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INTERNATIONAL CONSULTANTS

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United States-China Economic Relations

Mr. Chairman and Members of the Committee, thank you for inviting me to share with you my views regarding opportunities and challenges in the U.S.-China Economic Relationship. You have posed seven questions.

I. What are the key issues for the United States and China policy makers to consider regarding fair and open access to each other's market?

1. Keeping Bilateral and Global Markets Open
The most important issue for leaders in the United States and in China to keep firmly in mind is that their nation's prosperity requires keeping bilateral and global markets open. History shows that no country has done well by sealing itself off from the world.

Economist Dr. Gary Hufbauer in a comprehensive study published by the Peterson Institute for International Economics calculates that the opening of global markets since World War II has increased our nation's GDP by roughly $1 trillion per year, thus raising the average American household yearly income by $9,500. He further calculates that the additional opening of world markets to trade and investment could increase U.S. wealth potentially by another $500 billion per year, making the average American household richer by an added $4,500 per year. It is hard to think of another economic policy decision that could have such a positive impact on U.S. economic well-being.

And it is thanks to the opening of global markets that China has averaged double digit growth over the past three decades, enabling it to lift hundreds of millions of people out of dire poverty. Today, China has become the world's fastest growing major economy. This year it is likely to replace Japan as the world's second largest economy.

The benefits of open markets are enormous. The prosperity of the peoples of both China and the United States will be enhanced by maintaining a strong and vibrant economic relationship.

Yet economic hardship inevitably stokes economic nationalism. Last year for the first time since World War II, global trade plummeted 11 percent and global output fell into negative territory. Americans were hit by historic job losses, home foreclosures, and bankruptcies. China did not escape the crisis. It was forced to shutter hundreds of assembly and manufacturing facilities putting millions of people out of work.

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Although the International Monetary Fund forecasts world output will grow by more than 4 percent this year and global trade will increase by 7 percent, there is considerable pain remaining. Policy makers in the United States and in China will expedite the economic recovery that is now underway by resisting calls to impose market barriers on the trade or investment of the other.

In spite of our different histories, form of governments, and domestic sensitivities, an important fact for both Chinese and American policy makers to keep in mind is the enormous potential for extremely positive interaction between the largest and the fastest growing economies.

<u>2. Rebalancing our economies.</u>
While both of our economies are recovering, our policy makers cannot ignore the fact that the imbalance that exists in our respective economies could trigger another crisis. In the last half decade China has become the world's largest creditor nation, and the United States its largest debtor nation. Although China has cut its surplus from its peak in 2007 of 11 percent of its GDP to about 5 percent in 2009 and 3.5 percent in the first quarter of 2010, and the United States' external federal deficit has come down about from its peak in 2006 of 6 percent of GDP to 2.8 percent in 2009, thoughtful economists who have studied this issue believe that both declines were largely driven by cyclical factors and that structural changes are still required if we are to protect against future global financial crises.

The United States will need to reduce both its primary budget deficit and its external deficit. China will need to reduce its reliance on exports and heavy industry. Although the action that each government takes to restructure its economy is independent of the other, it is an issue that both policy makers must address.

II. What Potential Does the Chinese Market Hold for U.S. companies?

The actual and potential of the Chinese market is substantial and growing. China has become America's third largest export market behind Canada and Mexico and is our fastest growing export market. Between 2000, the year before China joined the World Trade Organization (WTO) and 2008, U.S. sales to China increased 340 percent whereas U.S. sales over that same period to the rest of the world increased just 29 percent.

Importantly, virtually every state in the union has seen near triple digit increases in its sales to China. Last year computers and electronics, crop production, chemicals and transportation equipment comprised our top four exports to China. These are all sectors that generate good domestic jobs.

And in 2009 when for the first time since WWII trade plummeted 11 percent dragging world growth into negative territory, U.S. exports to China held steady whereas U.S. exports to the rest of the world fell nearly 20 percent. This year through April, U.S. exports to China are up 42 percent and are 17 percent higher than the comparable period in 2008.

