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OPPORTUNITIES AND CHALLENGES IN THE U.S.-CHINA ECONOMIC RELATIONSHIP

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BEFORE THE

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OPPORTUNITIES AND CHALLENGES IN THE U.S.-CHINA ECONOMIC RELATIONSHIP

TUESDAY, MARCH 27, 2007

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

The hearing was convened, pursuant to notice, at 10:03 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Rockefeller, Bingaman, Lincoln, Schumer, Stabenow, Cantwell, Salazar, Grassley, Lott, Snowe, Thomas, Bunning, and Crapo.

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

The CHAIRMAN. Could we all come to order?

George Bernard Shaw wrote that "the unexpected always happens." That is certainly true in the relationship between America and China. Before the 1970s, no one expected Nixon to go to Maoist China. Before the 1970s, no one expected that ping-pong could serve as a tool of diplomacy. And before the late 1980s, no one expected that Communist China would embrace market economics. But the unexpected happened, and we are better for it.

Many continue to tell us what we cannot expect. Today, some say that we cannot expect China to stop counterfeiting and piracy, some say we cannot expect the administration to cite China as a currency manipulator, and some say we cannot expect American companies to compete with China.

But today we imagine what can happen. We imagine what America and China can do individually, together, and as part of a community of nations. Today we imagine the unexpected that can happen.

Today's is the committee's third hearing on international trade this year. Today we hear from the first of two panels on the U.S.-China economic relationship. Today we focus on trade, economics, and energy, and tomorrow we focus on currency.

Today we focus on what we can do. What can we do to make China's growing economy a greater opportunity for America's workers, farmers and ranchers? What can we do to ensure that China fulfills its WTO obligations, in letter and in spirit? And what can we do to help American companies and workers become more competitive?

We must also focus on what China can do. What can China do to accelerate mutually beneficial reforms? What could China do to move beyond its 2001 WTO commitments? What could China do to move its economy towards sustainable and balanced growth?

And we must focus on what China and America can do together. What can we do together in the international trade community to foster regional cooperation? What can we do together to advance the WTO negotiations? What can we do together to address global challenges, like energy and environment?

Imagining the possible and crafting solutions is never simple. Julius Caesar wrote that "no one is so brave that he is not disturbed by something unexpected." Many continue to be disturbed by China's unexpected transformations.

We need to imagine solutions to keeping the U.S.-China economic relationship on track, creating jobs and growing our exports. By focusing on what we can do, we can help Americans understand how our trading relationships are beneficial. When those relationships are not beneficial, Americans must understand what we are doing about it.

What we discuss today is bigger than China and America. Our economic relationship with China is a microcosm of America's greater global challenges. Piracy and counterfeiting are not uniquely Chinese phenomena, neither is currency manipulation. We face the same tariff and non-tariff barriers in many other economies, too; rising energy and commodity prices also affect all markets.

Our discussion has broader implications. If we can solve our problems with China, we can solve them elsewhere. If we can unlock the potential of the Chinese market, we can unlock other markets' potential. If we can learn to cooperate with China without illusions, we can build stronger partnerships around the world.

George Bernard Shaw wrote, "If the unexpected always happens, how incapable must man be of learning from experience?"

The solution to Shaw's paradox must be an act of bold imagination. To learn from America's experience with China, we must imagine anew. Let us begin that act of imagination today.

Senator Grassley?

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

Senator GRASSLEY. Mr. Chairman, we do occasionally look to the issue of our economic relationship with China, we need to do that, and I thank you for your leadership in doing that.

You have spoken out on this issue many, many times, probably more often than I have. But I think that we are working together in regard to solving these issues, as evidenced by the legislation that we put in in the past in regard to currency, as an example.

I, first, want to thank our witnesses for being here. And Mr. Chairman, I want to recognize somebody whom you are going to introduce later on: Norman Sorensen is here. He is president and CEO of Principal International. He's joining us from Des Moines, IA.

And if people forget about Principal International, this is the very same Principal that you see national TV advertising about. We may be in the Midwest, but understand we have a very important company there in services, like we do John Deere in agriculture manufacturing.

So in addition to introducing him, I welcome the opportunity to comment on our economic relationship with China. As with any important relationship, it is likely that difficult issues will arise from time to time. The question is, how do you respond to those issues? In my view, you do not retreat from the relationship, instead, you work hard to resolve the issues and improve that relationship.

Clearly, we have significant issues with the Chinese. Infringement on intellectual property rights is one; Chinese currency remains artificially under-valued relative to the U.S. dollar; the Chinese government appears to have a number of policies in place that are inconsistent with China's obligations as a member of the World Trade Organization; and issues that I thought by now would be resolved, considering how hard I worked for China to become a member of the World Trade Organization.

The Chinese government needs to do more to improve transparency. I think China could do more to help advance the Doha Round negotiations in the World Trade Organization, considering how active they were at Cancun when things seemed to be falling apart. It seems to me if you were part of that effort, then you ought to be part of the effort of putting Humpty Dumpty back together again.

Those are just some of the issues. I am very frustrated because China is not moving quickly enough, in my view, to resolve them. On the other hand, I recognize—and I think more Americans ought to recognize—that China is engaging with us in an effort to improve our economic relationships. It tends to get lost, the efforts that are being put forward, because of little irritants that would be so easy for China to take care of.

That ongoing engagement that we have with China means that there's hope that, with a lot of hard work, we can resolve all these issues. We have already been able to work through some very important issues with the Chinese. March, 2004, we filed a case against China's value added tax rebates discriminating against imported semiconductors. We were able to resolve that dispute.

In January, 2006, we were able to bring a case against China's imposition of antidumping duties on our exports of liner boards, and we were able to resolve that issue.

Last year we filed a case against China's discriminatory charges on imported auto parts. That litigation, however, is ongoing, but hopefully can be resolved.

In just the last month, we filed a case against nine prohibited subsidy programs maintained by the Chinese government. China responded by terminating one of those programs a very few weeks ago, and we are in consultation with the eight remaining ones. That is one of the benefits of having China in the WTO. We have a forum to resolve problems, and that is what the rule of law is all about.

I would like to address additionally, Mr. Chairman, our bilateral trade deficit. In 2006, our trade deficit with China exceeded $232 billion, which is over one quarter of our total trade deficit. But it is also true that, in 2006, our exports to China grew by 32 percent, which was significantly higher than the 18-percent increase in our imports from China.

Combined with Hong Kong, China is now our third-largest export market, behind Canada and Mexico. Our trade deficit with China is very much a function of U.S. consumption, because we are producing more and exporting more than ever before.

Some critics may argue that our trade deficit with China translates directly into jobs going to China, and that if we just reduce our deficit, those jobs will come back to the United States.

Of course, that is very simplistic and inaccurate. We have an open economy, and, if we were to somehow shut off trade with China, our trade deficit would most likely migrate to other countries in Asia, assuming our consumption patterns remained the same.

