses from $4 billion to $6 billion over the next year. In addition, through the G-20 Trade Finance Initiative, the G-20 governments ensured the availability of $250 billion in trade finance, with the Export-Import Bank providing $30 billion of this capacity. Restoring health to the international financial system, keeping international markets open to trade and investment, and reducing barriers to trade by actively opening new markets are also key components of the National Export initiative, particularly given the importance of growth in the rest of the world in achieving the U.S. export goal.

3. **I would think that many of the concerns we have been discussing today are shared by developed countries, emerging economies like Brazil and India, and developing countries within the G-77. You frequently converse with your counterparts in bilateral and multilateral fora. Do you find that other countries share our concerns? If so, how can we work together to underscore our message with the Beijing government in international arenas like the G-20?**

   It is important that we continue to take full advantage of third country and multilateral opportunities to complement and reinforce our bilateral message to China on its exchange rate policies.

   The G-20 has emerged as the preeminent forum for international cooperation on economic and financial issues, and one of our top priorities within the G-20 is to bring about policies that will help create a stronger, more sustainable, and more balanced global economy. I believe there are many countries, including China, that recognize that China moving to a more market-oriented exchange rate will make an essential contribution to this global rebalancing effort.

   We made sure that the Toronto G-20 meeting focused on these issues. As G-20 Leaders agreed at the Toronto Summit, "[s]urplus economies will undertake reforms to reduce their reliance on the external demand and focus more on domestic sources of growth," and in this context, "[m]arket-oriented exchange rates that reflect underlying economic fundamentals contribute to global economic stability."

   In addition, we are working aggressively both bilaterally and in multilateral fora such as APEC to secure support for our global rebalancing agenda from countries that are not G-20 members.

Currency Manipulation

4. **China let its exchange rate appreciate gradually from July 2005 until the middle of 2008 and Chinese officials have recently noted their intention to resume currency appreciation. To what extent has the recent European debt crisis affected China's**

timeline for adjusting its currency and how much patience do you intend to continue exercising?

The European debt crisis may have been one consideration in China's timeline for resuming currency flexibility, but it has now moved off the dollar peg and resumed moving toward a more market-determined exchange rate. What matters is how far and fast the renminbi appreciates.

Tax Credit for Energy Manufacturing Projects

5. **Secretary Geithner, China is investing in clean energy and we need to do the same. The American Recovery and Reinvestment Act of 2009 created a new tax provision which provided a credit up to 30 percent of an advanced energy manufacturing project. This credit was designed to assist in growing the nation's domestic manufacturing supply chain for alternative energy. It did so by providing a tax incentive to manufacture goods (like turbines and solar chips) used to produce alternative energy like wind and solar. This program created about 17,000 direct jobs and about 41,000 jobs when private investment is included. Projects from over 40 states, including a facility in MA were awarded the credit. This program was so popular it was oversubscribed by a ratio of 3 to 1 and according to the Department of Energy many worthwhile projects had to be turned down. As a result of this great success, the Administration's budget includes another $5 billion for this program. In addition, the American Power Act includes a provision which provides an additional $5 billion for this program. How do you think the expansion of this program will benefit our energy sector and do you think it will help make us more competitive internationally?**

The American Recovery and Reinvestment Act provided $2.3 billion in tax credits for investments in advanced energy manufacturing facilities. This "section 48C" credit was designed to help America take the lead in the manufacture of wind turbines, solar panels, electric vehicles, and other clean energy and energy conservation products. Eligible manufacturers receive a 30-percent tax credit for their investments in facilities to manufacture these products.

The section 48C credit represents a new approach for the United States. Previous tax incentives were aimed at increasing clean energy production. The section 48C credit, along with other policies and incentives, provides a powerful incentive to invest in advanced energy facilities that will produce clean energy equipment here in this country. According to the American Wind Energy Association Wind Industry Annual Market Report for the year 2009, ten new manufacturing facilities came online in the United States last year, twenty were announced, and nine facilities were expanded.

As you note, the $2.3 billion cap on the credit resulted in the funding of less than one-third of the technically acceptable applications that have been received. The President's

FY 2011 Budget proposes an additional $5 billion in credits that would support at least $15 billion in total capital investment, creating tens of thousands of new construction and manufacturing jobs. With an existing pipeline of high-priority projects and substantial interest from a variety of sources, the additional tax credits could be deployed quickly to create jobs and support economic activity.

