US-CHINA ECONOMIC RELATIONS REVISITED

Statement to the Senate Committee on Finance
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Chairman Grassley, Senator Baucus, other members of the Senate Finance Committee: My name is John Frisbie. I am President of the US-China Business Council, which represents approximately 250 US companies doing business in and with China. Thank you for this opportunity to provide you with our members' perspective on the state of US-China economic relations.

Introduction

The US-China Business Council (USCBC) favors a balanced approach to our trade policy toward China. This involves recognizing the significant benefits trade and investment with China have provided US companies and the American economy, while also understanding the challenges experienced by some sectors. A balanced approach also requires addressing the barriers still faced by US companies doing business with China, while expanding the opportunities created by the opening of China's economy.

These themes were addressed in our written statement submitted for last June's Senate Finance Committee hearing on China. Since then, China and Hong Kong combined have become our third-largest export market, passing Japan and trailing only our free-trade-area neighbors, Canada and Mexico. Moreover, China continues to be the fastest growing of our top fifteen export markets. Our exports to China have grown 150 percent over the past five years since China joined the World Trade Organization (WTO); the second fastest growing major market for American products during that time was Belgium, with a cumulative growth of 33 percent.

At home, US trade and investment with China will by 2010 result in an annual 0.7 percent increase in US gross domestic product and an annual 0.8 percent decrease in US prices—the combined effect of which will be an annual increase of up to $1,000 in real disposable income per US household.[1] At the same time, however, it must be acknowledged that China's expanding role in the international economy has likely contributed to the decades-long shift in US

[1] Erik Britton, Christopher T. Mark, Sr. *The China Effect: Assessing the Impact of Trade and Investment with China on the United States*. Washington, DC: China Business Forum, 2006. pp. 8 – 9. <http://www.chinabusinessforum.org/pdf/the-china-effect.pdf>.

employment from manufacturing to service sectors, even as our manufacturing output continues to rise.

Most of the USCBC's approximately 250 member companies are focused primarily on either exporting to, or manufacturing and selling in, China. This focus is reflected in the annual survey results of our membership regarding its China business. For USCBC member companies, the top concerns include improving the protection of intellectual property rights (IPR); fully utilizing newly granted distribution rights; increasing government transparency; finding and retaining local management staff; lowering market access barriers in various service sectors; and ensuring that Chinese technical, safety, and health standards do not hinder US companies' ability to sell in China. With the exception of IPR, companies using China as an export platform would not be concerned with these issues.

Before going further, it is important to understand the global dynamics of trade and investment affecting the US-China economic relationship. Increases in the US trade deficit with China are generally not the result of specific Chinese policies. Rather, they mainly reflect the ballooning US global trade deficit and shifts in patterns of trade and investment within Asia. Over the last ten years, China's share of the total US trade deficit remained fairly constant, increasing from 23 percent to 26 percent (even though it has grown significantly in real terms). During the same period, the rest of East Asia's share of our global trade deficit declined significantly, from 42 to 18 percent. Why has this happened? During that period, East Asian economies invested heavily in China, thereby shifting much of their manufacturing capacity—and therefore their trade surpluses with the United States—to China.

Furthermore, when taken as a whole, China and East Asia's share of the US global trade deficit actually has dropped from 67 percent to 44 percent over ten years. In contrast, our trade deficit with the rest of the world has grown across the board and now makes up 56 percent of our global trade deficit. Some of this increase is from petroleum imports. But even when the effects of petroleum are stripped out the growth of the US trade deficit with East Asia including China ($225 billion) is roughly matched by the growth in our trade deficit with the rest of the world ($205 billion) during this time. The US economy may have a trade deficit problem, but if so its causes extend beyond simply our trade with China.

On this basis, I would like to turn to key developments since last June's Senate Finance Committee hearing on China.

USTR's Top-To-Bottom Review

The USCBC welcomed the findings and recommendations of the Office of the US Trade Representative's (USTR) "top-to-bottom" review of US trade policy toward China released in February of this year. As the Committee is aware, the report proposed enhancing USTR's enforcement capabilities, increasing staff both in China and in Washington, and improving coordination with our other trading partners on China issues—all of which we believe are essential to addressing the concerns of the US business community.

The review demonstrates USTR's commitment to working on the key issues in our trading relationship and it highlights the balanced approach we describe above. While China is our fastest growing major export market and our commercial relationship with China is vital to the strength of the US economy, we also must take steps to resolve problems in that relationship.