In America, the consumer is king. There is a lot about what their desires are that the United States is not going to be able to give any direction to. Trade policy, then, should not be used as an attempt to restrict economic activity to the United States. We tried that once. It was called Smoot-Hawley, and that protectionism certainly did not help our economy any. It wrecked the world economy, and it directly led to World War II.

Instead, we should embrace the benefits of our open economy, focus on what other policies will help us to remain competitive and create jobs, and attend to the needs of our strikers and businesses here in the United States.

So let us review our economic relationship with China with open eyes. Let us acknowledge the benefits of that relationship and identify the problems that remain. Let us voice our frustrations and work for solutions. Above all, let us recommit ourselves to improving the economic relationship with China through engagement, not retreat.

In the meantime, I would suggest to the Chinese not to be so sensitive every time we raise issues about them. They are very quick to say the United States has no right to raise any questions about what goes on in China.

On the other hand, I think the Chinese know that we are a very transparent society and we welcome their criticism, or any other criticism a country has of the United States, but do not say that we do not have a right to be concerned about what goes on in the internal affairs of your country.

The CHAIRMAN. Thank you, Senator, very much.

Our first witness is the senior Senator from North Dakota, Byron Dorgan.

Senator, we deeply appreciate your coming here. You have been a very active voice on trade policy for a good period of time, and we very much appreciate your contribution. Clearly, this is a very, very important subject, and we just thank you again for taking the time to give us the benefit of your views.

OPENING STATEMENT OF HON. BYRON DORGAN, A U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. Well, Senator Baucus and Senator Grassley, members of the committee, first of all, thank you for holding this hearing. I think this is a very important hearing.

I am, of course, not surprised to enter the room and discover that the ghosts of Smoot and Hawley are not yet dead. I might observe, however, Senator Grassley, that Mr. Smoot and Mr. Hawley were trying to protect a very large trade surplus back then as opposed to trying to figure a way to get out of a very deep hole, these days.

Those of us who testify on trade issues are very concerned about our trade. Not that we do not support trade. I support trade, and plenty of it. I believe trade is very beneficial, very helpful. But trade must be fair.

We have engaged in this chanting of "free trade" without respect to the notion that trade, by and large, with some of our trade competitors, has been pretty unfair. China is an awfully good example of that.

I actually supported PNTR to China in September of 2000. Let me read to you what I said in the Senate record: "I want it to be clear that if we accord permanent normal trade relations to China and discover they are not, in fact, complying with the terms of the bilateral agreement we negotiated with them, then I believe we must reserve the right to revoke China's normal trade relations status."

I believe we are at that point. Clearly, China has not abided by either the spirit or the letter of the trade agreement we signed with them. I believe we should rescind permanent normal trade relationships with China and, instead, make it a year-by-year normal trade relationship vote here in the Congress in order to keep pressure and leverage on the Chinese.

When we granted PNTR to China in 2000, our merchandise trade deficit with China was $83 billion. I have a chart that I wish to show. Eighty-three billion dollars. That has exploded to $233 billion. The green is what we export to China, the red is what we import.

Now, I understand, and several of you have made the point, that, boy, we are sure doing a lot better, all these exports to China. Take a look at the chart and ask yourself whether that is doing better. It most surely is not. We are deep in a hole with respect to our trade agreement with China, and things are getting worse, not better. So that is where we start.

Now, what is the purpose of that? Well, for every $6 of merchandise we purchase from China, the Chinese buy about $1 from us. We have all kinds of staggering problems. They include intellectual property theft, piracy, currency manipulation, unfair barriers against our exports and an unfair playing field in which our jobs go to China because of sweatshop conditions in China.

Now, I represent an agricultural State. China should be, and in some cases is, a significant market for us. But I would observe that in North Dakota we export nearly 10 times as much to the country of Belgium as we export to China, just as an observation.

Now, why are the exports to China as limited as they are? Well, because China has not complied with the trade agreements. They agreed to significantly expand the amount of imported grain coming into China at relatively low tariffs, 8.5 million metric tons per year. We have not come close to that.

The proposition was that we should bring a trade action against China. In fact, in March of 2003, the USTR official in charge of agricultural trade with China said publicly that China had failed miserably to live up to its promises on wheat trade, and the U.S. would be well-justified in bringing a WTO case.

But the official said the administration was reluctant to do so because a WTO case would be seen as an "in-your-face" thing to do to China. I mean, so much for taking effective action. It just is not the case.

This, by the way, is a direct quote from an official in the USTR. We had the evidence, should have taken action, but it would have been considered an "in-your-face," I guess, translated, soft-headed foreign policy notion, so we should not take effective action in this case.

The USTR Report on China Trade Barriers had this to say: "Agricultural trade with China remains among the least transparent and predictable of the world's major markets. Capricious practices by the Chinese customs and quarantine officials can delay or halt shipments of agricultural products. Sanitary and phytosanitary standards with questionable scientific bases and a generally opaque regulatory regime frequently bedevil traders in agricultural commodities."

So the evidence is all around us. The question is not whether we want to do something. The question is, what should we do? I want to make just two last points. Senator Grassley, last year, in speaking about Vietnam PNTR, said "we need to make sure that we aren't played for a sucker in the case of Vietnam as we have been with China." I fully support that. I believe we have been played for a sucker with respect to that PNTR. They have not met any of the basic requirements.

Now, let me just make one final point. I have introduced S. 571 with a couple of my colleagues that would revoke PNTR and make it a yearly determination. I would ask for consideration of that by this committee.

Let me make a final point. As you know, you see the chart here, an unbelievable explosion of trade deficit. We have a bilateral deficit of $230 billion with China. It has gotten much worse since we passed PNTR.

Part of it is lack of enforcement and all the other issues I just mentioned. Part of it is incompetent trade negotiations and incompetent trade agreements. China is gearing up for a very, very substantial Chinese automobile export market.

Let me tell you what we did in bilateral automobile trade with China. We said this. We said, when you send Chinese cars to America, we will charge 2.5 percent tariff on cars you want to ship into the United States. And by the way, when we send American cars to be sold in China, you go ahead and charge 25 percent tariff.

We, in a bilateral agreement, had the ignorance to say, it is all right with a country that has a giant trade surplus with us, or we a deficit with them, it is all right for them to impose a tariff that is 10 times higher than our tariff on bilateral automobile trade.

It does not matter if it is Republicans or Democrats, as far as I am concerned. When we make those kind of deals, they are bad deals for this country. That is also a part of what causes these giant deficits.

But I am heartened just by the fact that you are holding this hearing. I hope that we will substitute action for discussion. We have had discussions for a long, long time. It is time to take some action.

Finally, I support trade, plenty of it. But I demand that we stop chanting about free trade and start doing something about fair trade and stand up for this country's economic interests.

Thank you for allowing me to say a few words this morning, Mr. Chairman.

The CHAIRMAN. You bet. Thank you very much, Senator. Very much. I have no questions or comments. Does anyone?

Senator DORGAN. I would like to bequeath my chart for the permanent record of the committee, if I might. It is a great chart to continue to look at.