Indigenous Innovation

6. **While we certainly want to see adjustments in China's exchange rate vis a vis the dollar, we also see China's indigenous innovation policies as an enormous challenge to American companies and workers. To be sure, we all support China's desire to innovate, but that cannot be done at the expense of US and other foreign players in the market. I know you raised this with your Chinese counterparts at the S&ED in Beijing last month. How do you and the Administration intend to address China's indigenous innovation policies going forward to ensure they do not discriminate against our companies and limit our access to that growing market?**

The Administration shares your concerns about China's indigenous innovation policies, and continues to engage China vigorously on this important issue at the highest levels. We have made some progress to date. For example, in response to some of our concerns, in April, China published a draft measure proposing revisions to some troubling elements of its product accreditation system, and, in May, Chinese authorities delayed implementation of the product accreditation system to review the comments submitted during this period. Moreover, at the Strategic and Economic Dialogue (S&ED), we secured commitments from the Chinese that their innovation policies would be consistent with an agreed upon core set of innovation principles and to participate in expert and senior-level discussions on innovation to find ways to address unresolved issues. There is no doubt, however, that we still have more work ahead. Working off of this broad set of shared principles, we intend to use these new discussions, the Joint Commission on Commerce and Trade, and the S&ED to continue pressing China to implement innovation policies that are nondiscriminatory, that are in line with internationally-accepted practices, and that do not unfairly disadvantage U.S. workers and firms.

The Administration is also pressing China to join the rules-based WTO Agreement on Government Procurement (GPA). China's GPA accession would help limit its ability to use government procurement to advance unfair trade policies, including the product accreditation system. In line with its S&ED commitment, China submitted a revised offer to join the GPA before the July 12, 2010 GPA Committee meeting, and we will continue to work with China to ensure that it provides broad coverage consistent with that of other GPA members.

<u>Senator Pat Roberts (R-KS)</u>

1. **Thank you Mr. Chairman for convening this hearing to explore the United States' economic relationship with China. It is a timely and critical discussion - especially given the global economic downturn that touches every country in some way.**

   No longer do international meetings encompass just a handful of developed nations. The G-20 clearly demonstrates the reality that more countries have a stake in the global economy. Decisions and policies can no longer be made in isolation without consequences to the world at large.

   The topic of this hearing is a clear example of this interconnectedness. Currency valuation has long been an issue of concern not only from the U.S. perspective, but from a broader view. By working together with other impacted nations, a balanced solution is possible. However, today I'd like to raise a concern that has more of a local impact: the growing regulatory burden that our community banks in Kansas and across the country are facing.

   <u>Secretary Geithner</u>: You recently received a letter on behalf of traditional, community banks – our Main Street banks – those that did not cause the problems that led to the economic crisis. The letter outlines their concerns about new regulations in the financial reform bill and the seemingly endless regulations that have been put forth over the past few years. The letter included two lists. The first is a list of 50 new or expanded regulations imposed by regulators in just the past two years. The second is a list of the 30 new or expanded regulations in the Senate version of the financial reform bill.

   While not every regulation applies to every bank, community banks say the total impact of these regulations are simply pushing them to the breaking point. Unlike Too Big to Fail financial institutions, these banks don't have a staff of attorneys to help them navigate wave after wave of new regulations. They are asking for your assistance to address this regulatory problem.

   These community banks are small businesses. The median size bank in this country has 40 employees. In Kansas, 60 percent of our banks have an average of less than 14 employees. Eighty percent of our banks are located in rural communities, those with populations of less than 5,000.

   Yet, these small businesses are singled out for a whole host of new regulations at a time when the administration is asking for their help to increase lending, particularly to other small businesses, to get our economy back on track.

There is only so much regulation that any small business can be subject to before it simply becomes too burdensome to stay in business. And that is where many community banks say they are, or are heading. This is bad news for our traditional banks, our small businesses and our communities.

What happens to the people and businesses in these communities when the bank can no longer offer products, such as mortgages, because of onerous regulations? What happens when the bank simply has to close? Who do their customers turn to?