It is not surprising that U.S. companies continue to seek to do business in and with China. In 2009 in spite of the economic crisis that adversely affected both China and the United States, the value of U.S. goods exported to China was about $70 billion roughly the same amount as before the crisis, and if sales of U.S. goods to Hong Kong are added, the total climbs past $90 billion. In addition, U.S. exports of services to China topped $15 billion. And sales of U.S. affiliates in China topped $84 billion in 2007 before the crisis and the latest year for these statistics. In short, the U.S. current market in China exceeds $100 billion dollars and that market is steadily growing.

III. What are the chief obstacles that U.S. companies face in China?

Foreign companies face a number of obstacles in doing business in China. There are voices in the Chinese leadership, as there are here in the United States and elsewhere, urging the adoption of restrictive measures to protect specific interests of domestic businesses. Measures in China that have been particularly nettlesome to U.S. companies include:

1. Government Procurement: "Indigenous Innovation" policy

In 2006, China, in an effort to produce "national champions", adopted an "Indigenous Innovation" policy that sought to encourage government purchases of domestic products in specific sectors. Last year the government produced lists of favored products. As a result of bilateral dialogues, the government has moved from mandating domestic purchases to encouraging them. However this "buy China" policy is a major concern to U.S. entrepreneurs, particularly those in the high technology sectors.

2. Protection of Intellectual Property

According to a survey conducted by the U.S.-China Business Council, two-thirds of U.S. companies found China's failure to protect adequately intellectual property adversely affected their businesses in China. Getting the legal structure right is important. In 2009, the United States brought and won a case in the WTO dealing with copyright infringement which resulted in China amending its laws. However, enforcement is a major problem at the central, provincial and local levels.

3. Standards and Testing

U.S. companies are adversely impacted by standards that are drafted to favor Chinese domestic products. For example, an ingredient that is harmless may be prohibited in a particular product when that ingredient is not used in competing Chinese products.

U.S. companies find China's testing process challenging. A Chinese certification board is responsible for testing most products sold in China. That top-down approach is different from the process used in the United States where industry develops the product standards in the first instance.

4. Investment Restrictions

A U.S.-China Business Council survey of its member companies doing business in China indicates that roughly 90 percent of its member companies invest in China to reach the market there, not to export back to the United States. Although some sectors are open, others including chemicals, automobiles, telecommunications and express delivery encounter some restrictions. China is in the process of revising its 2007 Catalogue Guiding Foreign Investment in Industry.

IV. How can the United States best strengthen its trade and investment ties while ensuring U.S. competitiveness in an increasingly competitive environment?

Our nation can strengthen its trade and investment ties with the trading nations of the world including China in a number of ways including (1) leading the 153 members of the World Trade Organization (WTO) to a successful conclusion of the Doha Round of Multilateral Negotiations;
(2) expanding efforts to open markets with the 21 economies comprising the Asia Pacific Economic Cooperation forum (APEC) starting with completing the Trans-Pacific Partnership; (3) approving the three pending free trade agreements that have been signed with South Korea, Colombia, and Panama; (4) completing the negotiation of a Bilateral Investment Treaty with China; and (5) addressing our restrictions on immigration that reduce our competitiveness.

1. Doha

For six decades the United States under both democratic and republican administrations led the world in opening global markets to trade and investment with the result that economic growth both globally and nationally soared for rich and poor nations alike. Our actions in the early multilateral negotiations under the General Agreement on Tariffs and Trade (GATT) accelerated the economic rebuilding of nations devastated by World War II. Today we could be equally far sighted by achieving an agreement in the Doha Round of Multilateral Negotiations that would integrate developing nations more solidly into the global trade regime and in so doing enlarge trade and investment opportunities that would fuel economic growth at home and around the world. Unfortunately, we are no longer leading efforts to open global markets.