The CHAIRMAN. There is a great tradition of charts from the Senators from North Dakota. [Laughter.]

Senator DORGAN. Right.

The CHAIRMAN. I appreciate it. Thank you very much, Senator. We deeply appreciate your time. Thank you very much.

We will now go to our other panel. Let me just call them all, if you will come up, please. Mr. Jagdish Bhagwati, who is professor of economics and law at Columbia University. Come on up to the table. Mr. Dan DiMicco, president and CEO of NUCOR. Good to see you, Dan. Mr. Norman Sorensen, president and CEO of Principal International, as already referred to and introduced by Senator Grassley. And Mr. Steven Chu is director of Lawrence Berkeley National Lab at Berkeley, CA.

Gentlemen, I thank you very much for taking the time to come and give us the benefit of your thoughts and your views. You all are very knowledgeable in specific areas, and also generally. I want to thank you very, very much for taking the time. I urge you—and I know you will anyway—do not pull punches. Say what you want to say. Life is short. Let us make the most out of this hearing.

I know Senators will ask very pointed, good questions, too. If they do not—I know they will, but if they do not—do not let that inhibit you, just say what you want to say. All right. We will begin with you, Mr. Bhagwati.

STATEMENT OF JAGDISH BHAGWATI, PROFESSOR OF ECONOMICS AND LAW, COLUMBIA UNIVERSITY, NEW YORK, NY

Mr. BHAGWATI. Thank you very much, Senator. Thank you so much for inviting me. It is a pleasure to be testifying before you, and also before Senator Grassley, who presided over the last time I testified on Jordan FTA.

Senator GRASSLEY. Good memory.

Mr. BHAGWATI. And I think after your two statements, I wonder whether I should be saying anything at all, since you have covered most of the sound points.

But let me just mention one thing on the macroeconomic issues. To me, they are a bit of a red herring—and no pun is intended in relation to China. Yes, certainly we run bilateral deficits, but this is no indication of fair trade or whatever you want to call it.

There is no reason why bilateral balances should be balanced, because if we started playing that game, there are lots of countries with which we would be considered protectionist, because you never have complete balance with each individual country that you are going for.

If we had worried about our deficit—it is our own excessive spending. I think Senator Grassley correctly pointed out, if you are spending too much, we may be able to fix the bilateral with China, but it will spill over into other countries. So we have to look inside at ourselves. But since you are having a hearing tomorrow on the macroeconomic issues, I will just leave it there and get into the trade issues.

The CHAIRMAN. No. Say what you want to say. You are here.

Mr. BHAGWATI. Well, I would simply say that, if you look at the surpluses which China is running and the reserves which they have, we should not really attach too much significance to that either, for two reasons.

One is, if you look at all of Asia, the Chinese reserves are about a third. The Japanese ones come pretty close to that. India, Taiwan, et cetera add up to about the same thing. So we are talking about one-third of the Asian reserves right now, so why pick on China in particular?

Two, both India and China are not going to want to hold onto reserves, largely because it is wonderful to have U.S. Treasury bills; we are a safe haven. Nobody is going to want to move into yen or the euro. But they have alternative users, because you do not get much rate of return on these.

Both India and China are under great pressure to expand their infrastructure, to support their increase, the high growth rates, and, too, getting great demands from within the system to spend socially, like we are. We, therefore, can fully expect that on medical, health, education, et cetera, both countries are going to have to spend more, so they are going to be running down their surpluses. So I would simply say, take it easy, on a variety of grounds. Do not go down this macroeconomic route.

I am a little disturbed about two Senators I greatly admire, Lindsey Graham and Charlie Schumer—who represents New York, which is where I live—going down this route which is almost a Buchanan kind of route. Buchanan, if you will remember, wanted across-the-board tariffs on Japan—just remember that time—and for pretty much the same reasons, and now we are threatening something similar, and I think it is really not a very wise way to go.

Let me now turn to the trade issues more directly. And that is where I think I am entirely with Senator Grassley. I am completely opposed to what Senator Dorgan said, which is that we really now have China inside the WTO.

As long as we deal with China, or earlier with Japan, if you go back and look at that experience, if you try to deal bilaterally with these issues, it is virtually impossible not to get a nationalistic reaction from these countries, because it will be looked upon as bilateral pressure.

But now that we have dispute settlement mechanisms, we can take it to the WTO—we have already had four cases—and have it settled one way or the other, and then that enables the ministers and the governments to be able to stand up to their own lobbies.

It also enables our USTR, et cetera, and our government to say to our lobbies, which are complainants, that, look, we have gone through an impartial dispute settlement. So that is the way out. You cannot really deal with these issues and move an 800-pound gorilla by saying, look, I am going to put pressure against you. It simply does not make sense. It is not the way to go.

Now that we have them inside the WTO, let us not play the old game of saying, look, we are going to hurt their feelings, and so on. Actually, it is better for them and for us to go to an impartial dispute settlement mechanism.

We went through this route with Japan, as you know. The Japanese used to say, do not take us to the WTO. It is going to make us feel embarrassed, and so on, and so forth. Actually, our relations with them eased a great deal once we started using the WTO.

And I think one thing we should avoid, although obviously our system is a lobby-intensive system, we should not necessarily take what our industries say as the final truth of the matter. I mean, it is simply, if they have a source or reason for complaint, take it to an impartial mechanism.

So, finally, I think I would just say that, should we be afraid of China as far as trade is concerned? There I feel that we grossly exaggerate the fear of China, which is really widespread through the system, which is also driving some of these complaints about China.

I think the size of China makes people worry, its growth rate makes people worry. But if you really analyze the size, the size is really not as big, per capita income is much lower, growth rates are likely to level off, and we should not really worry about it.

China and we can actually have a lot of trade opportunities and we can really grow simultaneously together. We put Europe and Japan back on their feet. They developed the kinds of expertise which they used to have which are closer to ours. I have never heard anybody say that that was a bad policy.

In the same way, when China accumulates expertise, engineers, skills, and so on and so forth, it is going to help us, not harm us, because trade in similar products will break out. You get a huge amount of specialization within industries. We can only look forward to very substantial mutual opportunities.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Professor.

[The prepared statement of Mr. Bhagwati appears in the appendix.]

The CHAIRMAN. Mr. DiMicco?

STATEMENT OF DANIEL DiMICCO, PRESIDENT AND CEO, NUCOR CORPORATION, CHARLOTTE, NC

Mr. DIMICCO. Good morning.

The CHAIRMAN. Good morning.

Mr. DIMICCO. Thank you for the opportunity to be here.

The CHAIRMAN. You bet.

Mr. DIMICCO. Thank you for having this hearing on this very important issue.

The CHAIRMAN. You bet.

Mr. DIMICCO. I am Dan DiMicco, chairman, CEO, and president of NUCOR Corporation. In 2007, NUCOR will be one of the largest steel producers and manufacturers in the United States and the largest recycler. I appreciate this opportunity to be here to address the challenges in the U.S.-China economic relationship.