The bankers I am hearing from are very concerned and frustrated that Washington is not listening and responding to their concerns.

Secretary Geithner, how do you reconcile the up to 80 new or expanded regulations that community banks are facing with statements from the administration that it wants to encourage banks to lend to small businesses?

I understand the administration is promoting a program to encourage community banks to lend to small business. However, what I am hearing from community banks is that they have small business customers who want to borrow, and they have money to lend, but regulators are making small business lending very difficult.

So no matter how much money is pumped into the system, it doesn't seem that progress can be made until regulatory issues are addressed. Have you taken steps to work with regulators? Have you made a commitment to our traditional, community banks to address their concerns?

We also hear concerns about the regulatory burden being placed on small and community banks and understand it is a serious issue, and we think the Small Business Lending Fund the Administration has proposed is well-designed to encourage lending in the current environment. The program is designed to give banks greater flexibility to lend to small businesses by providing them with capital. When a regulator tells a bank to cut lending, it is often saying the bank needs to hold more capital before the regulator can get comfortable with the bank taking on more risk. By providing additional capital, this program should – even in the current environment – give banks more flexibility to increase their lending.

Regulators are independent, and we have limited ability to influence their decisions. However, we will continue to work with regulators to develop guidelines—like those released last year on commercial real estate and more recently on small business lending—that balance the need for prudent supervision with concerns about not being overly restrictive.

<u>Senator Michael Enzi (R-WY)</u>

Chinese VAT Rebate on Soda Ash

1. **I understand that in the past you have raised the issue of China's VAT rebates on its exports with your Chinese government counterparts. Wyoming's highly competitive soda ash industry – and the jobs its supports across the United States – has struggled to compete against China's exports in an increasing number of global markets due to the VAT rebate. When you raised the VAT issue with your Chinese colleagues during the recent S&ED discussions, what was their reaction to the concerns expressed by the United States? Is there reason to suspect that there will be a change in the use of VAT rebates by the Chinese Government?**

   Frequent Chinese VAT rebate modification on a range of products, including soda ash, is an ongoing concern for U.S. industry and the U.S. government. We have raised this issue in both the S&ED and the JCCT, and the Administration will continue to work with you and other members of Congress, U.S. industry, and the governments of like-minded trading partners to press China, both bilaterally and in multilateral fora, to abandon VAT rebate policies that distort trade. At the S&ED in May, our Chinese counterparts took note of the VAT rebate concerns that we raised, and we will continue to press them on this important issue.

IRS Settlement and Appeal Officers in Wyoming

2. **When IRS Deputy Commissioner Miller appeared before this committee in April, I asked him about the lack of IRS settlement and appeals officers in Wyoming, but since I haven't heard from him, I'd like to ask you about this matter.**

   Section 3465(b) of the IRS Restructuring and Reform Act of 1998 states, "The Commissioner of the Internal Revenue Service shall ensure that an appeals officer is regularly available within each state," yet Wyoming and eight other states have no such personnel physically located within their borders.

   The Appeals process is the last step for taxpayers to argue the merits of their return before a Notice of Deficiency is recorded and collection processes begin. Therefore, it is critical that all taxpayers – even rural taxpayers – have unfettered access to IRS appeals officers.

   I realize that the 1998 Act also permits the IRS to consider the use of videoconferencing in rural areas, but when our nation's founding fathers guaranteed our rights to due process under the Constitution, I doubt they meant that the IRS could "phone it in."

   I understand that all agency budgets are strained and I'm not asking the IRS to hire new staff. Rather, I think it is perfectly reasonable to suggest that the IRS redeploy

existing resources to provide at least one full-time appeals officer and one full-time settlement agent in every state.

Secretary Geithner do you agree with the need to redeploy current IRS resources to guarantee at least one full-time appeals officer and one full-time settlement agent per state?

I look forward to your response. I'm sure my colleagues on this committee from Arkansas, Idaho, Montana, Kansas and North Dakota would be very interested in your findings since they also lack appeals officers and settlement agents in their states.