Currently in its ranking of 133 trading nations, the World Economic Forum ranks the United States behind 43 nations in terms of how open the domestic market is to trade. However, the Doha Round offers our nation an outstanding opportunity to do well by doing good. One example stands out. By agreeing to reduce meaningfully our agricultural subsidies, we could persuade other governments with high subsidies to do the same. Opening global agricultural markets would not only benefit our farm exporters, but it would show the world that we are serious about taking steps to put our nation on more a more sustainable fiscal path.

2. APEC and TPP

Expanding our trade and investment ties in Asia offers the United States a significant opportunity to stimulate domestic economic growth and job creation. The 21 members of the Asia Pacific Economic Cooperation forum (APEC) represent approximately 2.5 billion consumers, 58 percent of global trade, and more than half of world output. Over the past decade most of the increase in global growth has been generated by the APEC economies. Collectively these economies account for a majority of our nation’s exports. Further opening these markets to U.S. entrepreneurs would enhance our nation's competitiveness in the world's most vibrant region where other major trading nations including China, Japan, South Korea, the European Union and the economies comprising the Association of Southeast Asian Nations (ASEAN) have negotiated or are currently negotiating bilateral and plurilateral trade agreements that advantage their entrepreneurs over ours. Obtaining equal or better access to these markets would enhance our nation's competitiveness, create jobs, and boost growth.

Achieving this will require leadership and action on our part. To strengthen our trade and investment ties in this high-growth region, we should move forward promptly to negotiate the Trans-Pacific Partnership (TPP)[1], which could serve as a first step toward a broad market opening agreement in the region which over time could incorporate additional APEC members, such as Japan, South Korea, Indonesia, Malaysia, and eventually China. Such an agreement would not only enhance our nation's competitive position, it would also create a visible bond across the Pacific to work against the world splintering into three blocs (Asia, Europe, and the Americas) which would both impede global and national economic growth and increase the potential for global instability. The APEC Summit in Hawaii in 2011 gives the United States an excellent opportunity to showcase a completed TPP, which would demonstrate its renewed commitment to the region.

3. Approval of Pending Free Trade Agreements

A. Korea Free Trade Agreement

Approval of the Korean Free Trade Agreement would both enhance our competitiveness in Asia and demonstrate our continued interest in the region. Under its terms South Korea, currently our seventh largest trading partner, would open its market to U.S. farm products, goods, and services, enhance its protection of intellectual property and substantially open government procurement. Ninety-five percent of bilateral trade in consumer and industrial products would become duty free within three years. The agreement would cause trade to expand between our two nations and stimulate both economic growth and jobs in both markets and put our entrepreneurs on an equal footing with the growing list of major trading nations that have already negotiated trade agreements with South Korea. [2] Significantly, it has indicated an interest in negotiating a trade agreement with China, which if concluded, would put our exporters at a substantial disadvantage in one of our key export markets.

B. Colombia and Panama Free Trade Agreements

Approval of the trade agreements that the United States has signed but not ratified with Colombia and Panama would substantially enhance our competitiveness in Latin America. Colombia with its $250 billion economy is the second largest in South America. Today in excess of 90 percent of U.S. imports from Colombia enter the United States duty free while relatively high tariffs are imposed on most U.S. exports. The agreement would eliminate

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[1] Currently involving Australia, Brunei, Chile, New Zealand, Peru, Singapore, the United States and Vietnam.

[2] Korea currently has 5 Free Trade Agreements in effect, two that are signed and pending ratification, negotiations underway with 8 other countries and is considering entering negotiations with 6 more.

80 percent of those tariffs and open up markets to a broad range of services and investment. That would make exports more competitive and remove the additional disadvantage our exporters face not only by "leveling the playing field" between the two countries but also by achieving equality with Colombia's other trading partners like Canada that have already entered a free trade agreement with Colombia.

Similarly opening Panama's market would make our goods, services, and investment more competitive. It makes no sense for us to be the impediment that enables Panama to ship its products duty free and to assess duties on our services and goods including our competitive heavy equipment used for canal upgrades when much of our competition ships duty free.