President Reagan got it right over 20 years ago when he said, "To make the international trading system work, all must abide by the rules." When it joined the WTO, China agreed to these rules. Our relationship with China is not working today because China is not following those rules, and we are not holding them accountable for that.

Rather, China is breaking them on every front, using massive subsidies, manipulating its currency, tolerating widespread violation of intellectual property rights, and ignoring its own environmental laws, all to give its exports an unfair advantage in international trade. This behavior has cost the U.S. economy hundreds of billions of dollars and millions of jobs, and we have let China get away with it.

Our economic relationship with China can be explained in three simple charts. The first chart shows the growth in China's steel production. The steel industry here is an example of what has happened in many other industries.

A big explosion in steel production was no accident. In its zeal to turn China into the factory of the world, the Chinese government has funneled hundreds of billions of dollars into many industries from steel, to machinery, auto parts, and appliances.

These subsidies take many forms, including equity investments, cash grants, and the write-off of nearly a trillion dollars of loans by state-owned banks. An even bigger subsidy comes from currency manipulation. The Chinese government deliberately keeps the value of the renminbi well below its true value. This makes imports from China artificially cheap and exports to China artificially expensive.

Our own Federal Reserve Chairman Ben Bernanke stated that if China lets the market determine the value of the renminbi it will "reduce an important distortion in the Chinese economy, namely the effective subsidy that an undervalued currency provides for Chinese firms." These subsidies have worked exactly as the Chinese government hoped.

As chart two shows, Chinese exports to the United States of steel and downstream steel products have skyrocketed, similar to our trade deficit overall. I believe we would see exactly the same pattern from many other industries. It affects the entire U.S. manufacturing sector.

The impact of China's policies on the U.S. trade deficit has been dramatic, as shown in this next chart which you have already seen. According to one economic estimate, imports from China have cost the U.S. at least one million manufacturing jobs.

Since 2000, more than 3 million manufacturing jobs have been lost. About two-thirds of those may be attributed to the trade deficit, and China accounts for about one million of those jobs.

Were China to revalue its currency and stop its unfair trading practices, other Asian economies could do the same, and more than one million jobs could be reclaimed. If the trade deficit were cut in half, we could likely regain 2 million jobs over a period of 3 years.

Manufacturing has traditionally been the way for Americans who do not have a college degree to work their way into the middle class and provide a decent living for their families. I refuse to believe that the loss of manufacturing jobs is inevitable, as some have suggested. That is hogwash.

If we stop the hemorrhaging of manufacturing jobs by enforcing the rules of free trade—and that is all we are asking for—we will help to raise the widening wealth gap and ease the sense of insecurity among many Americans who have jobs. Recent polls have shown only one-third of Americans see free trade as a positive, and they see trade with China as a way of reducing wages and jobs.

While trade adjustment assistance can be useful, it is no cure and it is, at best, a Band-Aid and, in reality, an admission of failure. NUCOR workers would rather keep their jobs than retrain for new ones, especially when they are the best at it in the world.

Above all, they expect their government to stop the cheating and deliver the level playing field they have promised repeatedly by presidents of both parties. We could eliminate much of our trade deficit with China and both save and create many American jobs simply by enforcing the agreement upon which the rules of free trade are based, rules that China agreed to, to have access to our market.

We have to act. We have to act though, and not just talk. The administration has engaged in a dialogue with China for years, and China has done nothing. We must take decisive steps now. In some cases, this will require the passage of new measures to close loopholes and give us the tools we need.

A good starting point would be the passage of the Collins-Bayh bill that would revoke the free pass that China has received under the subsidy law. China agreed to be covered by the subsidy law when it joined the WTO. We must get on with holding China accountable for its commitments.

Restoring the U.S.-China economic relationship to a healthier balance is absolutely necessary to the long-term economic prosperity and national security of the United States, and the economic prosperity in the long run for China.

In closing, Mr. Chairman, I want to state for the record that defending and enforcing the rules of free trade is not protectionism, it is self-defense. It is time for Congress, the administration, and the American public to make China abide by the rules, rules to which it agreed to abide by in return for access to the U.S. and world markets. It is a very simple request. We hope you will do that.

The CHAIRMAN. Thank you, Mr. DiMicco, very, very much.

[The prepared statement of Mr. DiMicco appears in the appendix.]

The CHAIRMAN. Mr. Sorensen?

STATEMENT OF NORMAN SORENSEN, PRESIDENT AND CEO, PRINCIPAL INTERNATIONAL, INC., DES MOINES, IA

Mr. SORENSEN. Thank you, Chairman Baucus, Ranking Member Grassley, members of the committee, for the opportunity to testify today.

My name is Norman Sorensen. I am president of Principal International, based in Des Moines, IA. I testify today in my current role as president of Principal International and with the perspective as chairman of the International Committee of the American Council of Life Insurance.

The Principal Financial Group, a Fortune 500 company, is an Iowa-based financial services company focused on retirement benefits and asset management, operating in the United States and overseas.

As the Nation's 401(k) leader, we have a particular interest in providing retirement savings for employers, employees, individuals in the U.S. and around the world. I, by the way, testified in favor of PNTR for China in 2000.

The retirement savings products so successful in the United States have been emulated in other countries. In developing markets where the Principal Financial Group operates, like Brazil, Mexico, Hong Kong, and Chile, for example, retirement savings have been significant, and the seeds for wealth creation and strong capital markets have been firmly planted.

That is not yet the case in China. Up until this year, there was no formal private retirement savings program in China, and the country's aging population is putting pressure on the government's ability to pay for pensions. The number of Chinese retirees will double to 200 million in 10 years, and will be over 400 million people by 2050, almost 30 percent of the Chinese population.

That is why the new Enterprise Annuity Pension System is so critical for China. This new program is similar to our 401(k) system and will be very important for retirement benefits companies like Principal Financial Group and others.

Our estimates show that, within 10 years, the assets under management for this program should be close to $100 billion. Within 25 years, they should reach at least $1 trillion.

As a company, we have already seen large success in China. Our asset management company began operations less than 2 years ago in a joint venture partnership with China Construction Bank. China Construction Bank is the third-largest bank in China and was ranked 11th out of the top 1,000 global banks, by *The Banker* magazine.

The bank is 14,000 branches, 300,000 employees, and over $600 billion in assets. So far, our Chinese joint venture has successfully rolled out four mutual funds since November of 2005, with our most recent fund accumulating over $1 billion in a single day this month.

The joint venture has also earned awards for most innovative funds and for sales distribution excellence. All of these accomplishments are significant and have come about in a very short period of time. We have become one of the major asset management companies in China, but there is much yet to achieve. We hope that regulatory changes in the retirement arena will make that possible, and this is where this committee could play a very important part.

Principal, along with many other American financial services companies, sees great promise in the Chinese retirement market. We believe that development of the Chinese enterprise annuity market could represent a win-win opportunity for the U.S. and China.