The Treasury Department agrees that it is crucial that every taxpayer have timely access to the full appeals process, including the assistance of appropriate appeals staff. This requires that IRS employees with appropriate technical knowledge be available to handle a wide range of cases, including specialized docketed, non-docketed, exam, collection, estate and gift, and Tax Exempt/Government Entities cases. Because of the wide range of expertise required, field office location is determined by availability of specialized technical skills and experience level, taxpayer convenience, and inventory levels. The IRS Office of Appeals has permanent employees in 41 states and has appeals staff regularly available through circuit riding in the remaining 9 states. The appeals process uses circuit riding to mitigate the need for specialization and where the nearest office is more than 150 miles from the taxpayer, while at the same time ensuring that the needs of each and every taxpayer are timely met. This structure is consistent with the statutory requirement in the IRS Restructuring and Reform Act of 1998 (P.L. 105-206, Act Sec. 3465(b)), which provides the IRS Commissioner must "ensure that an Appeals Officer is regularly available in each state." IRS, as part of its regular planning, will continue to look at resource allocation, and is committed to ensuring adequate access to the appeals process for every taxpayer.

<u>Senator Bill Nelson (D-FL)</u>

1. **More than 1,900 homeowners in Florida and hundreds more in other Southeastern states have had serious problems with drywall installed in their homes that was imported from China. Problems include severe metal corrosion and terrible negative health impacts. The Consumer Product Safety Commission, in conjunction with the U.S. Department of Housing & Urban Development, recently released additional studies that conclusively tied the Chinese drywall to these problems -- and also provide remediation guidelines for impacted families. Most importantly, the agencies have now identified a number of Chinese state-owned companies that produced the defective drywall.**

   During an April reception at the Nuclear Security Summit in Washington, I raised the issue of defective Chinese drywall directly with President Hu Jintao. President Hu related that he had not heard of this issue, but assured me that he would ask his staff to educate him on the problem.

   Secretary Geithner, you just co-led the U.S. Delegation to the U.S.-China Strategic and Economic Dialogue in Beijing in May. I understand that the U.S. delegation asked the Chinese government to facilitate discussions on possible settlement with the Consumer Product Safety Commission, homeowners and Chinese manufacturers.

   Are you familiar with the discussions regarding Chinese dry wall that occurred during the U.S.-China Strategic and Economic Dialogue?

   What will you do to help facilitate an official response from the Chinese government on this important issue?

   This issue was raised at the S&ED in May with China's Minister of General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) Wang Yong. Through the S&ED mechanism we will continue our efforts to encourage China's regulators to cooperate fully with any U.S. investigations led by the Consumer Product Safety Commission (CPSC) on this issue. For further information, I refer you to the CPSC.

Opening Statement of Sen. Chuck Grassley
as Prepared for Delivery
Hearing, "The U.S. – China Economic Relationship: A New Approach for A New China"
Secretary of the Treasury Timothy F. Geithner, testifying
Thursday, June 10, 2010

Today's hearing provides an opportunity for the Committee to engage Secretary Geithner on the outcome of last month's Strategic and Economic Dialogue in Beijing.

I have serious concerns about the direction that China's government is taking with respect to its economic and trade policies.

I want to hear from the Secretary specifically what these meetings accomplished, and what the Secretary sees in the way of next steps in our bilateral relationship.

For example, what are China's intentions with regard to its currency exchange rate?

I emphatically disagreed with the Treasury Department's decision in April to delay issuance of its currency report.

The time is long past for the Treasury Department to admit publicly what everyone else already knows—namely, that China is manipulating the value of its currency in order to gain an unfair advantage in international trade.

Treasury obviously felt differently, and I'd like to hear what this delay in issuing the report has accomplished.

I worry that, by delaying the report, Treasury has raised expectations that won't be met. Is the Chinese government going to make a significant adjustment to its exchange rate, just because our Treasury Department held off on issuing this report? I doubt it.

I also want to hear about the Secretary's discussions regarding China's so-called indigenous innovation policy, which is a government policy to give preferences in China's procurement market to products that contain intellectual property developed in China.

Our Ambassador to the World Trade Organization has described this policy as one of several Chinese policies indicating, quote, "a policy direction that seems designed to limit market access for imports and foreign investors and pressure enterprises to localize research and development in China, as well as transfer technologies," end quote.