<u>4. Bilateral Investment Treaty with China</u>

As economist Dr. Hufbauer has ably documented U.S. outward foreign investment pulls U.S. exports into the foreign market, while inward foreign investment into the United States boosts economic growth and creates domestic jobs. To establish clear rules governing inward investment gives certainty to the market and confidence to investors, plus it helps to avoid controversy. In June of 2008 at the fourth Strategic Economic Dialogue, China and the United States agreed to begin negotiations of a bilateral investment treaty to protect the interests of their respective investors in the other's economy. Such an agreement would protect our investors against discriminatory measures that today account for a major portion of the obstacles that confront our businesses in China. With economic nationalism on the rise in both countries, moving ahead to conclude an investment treaty would enhance U.S. competitiveness by insuring that we can capture the growth and jobs that attend cross border investment.

<u>5. Immigration Contributes to U.S. Competitiveness</u>

We usually talk of trade ties in terms of goods, services, and investment and less frequently mention people and ideas. Yet the United States is a nation of immigrants. Talented people from all over the world come to work or study in the United States bringing their ideas, starting businesses, creating jobs and contributing to our competitiveness. According to a study published in 2008 by the Small Business Administration [3], immigrants constitute 12.5 percent of U.S. business owners and start 25 percent of new engineering and technology companies. Another study published in 2009 by the American Electronics Association, [4] found that immigrants were CEOs or lead technologists in one of four technology and engineering companies started in the United States between 1995 and 2005. These immigrant-founded companies employed 450,000 workers and generated $52 billion in revenues in 2006. Unfortunately for our economic growth, creation of new jobs, and overall competitiveness the annual number of H-1B visas is sharply restricted. Current law limits H-1B visas to 65,000 annually with up to 20,000 available for foreign nationals holding advanced degrees from an American university. America could boost its growth,

[3] Robert W. Fairlie "Estimating the Contribution of Immigrant Business Owners to the U.S. Economy," Small Business Administration Office of Advocacy, November 2008, http://www.sha.gov/advo/research/rs334tot.pdf

[4] "Workforce & Immigration Overview: Maintaining a High-Skilled U.S. Technology Workforce," 2009 http://www.acanet.org/GovernmentAffairs/gaet_1B_H1BVisa.asp

job creation, and competitiveness by opening its doors more widely to talent from beyond its border.

<u>V.The Strategic and Economic Dialogue is our bilateral forum for engagement on many of these issues. How would you rate the effectiveness on these issues?</u>

I believe that the Strategic and Economic Dialogue is an important bilateral forum that can help our government to build a solid relationship with the world's fastest growing economy. It provides the opportunity for our leaders at the highest level to meet their counterparts and discuss critical issues. These discussions can enhance our understanding of China's economic challenges as well as its strategic objectives and ensure that China's leaders understand ours. Mutual understanding is indispensable to finding solutions to tough issues. The list of economic issues that require collaboration for proper resolution is long and growing including rebalancing our national and the global economies, energy security, trade policy, financial reform, and environmental protection. To address effectively these and other issues, it is overwhelmingly in our national interest to maintain a close, candid and collaborative relationship at the highest levels, and the Strategic and Economic Dialogues help to do just that.

We know that high level engagement works. In recent years our Deputy Secretary of State met frequently to discuss issues of foreign policy.
In addition our Secretary of the Treasury led the effort called the Strategic Economic Dialogue (SED) whereby Cabinet level officials from both governments met to discuss economic issues for two days twice a year. The purpose of the SED was to discuss complex, long-standing, economic challenges and to craft solutions satisfactory to both governments.

Since both our governments are quite compartmentalized and have different organizational structures, these meetings helped to circumvent the stovepipe structures that impede decisions by bringing to the table all the high-level officials on both sides required for a decision.