China needs American pensions' expertise, and our companies can provide it. We will encourage this important discussion in China, in the U.S., and under the framework of the current strategic economic dialogue, the SED, led by Treasury Secretary Henry Paulson.

In fact, together with Beijing University, I will be hosting a major symposium on this subject in China two weeks from now. I happen to travel to China virtually every month.

However, the Chinese rules and standards for the provision of enterprise annuity pension systems remain unclear. The regulations currently prevent any company from providing a comprehensive package of services and involve several regulators.

As a start, we believe that China should clarify the regulatory framework to authorize single-provider plans under a single license. Also, American and foreign companies should be allowed to fully participate in the Enterprise Annuity Pension System.

As pensions are included in China's WTO commitments, we believe that foreign equity ownership and all enterprise annuity companies should be allowed up to at least the same current limit as life insurance companies, which is 50-percent, and eventually 100-percent ownership.

On the life insurance side, our objectives are simple: freedom to choose a form of establishment, branch, subsidiary, or joint venture; the ability of a U.S. financial firm to own 100 percent of its operations, currently not possible; and non-discriminatory treatment of foreign companies.

Our highest priority, both on the enterprise annuity side and on the life insurance side, is for improved access in the removal of equity limitations. We believe China has an opportunity to show leadership in this area.

Mr. Chairman, in conclusion, I sincerely appreciate the interest of the committee and ask for your support to leverage the strategic economic dialogue, led by Secretary Hank Paulson, to get positive outcomes in both enterprise annuity and life insurance from the current SED meeting, which is meeting in Washington in late May.

Our industry and I are working with the Departments of Treasury, State, Labor, Commerce, and USTR to push for positive commercial outcomes in this area, and your strong support is deeply appreciated. Thank you very much.

The CHAIRMAN. Thank you, Mr. Sorensen.

[The prepared statement of Mr. Sorensen appears in the appendix.]

The CHAIRMAN. Mr. Chu?

STATEMENT OF STEVEN CHU, DIRECTOR, LAWRENCE BERKELEY NATIONAL LABORATORY, BERKELEY, CA

Mr. CHU. Thank you, Chairman Baucus and Senator Grassley.

I am pleased to talk about something I know a little bit about with regard to U.S.-China issues, and that is energy issues. I am Steven Chu. I am the director of Lawrence Berkeley National Laboratory, and I am also currently serving as co-chair of an inter-academy council study, Transitioning to Sustainable Energy.

For your information, the inter-academy council represents over 90 science academies around the world, and our report is intended to provide a road map to scientists and policymakers on how to achieve affordable, sustainable, and clean energy.

My co-chair is Jose Goldenberg, who is currently Secretary of Environment of the State of Sao Paulo, and the person responsible for the Brazil sugarcane ethanol industry.

I was also a member of the report, "Rising Above the Gathering Storm," that Senators Bingaman and Alexander called for. This is the Augustine report.

China is the world's second-largest energy consumer, and over the past 2 decades China has averaged roughly 9 percent growth per year. Its official number may be 9 percent, its unofficial number is higher. It is probably 12 percent. It is the only country that plays down its economic growth.

This growth has dramatically lifted the standard of living of Chinese citizens, but has also created enormous challenges for China and the world. China's rapidly growing reliance on coal as its core energy source has substantially added to global CO_2 emissions, and it is a growing threat. China's need to guarantee access to its future oil and natural gas supplies could potentially lead to future conflict with the United States and the rest of the world.

The local air pollution has become global in China. There are days now in the mountains of California where Chinese contribution to air pollution is comparable to that of California's cities.

China uses about 15 percent of the global energy, while the U.S. consumes approximately 25 percent. Almost half the world's CO_2 emissions are due to these two countries. And while our energy consumed per GDP is significantly better than China, the U.S. consumes about 8 times the energy as China per person.

Now, as far as the world environment is concerned, carbon emissions per person is the relevant metric. The planet Earth does not care about the GDP of the world, only about carbon emissions.

The U.S. energy consumption and the CO_2 emissions per person are about twice as high as Europe and Japan. And just as the United States must significantly reduce its carbon footprint, China must strive to achieve higher efficiencies as its economy grows.

In the next 2 decades, roughly half the buildings in the world will be constructed in China. More than 300 million Chinese, the entire population of the United States, will move into cities. During this massive construction, it is vital that new cities be designed to maximize energy efficiency.

China has a strong efficiency program for commercial and residential appliances and electronics lighting, but China's energy consumption is dominated by the industry sector where efficiency programs are weak or non-existent. The need for such programs is urgent.

Before my message is lost, let me state my take-home message. Engagement with China on energy issues must be strengthened and expanded. Full Chinese participation in the mechanisms for the International Energy Agency is appropriate.

China's rapid rise to the top of the global economic leadership suggests that full participation in global dialogues such as G–8 are warranted. I further support my colleague, Dr. Bhagwati, in saying that it is these international forums that are crucial, like the World Trade Organization, to force China to do the right thing.

Chinese government officials see affordable energy as its primary economic engine. As their economy grows, the reduction of carbon emissions pledged by the European Union will be outstripped by the growth of energy use in China and the United States.

China added 90 gigawatts of coal-fired power plants in 2006 alone, and these, over the lifetime of these plants, will be emitting 500 million tons of carbon per year; by comparison, the entire EU commitment of reduction is 300 million tons per year.

The United States currently plans to build about 150 U.S. coal-burning plants in the new few years that will also equal the planned EU reductions.

Between 1980 and 2000, China quadrupled the size of its GDP, while only doubling its energy consumption. This is a fantastic achievement. However, free market forces were unleashed in China, and energy demand is now increasing at 1.5 times the rate of its economic growth.

The central government of China has announced last year an ambitious plan to decrease energy intensity by 20 percent by the year 2010, but it is already falling behind these goals.

Knowing what to do and finding the political will to do the right thing are very different matters. The central government in China does not have complete control of the country. Local governments are reluctant to close down heavily polluting or energy-inefficient plants and factories for fear of widespread unemployment or decreasing tax revenues, including tax on power generation in older industries.

China's energy structure has been dominated by coal and will remain so unless the world can find technological solutions. China has also become rapidly dependent on petroleum consumption and is responsible for 30 percent of the growth of demand.

It has implemented strict automobile efficiency requirements, but at the same time it is following the United States' example of using domestic production of automobiles as an engine of economic prosperity. China has constructed the equivalent of the entire U.S. interstate highway system in little under a decade.

Biofuels. While the international oil prices have spurred efforts all over the world to develop fuel alternatives, China is considering coal-to-liquid conversion.

A coal-to-liquid refinery capable of 1.2 million barrels a day has been submitted for review. The environmental consequences of a massive coal-to-liquid conversion program would be staggering, and the world must find other alternatives.

Biofuels are a much more attractive possibility, but ethanol produced from corn or biodiesel from oil-bearing plants is not the solution. The yield of fuel per acre is too low and does not reduce overall CO_2 emissions.