In other words, instead of doing everything it can to comply with the letter and spirit of its World Trade Organization obligations, the Chinese government appears to be looking for ways to evade those rules, or to find loopholes and gaps in the rules that it can exploit.

This is a troubling development that, in my view, calls for some careful rethinking about our overall approach to China on trade matters.

For example, if China continues to refuse to make a serious offer to join the Government Procurement Agreement in the World Trade Organization, we should take a harder look at our own procurement rules as they apply to the procurement of goods and services from China.

Separately, if China chooses to apply a "national economic security" test when it reviews foreign investment through mergers and acquisitions, perhaps we should do the same with respect to Chinese investments in the United States.

The point is, if one of the major beneficiaries of the world trading system engages in a pattern of refusing to play by the same rules as everyone else, then we should reconsider the rules that we apply to that country.

I look forward to hearing from the Secretary his intentions for prompt action to address these important issues.

COMMUNICATION

National Retail Federation®
The Voice of Retail Worldwide

Statement for the Record

Senate Committee on Finance

The U.S. – China Economic Relationship:
A New Approach for A New China

June 10, 2010

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On behalf of its members in the U.S. retail industry, the National Retail Federation (NRF) welcomes the opportunity to submit these comments to the Senate Committee on Finance regarding China's exchange rate policy.

As the world's largest retail trade association and the voice of retail worldwide, the **National Retail Federation**'s global membership includes retailers of all sizes, formats and channels of distribution as well as chain restaurants and industry partners from the U.S. and more than 45 countries abroad. In the U.S., NRF represents the breadth and diversity of an industry with more than 1.6 million American companies that employ nearly 25 million workers and generated 2009 sales of $2.3 trillion.

Retail Industry Profile

Retailing represents one of the largest industries in the United States in terms of the number of companies, employment, and contribution to gross domestic product. According to the most recent annual (2009) statistics:

- The U.S. retail industry comprises more than 1.1 million retail companies;
- Among American retail companies, the vast majority (98.5 percent) are small businesses located in every Congressional district in the country;
- The U.S. retail industry had annual sales more than $4.1 trillion;
- Of the more than two-thirds of U.S. GDP generated from consumer spending, over 41 percent of that spending (*i.e.*, nearly 30 percent of U.S. GDP) occurs in retail establishments;
- With 24 million employees – nearly one in five American workers – the retail industry provides more jobs than any other U.S. industry;
- Retail employees averaged $16.77 per hour in total compensation (wages, salaries, and benefits).[1]

Like any other business, retailers face the daily challenge of creating value for their customers and shareholders, in an industry marked by cutthroat competition and an average profit margin of 2-3 percent. Currently, retailers are slowly climbing their way out of the worst economic environment for our industry in over 40 years. During the past 18 months, retailers suffered a huge number of bankruptcies, store closures, and over one fifth of all the job losses in the United States.

Retailing is also an extremely trade reliant industry that is directly impacted by the direction and operation of U.S. trade policy. Like other U.S. industries, including manufacturing and agriculture, every retailer, from the

[1] Source, *Retail Industry Indicators*, Prepared for the NRF Foundation by The Trade Partnership.

largest national chains to the smallest neighborhood shop, depends on a global supply chain to procure the products that its customers – the American consumer – need and want.

The commercial activity generated by global sourcing of consumer goods by American retailers supports good-paying, skilled blue and white collar jobs, many of them union jobs. These millions of American workers are employed not only in the retail industry, but also in many ancillary industries that support retail operations and supply chains – *e.g.*, manufacturing, farming, ports, rail, trucking, warehousing, air delivery, and logistics.[2]

As an industry engaged in importing, we would point out that, contrary to popular opinion, evidence shows that imports as a whole support millions of U.S. jobs, and help, not only retailers, but all U.S. companies involved in international commerce to enhance their productivity, competitiveness, and ability to expand employment. Research demonstrates that imports support more than 10 million American jobs, and that imports from China alone support nearly 1 million net jobs in the United States.[3]

U.S.-China Trade Relations

Much of the national economic anxiety over trade and globalization is focused on issues in the U.S.-China trade relationship as China has become an increasingly significant player in the global economy. In the unfolding debate on the U.S.-China trade relationship, few U.S. industries have more at stake than retailers. Consumer goods comprise nearly 80 percent of all U.S. imports from China, and China is a key supplier, and sometimes the dominant supplier, in every consumer goods category. Moreover, retailers have been adversely impacted by a recent increase in trade remedies investigations (antidumping, countervailing duty and safeguards) against imported consumer products mainly targeting China. Indeed, many of the proposed changes to the trade remedies laws currently under consideration before this committee are intended primarily to target imports from China.