These face to face meetings enabled both sides to understand the concerns of their counterparts and led to a number of positive outcomes. For example in 2007 when food and safety issues were very much in the news, high-level officials from both governments seriously discussed at an SED meeting effective ways to deal with these issues.

At the next meeting of the SED, representatives of our Food and Drug Administration and our Consumer Products Safety Commission and their Chinese counterparts were able to announce a Memorandum of Understanding covering how they would cooperate in food

and safety investigations. Representatives of our FDA have publicly stated that they had never before enjoyed such a high level of positive interaction with their counterparts in China. They have established offices in Beijing, Guangzhou, and Shanghai.

More recently at the S&ED meeting this past May, after discussion the Chinese government agreed to submit a proposal to join the WTO Government Procurement Agreement by the end of July. Such an agreement would protect our entrepreneurs against the some of the discrimination that they name as the top obstacle they encounter today in penetrating the Chinese market.

The economic dialogues not only provided an effective forum for raising and solving economic issues of concern to both our governments, but they also created a mechanism that avoids having to initiate talks among strangers in the heat of a crisis.

Accordingly I was very pleased when it was announced that our Secretaries of State and Treasury would share leadership of a high-level bilateral dialogue, now called the Strategic <u>and</u> Economic Dialogue. The S&ED first met in July last year and again last month for two days on each occasion. The plan is to hold these meetings on an annual basis dedicating one day to a plenary session and the second day to separate discussions on economic and strategic issues.

The one downside that I see in the new structure is its sheer size. In May our delegation to Beijing comprised 200 senior officials, the largest U.S. delegation to China in the history of our bilateral relationship. The merged strategic and the economic groups bring together such a large number of participants that relationship building that has been so helpful in the past will be far more difficult.

Another downside I see is that the stated intention is to meet yearly rather than twice each year. Formerly, two full days twice a year, four days total, were devoted to economic discussions. Now only one day each year will be devoted exclusively to economic issues. Our bilateral economic agenda is long and growing longer which suggests to me the need for more rather than fewer meetings.

There are two other bilateral dialogues that provide valuable means to have sustained focus on critical economic issues, but they are not conducted at the same high level. One is the Joint Commission on Commerce and Trade, a senior officials group that has formed some 17 working groups to address specific issues including industrial and competition policy, intellectual property, information technology, and trade and industry. Most of these plan to meet twice a year.

The second is the U.S.-China Investment Forum, a deputies led group that is focused on such issues as procurement, standards, and access to markets for services.

VI. Can we maximize our ability to address concerns about certain Chinese economic policies through multilateral fora such as the G20?

The G20 group of nations representing the world's 20 largest economies which has replaced the G-8 representing the eight large industrialized nations is far better equipped to deal with today's global economic challenges.

Three issues of key importance to both the United States and China are better suited to the G20 forum than bilateral discussion: (1) China's currency regime; (2) the need to rebalance the global economy; and (3) the need to keep global markets open in the face of domestic calls for protectionism.

1. China's Currency Regime

China's currency controls have been an issue of contention not only with the United States, but also with the European Union, which is China's largest trading partner, as well as a number of other nations. China's announcement a few days ago that it will permit the yuan to gradually appreciate will help to reduce those tensions. Monitoring this issue at future G-20 meetings will be helpful in that it will maximize pressure on China which wants to be seen as constructive in international fora and minimizes bilateral contention.

2. Rebalancing the Global Economy

The global recovery that is currently underway, faster for some than for others, could be derailed by the serious imbalance of the global economy that has ballooned in recent years. China, Germany, Japan, South Korea, and other Asian economies have built their growth on exports, whereas the United States, the United Kingdom, and Spain among others have relied excessively on domestic consumption, particularly in the housing sector, to fuel economic growth.

Although investment excesses by the financial sector triggered the fiscal crisis in 2008, there is general agreement that the global imbalance made the crisis much worse. As stated last year by Gerald Corrigan, former President of the New York Federal Reserve: "It is highly likely that these imbalances would create a serious macroeconomic problem even if we had not had the fiscal problem."