I am confident that we can develop—we, being the U.S.—far better biofuels based on perennial grasses. In an unaerated, unfertilized plot of land in Illinois, it is shown to produce 10 times as much ethanol per acre as corn.

Research will be needed in all parts of the world to identify and improve plants to be used as energy crops. The U.S. is poised to be a leader in the development of cellulose-based biofuels. This work will help the world develop alternative sources of transportation fuel and greatly alleviate pressures to guarantee access to oil.

Thank you.

The CHAIRMAN. Thank you, Mr. Chu. That was very good, very helpful, very informative, very constructive.

[The prepared statement of Mr. Chu appears in the appendix.]

The CHAIRMAN. I now would like to ask each of the witnesses kind of one basic question. That is, what should this committee take from each of you, what is the main point you want to make with respect to our relationship with China that you think is most important, and what do we do about it?

What action do we take? Instead of just talking about it, what action do we take? What is the one sort of major take-away that this committee should have from each of you?

Each of you is an expert in your field and is certainly very knowledgeable about China. So what would you recommend? We can go down the row there, or whoever wants to go first can raise his hand, whatever.

Mr. Bhagwati, why don't you proceed?

Mr. BHAGWATI. Senator, I think the most important thing your committee could do would be to defuse these tensions with China and really provide a first-rate analysis of why we are exaggerating the problems with China and understating the opportunities which Mr. Sorensen, for instance, was talking about.

I think we need to point out that, really, China is part of the world system. It has been a fairly good player on many dimensions in relation to the WTO, and I think, even on the Doha Round, it could have played a bigger role. But remember, we got them to accept many WTO-plus obligations beyond what, in fact, they had, and made the down payment.

So I think we need to say, look, they are good players. We can, where we have differences, take them to the international organizations. We should not pay too much attention to the macroeconomics because it is really badly argued in most cases, and we really have an opportunity.

So I think the main message would be to say, look, China is an important player. We have had good relations. We can have good relations. And where we have differences we can negotiate them, and where we cannot negotiate them, take them to——

The CHAIRMAN. Very briefly, Mr. DiMicco says China is not playing by the rules, we are not doing enough. What do you say about that? Just briefly. Very briefly.

Mr. BHAGWATI. I do not think that is correct, actually. He definitely has a point of view. But suppose the steel industry—and I see Senator Rockefeller here, my regards to you.

The CHAIRMAN. I am waiting. I am waiting.

Mr. BHAGWATI. Yes. We can take them to court. We can take them to a settlement that really works. It really works. It really works in a very efficient way.

The CHAIRMAN. Mr. DiMicco? The take-away here. What do we do about it?

Mr. DIMICCO. Thank you. The basic message that we have as manufacturers, as well as steel producers is, it is time for us to get China to live up to its obligations and commitments. We are not asking for more than that.

We are not asking for government handouts, we are not asking for anything except our government to do what it is supposed to do and give our manufacturers as level a playing field as possible. Globalization is here to stay.

China is going to be a dynamic, growing economy. There is a lot of good in that, but there is also a lot of bad in that. The bad is not being over-exaggerated by any means. It is a serious issue. It rears its ugly head on a regular basis from one industry to another.

Please have them live up to their obligations. I agree with the Professor, the WTO is a good place to go. Unfortunately, it is not the best place to go because WTO does not always rule in our favor.

The CHAIRMAN. Right. My time is expiring.

Mr. Sorensen?

Mr. SORENSEN. Mr. Chairman, engage with China, especially on financial services. One little-known factor—I used to be chairman of the Coalition for Service Industries of the United States, representing all service industries—the only surplus that we have is in services. We have $60 billion in services surplus in our overall trade balance in the United States with all the world. Part of that is financial services.

Financial services is the most competitive area that the U.S. has with regard to the rest of the world, particularly with China, and the total surplus in that area could increase incrementally if we applied our forces toward that service.

And they need us. They need our pensions, they need our mutual funds, they need our banking services. I think that is one area where it could be extremely useful. And use the WTO for enforcement, aggressively, as Senator Grassley had indicated.

The CHAIRMAN. All right. Thank you.

Mr. Chu?

Mr. CHU. I just want to reiterate my point that China, Inc., does not really exist the way most Americans portray it. There is a central government, but sometimes the local governments do not really listen as well, and sometimes they cannot listen.

This is particularly in regard to pollution and industry practices. Local pollution is killing their people, and they know it, yet they cannot shut down these factories because it is a loss of tax revenues, it is unemployment, and potential unrest.

The CHAIRMAN. Well, what do we do about that?

Mr. CHU. I think we can help China and transfer a lot of the technologies that we have. It is actually a money-making proposition to the United States to help them transfer some of these technologies to shut down these grossly polluting plants and very inefficient plants. So, I think one should work with China in helping them.

If you just put pressure on the central government, the central government cannot really effectively turn around and say to local government, put your people out of work. That is the deadlock. I would be glad to discuss this at great length with you.

The CHAIRMAN. I would, too. This is a fascinating subject. Unfortunately, this setup does not allow us to pursue a lot at this point. But thank you very much. We will pursue it in other ways with a lot of the questions that a lot of us have.

Senator Grassley?

Senator GRASSLEY. Thank you, Mr. Chairman. A very good panel. I appreciate the divergent points of view, and I want to suggest to the panel and to the Chairman that I am going to have to submit some questions for answer in writing because I have to go to an FBI hearing that is going on now before the Judiciary.

Mr. Sorensen, you noted in your testimony that Principal has, in a short period of time, already had significant success in China. How much did China's accession to the World Trade Organization contribute to the ability of Principal to establish operations in China?

Mr. SORENSEN. It would not have been possible without it, Senator, because the WTO permitted the entry of financial services industries in a graduated fashion over 5 years. It started with life insurance, then it went to mutual funds and banking.

Senator GRASSLEY. All right.

Separately, you stated that Principal would like to see China provide full transparency in its financial services regulations. Can you provide specific examples of how China could improve that regulatory transparency? Hopefully there are people from China here listening.

Mr. SORENSEN. Yes, sir. There are four ministries and four agencies which are critical to the development of financial services: CBRC is the China Banking Regulatory Commission; CIRC is the China Insurance Regulatory Commission; the MOLSS is the Ministry of Labor and Social Security; and CSRC is the China Securities Regulatory Commission.

These agencies do not work in an interagency basis. They sometimes do not talk to one another. In the pensions area, which is our specific interest and which could provide a tremendous opportunity, $1 trillion within 10, 15 years in assets under management, these agencies need to provide a single-license environment such that one regulator regulates pensions, like we do in the United States.

Senator GRASSLEY. All right.

Also, is it your impression that Chinese officials share the view that more transparency in China's legal system is needed?

Mr. SORENSEN. Definitely, sir. That is one area where China is conflicted. The legal system in China is still in development. It is a young system. It is not 5,000 years old, as the Chinese culture is. It is a very young system, less than 50 years old. Lawyers are not a very common process of dispute resolution. It is typically arbitration or consent.