The retail industry acknowledges that there are serious and legitimate issues with China that need to be effectively addressed, including inadequate

[2] *See, Imports and America: The Rest of the Story*, prepared by The Trade Partnership for the National Retail Institute and the Council of the Americas, August 1998, and *Impact of Imports from China on U.S. Employment*, prepared by Trade Partnership Worldwide, LLC for the National Retail Federation, November 2005.

[3] *See, e.g., Imports and America, Ibid.*

protection of intellectual property rights, proliferating market access barriers, the need for a monetary system that allows for more flexible exchange rates and a fully-convertible currency, ensuring that China abides by its obligations under international trade rules, and dealing with the difficulties inherent in China's transformation from an isolated, centrally-planned, non-market economy to a market-economy country. In considering how best to address these issues, the retail industry urges prudence and thoughtfulness on the part of policy makers. Policy makers should support appropriate action through diplomatic efforts and the use of multilateral mechanisms to address issues in the U.S.-China relationship that can yield effective progress and are consistent with World Trade Organization (WTO) rules.

However, we continue to see descriptions of issues in the U.S.-China trade relationship presented in the most reckless, sweeping, facile, and grossly exaggerated terms – China "cheats"; China has "stolen" "millions" of American jobs; China exports goods made by "slave labor" working for "pennies a day"; the "devastating" impact of China's "enormous" subsidies and "massive" currency undervaluation; a "flood" of "unsafe and poisonous" Chinese products; etc.[4] Indeed, from the tone of many of these and other statements, one might be led to think that China is responsible for the loss of every manufacturing job in the United States, is largely to blame for the current state of the U.S. economy, and that China's exchange rate policy is the main reason behind the U.S. bilateral trade deficit with China. These are absurd propositions on their face.

Too frequently, the intention behind this hyperbole is not to propose serious solutions to any of the issues the United States has with China. Rather the goal is to justify a protectionist agenda – blocking imports from China and punishing U.S. companies that do business in China all purportedly in the emotionally-charged, but largely meaningless name of "fairness." The U.S.-China trade relationship is simply too complex and important to be driven by such emotional rhetoric.

In looking at serious policy options to address issues in the U.S.-China trade relationship, NRF and the retail industry have consistently supported the Strategic and Economic Dialogue (SED) and recent actions by the U.S. Trade Representative's Office against China under the WTO dispute settlement mechanism over practices that violate WTO rules, and coordination at the multilateral level. We applaud statements by the Obama Administration and Chairman Levin emphasizing the use of all available diplomatic avenues and constructive dialogue with China to address issues such as currency policy and

[4] *See e.g.*, AFL-CIO website, www aflcio.org; American Trade Action Coalition (AMTAC) website, www.amtacdc.org; National Council of Textile Organizations (NCTO) website, www.ncto.org; Public Citizen website, www.citizen.org; Stand Up For Steel website, www.standupforsteel.org; UNITE-HERE! website, www unitehere.org.

practices. By the same token, we believe it is appropriate for the United States to protect its rights by challenging China at the WTO where there are clear violations of international trade rules. Diplomatic avenues, such as the SED, and dispute settlement through the WTO may be slower processes than some may prefer, but are most likely to yield positive results while avoiding unintended consequences that could hurt the U.S. economy and jobs.

On the other hand, the Administration and Congress should reject unilateral, counterproductive, and WTO illegal restrictions on imports of Chinese goods as a policy tool to compel action by China. There is no evidence that these actions would be effective in addressing any of the issues in the U.S.-China trade relationship. Meanwhile, they would impose huge costs on the U.S. economy, seriously harm U.S. retailers, manufacturers, services providers and farmers that depend on trade with China and global supply chains, and adversely affect millions of American consumers.