USCBC member companies, like most businesses operating in China, agree that these key issues must be addressed. IPR protection and enforcement remain inadequate. China's regulatory process still remains too opaque. Market access for foreign companies operating in China remains inconsistent. China's financial sector reforms are unfinished.

Resolution of these problems is best pursued through the type of constructive engagement that USTR described in the top-to-bottom review. We support the refocusing of resources and anticipate tangible results from stepped-up engagement.

China's Currency

One issue more than any other has captured the attention of Congress and much of the American public: the exchange rate between the US dollar and the Chinese yuan. Many say that China's government keeps the value of its currency artificially low in order to boost its exports and that this is the main cause of the bilateral trade deficit between China and the United States.

As we noted in our submitted testimony last year, China should indeed adopt a market-determined exchange rate. Toward this end, our focus should be on encouraging China to undertake the broader financial sector reforms that will enable China to remove capital controls at the appropriate time and allow market forces to determine fully the value of its currency. These include opening the financial sector to more private companies, introducing more financial market products such as currency futures, requiring greater commercial accountability from existing financial sector companies, and, of course, allowing more foreign participation in China's capital and credit markets. We understand that the Treasury Department has made these reforms a central part of its engagement with China's government and we fully support this dialogue.

In the meantime, China should move more quickly to allow market influences from trade flows to be reflected in the exchange rate between the dollar and the yuan. Last July's change in China's currency policy was welcomed by all. Movement since then to allow market influences a greater role in setting the exchange rate has been slow, although the pace has increased during the past month. Many economists and the local press in China expect gradual appreciation to continue for the balance of this year.

It should be noted, however, that the effect of China's exchange rate policy on bilateral trade is likely overstated. USCBC member companies generally do not cite the exchange rate as a key business issue affecting their competitiveness in China. Many are concerned, though, about potential repercussions should the political dispute between the two countries over the exchange rate worsen. More broadly, recent research indicates that even a 25 percent revaluation of the yuan against the dollar—far greater than expected—would decrease the total US trade deficit, which was $766 billion in 2005, by $20 billion.[2]

Even so, any benefit China gains from an undervalued currency—even if its actual impact on the US economy is not great—should be addressed. The best way to eliminate any such unfair

[2] Ibid, p. 8.

advantage is to continue to push for greater market influences to be reflected in the exchange rate now, and for broader financial reforms that will lead to the removal of capital controls at the appropriate time and a truly market based currency in the future.

Joint Commission on Commerce and Trade

As the members of this committee are aware, the Joint Commission on Commerce and Trade (JCCT) will meet on April 11, 2006 in advance of PRC President Hu Jintao's visit to the United States later in the month.

Before I note some of the issues that the USCBC's members hope will be addressed at this year's meeting, I want to highlight a concern about the process in general. The JCCT originally was created as a means to promote commercial opportunities. In recent years, the JCCT has focused solely on resolving trade problems.

There are, of course, many more issues of concern between our two countries than can be resolved in a single annual meeting. As one would expect, negotiators on both sides frequently begin to plan for the JCCT several months in advance with extensive lists of possible topics that may be included in the final JCCT agenda. As the list of issues is reduced to a manageable number, unresolved issues are put aside until the next opportunity for resolution—frequently, the following year's JCCT.

Given the breadth of the issues, US government and industry need to see engagement with the PRC in the areas of concern on a more regular basis. The current, irregular, schedule of the JCCT and its limited scope of coverage are not adequate to make continued, meaningful progress. For instance, issues affecting US media companies are, for the most part, outside of the portfolio of China's JCCT team. A mechanism for broader and more frequent engagement is necessary if we hope to resolve the irritants in our economic relationship with China.

Until such a mechanism is established, however, the JCCT remains the best means to achieve progress on the greatest number of issues. China has done moderately well in following through on the commitments it has made as part of the JCCT process, though some issues remain unresolved.

Two areas that the USCBC believes must be central in this year's meeting should be highlighted. First and foremost is IPR enforcement, the top problem cited by our membership in our most recent survey. USCBC continues to regularly lobby the PRC government on the need for improved IPR enforcement. We will be submitting recommended regulatory changes directly to the PRC government this spring. And we are providing American companies with "best practice" tools so that they can do the maximum to reduce their exposure in a difficult environment.

Intellectual property piracy simply cannot be tolerated. At the same time, this far-reaching problem will not be solved overnight. The key is for China to show steady progress in reducing piracy—that effective steps are being made toward the goal. The challenge for us is to identify specific measures for adoption in the JCCT process that, if implemented, would lead to such tangible progress. Last July's JCCT IPR measures were a good step in this direction; we need to continue this approach in April. And, China needs to bring greater transparency to its enforcement efforts so that all can assess if progress is being made.