If we are to protect against future global financial crises, the global economy must be brought into better balance. That will require debtor and creditor nations to alter their existing economic models to put their economies on a more sustainable growth plan. Debtor nations cannot continue to consume at the excessive levels of the past, and creditor nations must look more to their own consumers to fuel their economic growth.

This is a global problem and requires a global solution. However, global balance is more likely to be restored if the world's largest debtor nation and its largest creditor nation were to lead by example with each committing to specific structural reforms, spelling out the steps that each would take within specific time frames, and agreeing to provide periodic updates regarding progress. That would boost confidence in the future health and stability of the global market, which in turn would help keep our respective domestic economies on a sustainable growth path.

The required changes will take time to implement. But a plan of action over a period of years could be announced that would give confidence to the market and to investors. One could imagine the United States announcing a plan at a G20 meeting to bring its primary budget deficit into balance within a specified period like 5 years and its external deficit into balance in a specified period like 10 years and to report regularly at future G20 meetings on its progress.

Similarly, one could imagine China announcing at a G20 meeting a plan to stimulate its domestic consumption by correcting its under-pricing of capital, water, land, and energy to large enterprises, permitting interest rates to rise on bank deposits, making credit more available to small and medium size businesses, and continuing the steady and gradual loosening of controls on the yuan that it announced this past weekend with progress reports on these structural changes at future G20 meetings.

Such a commitment by the United States to undertake structural reform necessary to achieve more balanced growth would not be a favor granted to nor conditioned on action by China, nor would a decision by China to make structural changes to stimulate domestic consumption be a favor granted to or conditioned on action by the United States.

The policy corrections that each needs to make are necessary to ensure each nation's future financial stability and prosperity, for if corrections are not made the global imbalance will likely ignite another economic crisis. By their respective actions, they would not only give confidence to the market but also help persuade other nations with imbalances to follow their lead. The G20 provides an appropriate forum.

3. Keeping Global Markets open.

Leaders of the G20 nations which account for 85 percent of world output and 80 percent of world trade have taken a leadership role with respect to the global economy. They meet biannually to consult and collaborate on critical global economic issues.

The G-20 leaders instead of simply pledging support could take action and make history by bringing the Doha Round to a successful conclusion. Economic studies document that the reductions in trade barriers that could be secured in this round of trade talks would boost world output between $300 billion and $700 billion a year. We need that growth now.

VII. What are your broad views on the importance of the economic relationship as part of a larger foreign policy agenda?

There is no question but that a collaborative, constructive economic relationship creates a positive environment for discussing tough and contentious foreign policy issues. Even where national interests on foreign challenges diverge, a solid economic relationship makes serious discussion of and possible narrowing of those differences more likely.

That does not mean that we should forego pressing our economic interests. From time to time we will have economic differences with our large and important trading partners, including China. When we believe that China or any trading partner has violated recognized rules of the WTO, or the rules of other international agreements, we should act and use the dispute settlement mechanisms provided to resolve the problem. And where the rules of the system are insufficient, we should negotiate to ensure that they reflect market realities.

Our government has taken China to the WTO eight times. We have settled four of the cases, won three and have one pending. China has brought five cases against us. We have settled one, won two, and lost two.

This is how the WTO trade regime should work. It enables us to resolve trade issues under mutually agreed transparent rules minimizing friction.

Conclusion

Managing U.S.-China relations presents challenges but also very substantial opportunities. Many in America ask: Can the world's largest and fastest growing economies constructively work together to enhance our future prosperity and stability? Or have the differences between our increasingly competitive economies along with those differences in our histories, forms of government, and domestic sensitivities become too great to enable us to harness our respective strengths to deal effectively with today's bilateral and global challenges?

My answer is that we can, should and must work constructively together. Most importantly, I believe that by doing so we can build habits of cooperation that will help us deal effectively with new challenges as they arise which will not only enhance the wellbeing of the people of the United States and of China but will contribute meaningfully to global peace and stability.