Chinese Currency and Exchange Rate Policy

The subject of this hearing – Chinese currency policy and the value of the yuan – are central issues in the debate over U.S.-China trade relations. Some claim that the yuan is greatly undervalued vis-à-vis the dollar, and blame it as the driving factor behind the sizable bilateral trade deficit with China and the loss of U.S. manufacturing jobs.[5] Among their proposed remedies is to impose trade barriers to imports from China through various means, including changes to the U.S. antidumping and countervailing duty laws. They would also essentially force the U.S. Trade Representative to initiate dispute settlement proceedings at the World Trade Organization (WTO) against Chinese currency policy and the Secretary of the Treasury to determine that China is a currency manipulator. Not surprisingly, these proposals are strongly endorsed by certain domestic industries, such as steel and textiles, that for decades have relied on, and continue to seek new means to impose trade barriers against imports, particularly from China.

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[5] Evidence does not support the claim that China's exchange rate is a significant factor in the size of the U.S. trade deficit or in the loss of "millions" of U.S. manufacturing jobs. As the US-China Business Council correctly observed in its paper, *China and the US Economy: Advancing a Winning Trade Agenda* (Jan. 2009), much of what is imported from China had been imported from other Asian countries. Moreover, while transportation and labor costs, as well as inflation had a significant impact on the price of imports from China in the first half of 2008, there is little evidence of such an impact from the 20 percent appreciation in the Yuan, which had the offsetting effect of lowering the cost of imports into China. Accordingly, it is simply not credible that forcing China to appreciate its currency further will reverse the U.S. trade deficit. The economic crisis itself resulted in a huge drop in Chinese exports – 17.5 percent in January 2009 – which adversely impacted both the U.S. and Chinese economies.

There is no real disagreement that China must move toward a more flexible currency regime. The only disagreements are the means to effect that change and how quickly it can reasonably be accomplished without creating further turmoil in the financial sector, and adversely impacting the U.S. economy. As a guiding principle, we oppose unilateral, counterproductive, and WTO illegal restrictions on imports of Chinese goods as a policy tool to compel action by China. By the same token, we are convinced that the best course of action is dialogue and negotiation through mechanisms such as the SED and the Joint Commission on Commerce and Trade (JCCT). A deft diplomatic and multilateral strategy by the United States will ultimately be a much more effective tool in identifying mutually-beneficial goals, and moving the Chinese Government in a more constructive direction, while strengthening, rather than undermining the important U.S.-China economic relationship.

By the same token, we will continue to oppose the use of trade remedies as a means to address China's currency policy for two reasons. First, many of the proposed changes to the trade remedies laws would violate WTO rules. Second, there may be widespread consensus among economists that the Chinese currency is undervalued, but there clearly is no agreement over the extent to which the yuan is undervalued. Thus, any attempt to quantify the degree to which the yuan may be undervalued, with the degree of specificity required in an antidumping or CVD case, will result in an entirely arbitrary and inaccurate calculation.

One proposal to address the currency issue through the use of the trade remedies laws that raises particularly troubling concerns is legislation that would redefine countervailable subsidies to include the undervaluation of a foreign currency through exchange rate manipulation or misalignment. NRF has argued in the past that this unilateral attempt by Congress to redefine what constitutes a countervailable subsidy would conflict with WTO rules and invite trade retaliation or reciprocal action to the detriment of U.S. companies and workers.

The WTO Subsidies Code[6] identifies three types of subsidies – prohibited; actionable (*i.e.*, subject to countervailing duties); and non-actionable (*i.e.*, permitted). Articles 1 and 2 of the Subsidies Code specify that to be countervailable, a subsidy must be: (1) a financial contribution from a government (2) that provides a benefit (3) to a specific industry or industries or enterprise or group of enterprises.

[6] WTO Agreement on Subsidies and Countervailing Measures of the General Agreement on Tariffs and Trade 1994.

Because the "benefit" from currency valuation is generally available to all economic players in a country, the proposed legislative change would conflict with the specificity requirement under WTO rules. Because currency policy does not involve the transfer of anything of tangible value from the government, the proposed legislation would also conflict with the financial contribution requirement under WTO rules. Currency policy also cannot meet the WTO definition of a prohibited subsidy because its benefit is not contingent on exportation and does not require the use of domestic goods.