China published just recently its 2006 IPR Work Plan. The plan suggests that many of the July 2005 JCCT actions are being implemented and additional measures are being taken. We encourage USTR and the Department of Commerce to evaluate this plan's effectiveness and identify additional specific measures that could be incorporated in this year's JCCT that would encourage further progress on IPR enforcement in China. We hope these measures would include China's favorable response to the request for case information under Article 63.3, which would bring more transparency to the enforcement effort.

A second issue that the USCBC believes must be addressed in this year's JCCT is subsidies. If we are to seek a level playing field for US companies operating in China, as well as for American companies facing Chinese competition at home and in other markets, we need to devote more effort and resources to better understanding this aspect of China's economy. While China's economy continues to evolve, it is transitioning from a state-run, command economy that directly subsidized much activity in the past. There may be remnants of the old system still in place that are benefiting Chinese companies at the expense of foreign competitors.

China's WTO accession required it to file a report on its subsidies upon accession in December 2001. That deadline was missed. At the 2005 JCCT, China agreed to submit the report by the end of the year. It still has not been submitted. The report must be completed and submitted now. It will not likely provide the detail or complete picture needed, but it is a necessary first step to getting at this important aspect of the level playing field.

Beyond these issues, we hope the JCCT will successfully address other issues, such as: establishing a start date for negotiations on China's accession to the WTO Government Procurement Agreement; resolving the auto parts customs classification issue; addressing several air express delivery concerns with China's draft Postal Law; and allowing direct selling companies to practice their internationally accepted model in China. We also hope to see progress on several other issues that USTR and the Department of Commerce are discussing with their PRC counterparts.

A Bigger Framework?

The USCBC hopes that President Hu's visit will provide additional incentive for resolution of bilateral concerns. The main goal for the United States, however, should be to reinforce at the highest level China's continued commitment to implement fully its WTO obligations and to participate in the global economy as a mature trading partner.

One of China's goals is recognition by the United States as a market economy. US law clearly lays out the criteria for market economy status, one of which is the extent to which a country's currency is convertible into other currencies. Given the need for tangible progress on that and other issues, it may be time to provide China with a clearer roadmap of how to meet those criteria. As further encouragement, perhaps we should also consider the steps China could take to become a member of what would then become the "G9." Setting positive, mutually beneficial goals and outcomes may help facilitate progress in China on the reforms and market openings needed to get there, including resolution of issues adversely affecting American companies and the American economy.

Conclusion

Since the Senate Finance Committee hearing on China last June, we have seen progress in a number of important areas:

- A JCCT meeting took place in July, at which several specific IPR-related measures were included. China has enacted several of those measures. China announced a 2006 IPR Work Plan in March that incorporates many of these measures, plus additional actions.
- Other, non-IPR measures agreed to at last July's JCCT have also been implemented, including a meeting under the US-China Insurance Dialogue in December to address regulatory issues; a meeting of the Information Technology Working Group in January to work on capitalization requirements and other issues; and a delay in issuing regulations on PRC government procurement of software.
- China revised its currency policy in July, along with a 2.1% revaluation of the exchange rate, and has allowed the yuan to appreciate slowly since then.
- US exports grew 20% last year, making China our fourth-largest export market, or third largest when combined with Hong Kong.
- USTR released its top-to-bottom review of China trade policy, offering a comprehensive approach to addressing trade concerns.

However, we also need to see more progress in some of these same as well as other areas:

- IPR protection is still a significant problem for US (and other foreign and Chinese) companies. While the IPR problem cannot be solved overnight, we have to see progress toward reaching that goal, with more transparency needed from China in its enforcement effort.
- China should allow market influences to be reflected in its exchange rate at a faster pace. We should keep in mind that broader financial reforms and market openings are also needed to get to the eventual goal of a fully market-based exchange rate.
- The bilateral trade deficit grew to just over $200 billion in 2005. While our bilateral trade balance needs to be put into the context of our shifting trade pattern with East Asia as a whole and with the rapid growth in our trade deficit with the world, we nonetheless need to make a more fact-based assessment of the "level playing field," including subsidies that may give Chinese enterprises an unfair competitive advantage. On our side, we need to boost our exports by continuing to engage the PRC on removing market barriers and by devoting more resources to helping American companies—especially small- and medium-sized enterprises—enter and succeed in the China market.
- Insurance licensing, telecommunications capitalization requirements, and government software procurement questions remain, despite the limited progress noted above. Further attention to these issues is required to ensure progress continues to be made.
- China needs to start accession negotiations to the WTO Government Procurement Agreement by the middle of this year; allow direct selling firms market access based on internationally accepted practices; ensure that its standards setting process does not exclude foreign competition; and engage in meaningful discussions with the US government to eliminate or reduce numerous other market access barriers.