Senator GRASSLEY. And Dr. Chu, in previous hearings before our committee, the director of the National Renewable Energy Lab gave testimony expressing concern that Europe and Asia have grown to dominate a $40 billion international energy technology and equipment industry. Is China still a net importer of advanced energy technology, and if so, what role does the United States serve with that industry?

Mr. CHU. I believe it is a net importer of those technologies. Unfortunately, the leadership of energy efficiency technologies is no longer in the United States. For example, wind power is shared by Siemens and GE, but was really developed for the European market. Solar technologies are led by Japan. The nuclear industry is led by France. The Westinghouse branch is now owned by a Japanese company. There is a little smattering of GE that still has some nuclear technology.

The best thing the United States can do to serve in this industry is regain leadership in these industries, so we should be doing that at home. What that would require is long-term plans that give signals to the companies, not up and down, one after another, changing your mind, but long-term plans.

Once you have a long-term plan in mind, then the U.S. industry will move in the right direction. But they need a 10-year signal. They do not need a 2-year signal.

Senator GRASSLEY. Professor, you referred in your written testimony to the "volatility of the comparative advantage in today's global economy and enhanced competition," and those are words directly from your testimony.

Can you please elaborate on what you mean by "volatility of comparative advantage"?

Mr. BHAGWATI. If you go back to something like Tom Friedman's remark about flattening of the world, essentially there are many reasons why, if you are a CEO and a manufacturer, or even a financial firm, if you look behind you, there is somebody stealing up on you. But it need not be from India and China. That is where Tom goes wrong. It can be anybody. There is no CEO in a trading sector who is leading a happy, comfortable life, except in France, perhaps, because they are deeply protected. [Laughter.]

So you are on your feet, on your toes all the time. It is not just the poor countries. Boeing and Airbus are neck-and-neck. A380 was a disaster for Airbus, so Boeing has gone ahead. Boeing will make its own mistake, and Airbus will get back into the act. But we have knife-edged competition, so we have volatility in comparative advantage.

So I think that is the view of globalization we have to have, a strategic vision of, what does it involve? And I think everything flows from that, in my view, in the sense that we now no longer can think in terms of workers getting security.

I am a Democrat, so I believe in security for the workers. But you cannot have a specific job. You have to think in terms of the workers themselves. How do we provide security for them? Through education, increasing the capacity to move from one job to another, and so on, and so forth.

I think that is where, also, you need adjustment assistance in a very big way, which is one of the positive things your committee could emphasize. China feeds into that because China also, as I say in my testimony, is like a tsunami.

Japan in the 1930s, when the $1 blouse and the yellow peril came up. It was growing very rapidly with a high ratio of trade for GNP. Japan, in the 1980s, when I think I testified before this committee, and Senator Baucus will remember those debates, too. Semiconductors, autos, and so on.

So that was a time when we were worried desperately about the yellow peril again. Now we are worried about China, because in all three episodes the growth of the economy in question was very, very considerable and the high ratio of trade to GNP meant that people were creating waves.

Now, of course, it was not like a tsunami overall, and that is where we have to be very sensible. It is not China in its totality, but it creates problems for specific sectors like Mr. DiMicco's, and so on. That is where we need to have adjustment assistance, because we need to worry about specific sectors where adjustment will be required.

The CHAIRMAN. All right. Thank you very, very much. Thank you, Senator, very, very much.

Senator Bingaman?

Mr. DIMICCO. Can I add something?

The CHAIRMAN. You bet, if you want.

Mr. DIMICCO. On that point.

The CHAIRMAN. You bet.

Mr. DIMICCO. Our people do not want assistance in the form of, you lost your job, here is some money to get you through. Because we can compete with anybody in the world hands down. All we want is a level playing field to compete upon.

The CHAIRMAN. Thank you.

Senator Bingaman, you are next.

Senator BINGAMAN. Thank you very much.

Let me ask, Mr. Chu, picking up on your comments about the energy relationship we have with China and its impact on the world: one of the arguments, of course, that we are encountering in trying to deal with greenhouse gas emissions in this country is that China is not playing by the rules, as Mr. DiMicco says, in a great many ways with regard to trade relations with the United States, in their currency, and a variety of things. That is the argument that is made.

Accordingly, it makes no sense for us to be further handicapping ourselves in international competition by trying to limit greenhouse gas emissions, where any reduction in greenhouse gas emissions we could achieve would be overwhelmed by the growth in emissions which is expected in China, and they are not willing to do anything about their greenhouse gas emissions.

Europe is wasting its time trying to deal with the problem because of the relatively modest impact that they are able to have on the problem.

How do you respond to that? Is there some argument that you see against that perspective?

Mr. CHU. Well, this is the common—I cannot say it is wisdom—but the common feeling that China and the United States stare at each other. The United States says, why should we do anything to hamper our industry that puts us at an economic handicap unless China does something, and China says, why should we do it, we are a developing country? The United States should lead. Europe shakes its head at both of us, but is not living up to its own protocol targets.

So there is a stand-off. This is a real issue. I think I am hearing some mumbling somewhere. I think this is the stand-off. I think we have to push ahead. We have to help China. The first thing is, we should help China with their own local pollution, and we can help that technologically. This at least gets it in line with dealing with the harder issue, namely the CO_2 emissions.

Now, with regard to the U.S. versus China, which one goes first, I think in some way we are going to have to both go together or neither of us is going to go at all, and that is my big fear. We have to get China on board. They have to do it as well as we do. We are 25 percent of the CO_2 emissions in the world, and we are not 25 percent of the population.

This is a very scary concept. If we do not do anything and China does not do anything about it, nobody else will really be effective. So, this is a dilemma. We have to engage China and help each other do this together.

Senator BINGAMAN. Thank you very much.

Let me ask you, Dr. Bhagwati. You say we should not be concerned about the macroeconomic issues, as I understood your testimony. Do you think it should be of concern to us that we are running a very large current account deficit with the rest of the world, and have been for many, many years?

Do you think at some point that that begins to undermine the value of our currency, or our standard of living? Do you think there is any consequence that results from that, or do you think we can just continue to ignore it as we have very effectively for the last several decades?

Mr. BHAGWATI. No, I am with you on that. I definitely believe that the current account deficit which we have is a gigantic one, and I think we are sort of staring at it down the road. So I think that needs to be done, but that has nothing to do with the bilateral deficit with China.

Senator BINGAMAN. Well, how do you propose we fix the current account deficit?

Mr. BHAGWATI. Try to fix the budget deficit, for example. That is another committee, probably, huh?

Senator BINGAMAN. No, no.

Mr. BHAGWATI. The Committee on Finance.

Senator BINGAMAN. It seems to me, and my recollection is not 100 percent, but I remember going through this debate back in the 1980s here in Congress, where we started running a very large current account deficit. Everybody said the problem was the budget deficit. We saw the current account deficit go down again. Everybody backed off of that problem. The budget deficit continued.