Moreover, some proposals would direct that currency misalignment be determined on the basis of a country's trade balance, amount of foreign direct investment, and foreign currency reserves. What these proposals fail to recognize is that these matters are influenced by many factors that may have nothing to do with a country's currency policy.

In the end, defining a countervailable subsidy in a way that violates WTO rules would undermine efforts to ensure that other countries abide by international trade rules, expose exports of U.S. goods and services to possible trade sanctions, and does nothing to address the underlying issue in an effective manner.

Another troubling proposal with respect to the currency issue would require adjustments to antidumping margins in investigations and reviews to offset the amount by which a country's currency may be undervalued or "misaligned." There is, however, no widely accepted benchmark for determining the extent to which a particular currency may be undervalued. In the case of China, it was claimed the Yuan was undervalued by 15 to 40 percent. That is a huge range that demonstrates the imprecision of the calculation. Thus, any calculation by the Commerce Department, that has no expertise on such matters, will be an entirely arbitrary exercise, and therefore subject to political influence.

However, the bigger threat from this proposal is the precedent it would set to allow any country to game the antidumping process by unilaterally setting an arbitrary value on another country's currency. The result will be to make the trade remedies system even more unpredictable for U.S. importers and exporters.

Another problem with this proposal is that it would violate Article 2.4.1 of the WTO Agreement on Antidumping (AD Agreement), which establishes the rule for currency conversion and adjustments by reference to the value set by currency markets:

> "When the comparison [between export price and normal value] requires a conversion of currencies, such conversion should be made <u>using the rate</u>

of exchange on the date of sale, provided that when a sale of foreign currency on forward markets is directly linked to the export sale involved, the rate of exchange in the forward sale shall be used." (emphasis added)

No other provision of the AD Agreement would permit this type of adjustment. Notably, Article VI.2 of the General Agreement on Tariffs and Trade applies only to multiple currency practices, not "fundamentally misaligned currencies."

In addition, the surrogate country methodology used in AD investigations against imports from China and other non-market economy (NME) countries already addresses the effect of any currency undervaluation. In calculating an AD margin in NME cases, the Commerce Department uses market-based values from a surrogate country to determine the normal value of the subject imports, which it then compares to the U.S. export price. As a result, the AD calculation effectively offsets the effect of the currency undervaluation on price. Requiring an additional adjustment would violate WTO rules by capturing the effect of the undervaluation twice.

Thus, we are left with the question of what would be an effective approach to the currency issue. We agree with several points on this issue raised in an article in the opinion section of the Wall Street Journal on March 18, 2010.[7] In particular, moving China to a fully-convertible currency and loosening capital controls are more important reforms than a futile attempt to force China to revalue or float the yuan. As pointed out in the article, lack of full convertibility and excessive capital controls are two factors spurring the Chinese government to buy huge amounts of U.S. Treasury notes and hindering efforts at further liberalization of the Chinese financial sector.

In any event, as also noted in the article, there is no assurance that a revaluation or full float of the Chinese currency will have any appreciable impact on the U.S. bilateral trade deficit with China, especially if the Chinese economy is adversely affected through deflation and imports into China decline as a result as happened under similar circumstances with Japan in the late 1980s and early 1990s. Indeed, appreciation or float of the yuan will certainly have no impact on the overall merchandise trade deficit as any Chinese production adversely impacted by a higher valuation of the yuan will likely simply move to another foreign country.

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[7] *The Wall Street Journal*, Opinion: The Yuan Scapegoat, The U.S. establishment flirts with a currency and trade war with China (Mar. 18, 2010).

In conclusion, before acting on any legislation targeting Chinese currency policy, Congress and the Administration need to ask three questions: (1) Does the legislation conform to WTO rules?; (2) Will the legislation be effective in achieving the stated goal?; (3) Will any benefits of the legislation outweigh the harm it may inflict on U.S. companies, workers, and the economy? If the answers to any one of these questions is no, then the entire exercise will be seen as merely protectionist political posturing.

NRF appreciates the opportunity to comment on China's exchange rate policy. Should you have any questions please contact me at (202) 626-8104 or by e-mail at autore@nrf.com.

Sincerely,

Erik O. Autor

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