In closing, we feel it is important to comment on the call for protectionist policies from some quarters in response to the challenges of trade. As noted in our statement submitted to the Senate Finance Committee last June, the US-China Business Council is very much aware that the benefits and costs of international trade do not distribute to all Americans evenly. We recognize that some sectors of our economy struggle with the challenges brought by trade with China and the rest of the world. We must also remember, however, that our large global trade deficit is not caused solely or, perhaps, even mainly by Chinese policies.

In addition, the benefits of trade, in the form of substantial exports, a lower cost of living, and less inflation, are large and clearly outweigh the challenges. Business and government should work to guarantee that all Americans have the opportunity to enjoy these benefits. Part of this work requires us to press China to abide by its international trade agreements and to enforce our trade remedy laws to ensure a level playing field, but jeopardizing the US economy with tariffs or other protectionist measures is not an acceptable way to inform China that it must change some of its policies. Rather, we should also focus on policies to correct a trade deficit that has grown remarkably with all regions—not just China—such as reducing our large fiscal deficit and enhancing the competitiveness of our economy.

THE US-CHINA BUSINESS COUNCIL
美 中 贸 易 全 国 委 员 会

AN INTRODUCTION TO THE US-CHINA BUSINESS COUNCIL

The United States-China Business Council, Inc. is a private, non-profit, non-partisan, member-supported organization. It is the principal organization of US corporations engaged in business relations with the People's Republic of China. Founded in 1973 as the National Council for US-China Trade, the Council originally served the early efforts of United States business in China in the absence of formal diplomatic relations between the two nations. With the massive growth of US-China economic engagement since the end of the 1970s, the Council has continued to assist firms entering the field for the first time, but increasingly the bulk of its work has served the interests and needs of US firms with well-established commercial relationships in China. Headquartered in Washington, DC, the Council also serves its corporate members from field offices in Beijing and Shanghai.

The Council provides extensive, tailored Business Advisory Services on a wide range of business interests and concerns to individual member companies. Its meetings and programs, in the United States, China and Hong Kong, provide both broad-gauge and highly business-relevant information, and offer companies the chance to share ideas and experiences as well.

The Council continues to play a central role in analysis and advocacy of key policy issues of significance not only to US businesses but also to the future of US-China relations. The Council's activities in support of government policies conducive to expanded US-China commercial and economic ties include educational meetings with Members of Congress and Congressional staff, and frequent testimony on behalf of the US business community in Congressional or other venues. The Council also works to enhance media and public understanding of complex issues in US-China relations, appearing frequently on major broadcasts and providing accurate statistical and analytical information to media representatives.

The Council's numerous publications include the leading US periodical on China trade, the *China Business Review*, the members' weekly electronic newsletter, *China Market Intelligence*, two web sites, www.uschina.org and www.chinabusinessreview.com, and numerous focused studies on topics of current business interest.

The Council serves as a valued and economical complement to the intensive in-house efforts that US companies devote to business development in China. Council membership in 2006 currently stands at approximately 250 firms, and continues to strengthen in response both to China's economic growth and to the many challenges and complexities US firms face in the Chinese environment. Among the Council's members are many of the largest and best known US corporations, but smaller companies and service firms make up a substantial portion of the overall membership as well.

The Council is governed by a Board of Directors composed of distinguished corporate leaders. The Council's current chairman is Michael L. Eskew, Chairman and Chief Executive Officer of UPS. Since November 1, 2004, the Council's president has been John Frisbie.

The US-China Business Council has long served as a respected host for senior visitors from China and from the United States government. In recent years, the Council has been honored to receive His Excellency President Hu Jintao; Premier Wen Jiabao; former President Jiang Zemin; former Premier Zhu Rongji; and other distinguished Chinese guests from central and provincial government entities. Recent American public figures to meet with Council members have included Commerce Secretary Carlos M. Gutierrez; former US Trade Representative Robert B. Zoellick; US Ambassador to China Clark "Sandy" Randt; key figures from the United States Congress; and numerous specialists on US-China affairs from various agencies of the Executive Branch of government.

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