Then the budget deficit went away, the current account deficit went up. So, I do not know that there is a close correlation between what we do with our budget deficit and what happens to our current account deficit. Everything I have seen indicates that the two are somewhat disconnected.

Mr. BHAGWATI. You would have to analyze each episode. You cannot just go by these correlations. Right now there is no question in anyone's mind that the Iraq war, which really has led to tremendous excess spending, has contributed to the reversal of what President Clinton had brought about, which was to get a major surplus in the budget, which I think really helps as far as excess spending is concerned.

So, ultimately what happens in the international payments has to reflect the state of the aggregate spending and your aggregate income, so obviously you cannot have a payments deficit unless you are spending more than you are actually producing. It is just a necessary relationship.

Senator BINGAMAN. Well, but the spending you are talking about there is spending throughout the economy.

Mr. BHAGWATI. Right.

Senator BINGAMAN. Not just by the government.

Mr. BHAGWATI. Right. But you go down the corporate sector, the household savings, and so on. Then clearly the fact that your budget is out of whack is contributing to the deficit.

Senator BINGAMAN. No, it is a factor. I would agree with that. My time is up.

Mr. BHAGWATI. I am definitely an alarmist, if you would like, or a realist on this question. I think we have to bring it back into balance, or closer to balance.

The CHAIRMAN. Thank you, Senator.

Senator BINGAMAN. My time is up. Thank you.

The CHAIRMAN. Senator Stabenow?

Senator STABENOW. Thank you, Mr. Chairman, for this hearing.

First of all, just as a side note, we passed a Budget Resolution last week that brings the budget into balance within the next 5 years, so we are focusing on that.

Professor, I have to respectfully say that, from where I sit, we are not exaggerating problems with what is happening. When we look at, according to the Chamber of Commerce alone, counterfeiting from China has cost us 750,000 good jobs and 3 million manufacturing jobs, good jobs leaving, even though we are doing high-tech manufacturing in America.

I guess, before a question, let me just say for the record that when we look at intellectual property rights violations, counterfeiting, currency manipulation to name just three, we see a track record on lack of enforcement that is extremely concerning.

We see civil penalties for IPR violations, and almost no criminal penalties have been brought. Right now, piracy and counterfeiting remain epidemic: 90 percent of infringement violations, with 90 percent of infringement levels for all forms of intellectual property right. Ninety percent right now is what we are dealing with.

I do not mind the numbers we have looked at if it is a level playing field. I would say let us just get ourselves going. But they achieve this by cheating. It seems to me that, shame on us to allow it to continue.

One other thing I would just say for the record. I have a question related to what you believe we should be doing. We do have several provisions to deal with violations to address dislocations caused by increased imports from China, but in fact when it is found to be true and the International Trade Commission in fact files a section 421, in four cases where they found it to be true and recommended import relief to the President, the President refused to apply any import relief on the basis that it was not in the national interests of the United States.

I might just say that attorneys for the wire hanger and duct iron waterworks fitting industries claim that failure to order these safeguards has led to the demise of two domestic industries in the United States.

My concern is that we are not standing up for Americans in this fight, where we need to be having a fair fight, and so I would ask Mr. DiMicco, as somebody on the front lines of this, what do you think? I mean, when we look at a level playing field, I think it is the biggest challenge facing our country.

How do we create a level playing field in a global economy which exists, and will exist? We all want to trade, but how do we do this in a way that keeps middle-class America, keeps our customers, keeps our economic engine from the middle class? I mean, how do you see us overall effecting that level playing field?

Mr. DiMicco. Thank you. I agree with all of your comments. A level playing field will not be achieved unless we are, first, willing to negotiate fair and reasonable trade agreements, number one, and then enforce the rules of those trade agreements, number two—and we have failed on both counts.

That is absolutely critical. There are things we need to do here at home as well. Do not get me wrong, it is not all the other guys that are doing this to us, but 80 percent of it is. It needs to be dealt with.

Our government is finally going to the WTO on the export subsidies that China illegally has. They have knocked one off the list, and there are seven more to go. But then there are a whole host of domestic subsidies that they give, to the tune of billions of dollars, that also help them compete internationally. We just need to enforce the rules that are in place on this issue, both in the WTO and in our own laws here in the United States.

Senator Stabenow. Would you add the way we structure our health care costs in this country as a part of what we need to change to level the playing field?

Mr. DiMicco. Health care issues, over-taxation compared to the rest of the world, excessive tort issues, and an energy program that is totally non-existent in this country, which should be a top priority. All of these are things that U.S. manufacturers need to have done in a way that allows us to be globally competitive.

Senator Stabenow. Thank you.

Thank you, Mr. Chairman. This is such an important issue for us, and I appreciate the testimony of the witnesses.

The Chairman. Thank you, Senator.

Senator Lincoln?

Senator Lincoln. Thank you, Mr. Chairman. I concur with Senator Stabenow. We appreciate you bringing up such an important issue and giving us an opportunity to visit here with the panel, and I hope we will continue on this.

I would like to say a special welcome to Mr. DiMicco. Mr. DiMicco actually has a few Arkansas roots, with NUCOR Steel being one of our very responsible corporate citizens in Arkansas, with very effective and efficient minimills, which have been a tremendous asset to our economy in Arkansas, but they have also been great stewards, corporate stewards. So, we appreciate it. We are glad the entire panel is here, but I wanted to welcome Mr. DiMicco for sure.

We have had lots of discussions over the years, that is for sure. I have been over at the ITC. I am a known face over there in many instances. Mr. DiMicco's last comment about making sure that we implement actually what we have in this country to help—steel pipe is a good example, with section 421 which we recommended to the President to use.

Actually, the ITC actually concurred with us that a section 421 would be appropriate on the imports of steel pipe, and yet we still did not see that happen. So using our own trade laws, and certainly using what we have available to us, is critically important.

Mr. DIMICCO. Absolutely.

Senator LINCOLN. But I do think that it is true that there is more we can do.

Just a couple of questions. And Mr. DiMicco, I hope you can express to the committee some of the things we have talked about in the past, and certainly to the effect of what was said here earlier.

That is, is it true that U.S. industries that have been injured by illegally subsidized Chinese products cannot bring a trade case? The U.S. Department of Commerce is considering changing their policy on this.

If so, do we need legislation to clarify that the subsidy law applies to all countries, including China and other non-market economies? We have had a bill in the hopper in the last session. There is one that has been recently introduced here to really clarify what we have to use as a tool.

Mr. DIMICCO. First off, I completely agree with you that we are not using the tools that we have in our tool box to address these issues. As far as China goes in relation to the last part of your question, they agreed to be subject to subsidy issues when they got preferred status.

And our Department of Commerce, for 20 years, had the ability to apply our subsidy laws against non-market economies, but it chose not to. Now they are getting to the point where they are considering doing that, and hopefully we are going to have a positive ruling here in the near future.

But I will tell you right now, for 20 years of not doing it and maybe 1 year of doing it, I think legislation absolutely needs to be passed to make sure that, for the long term, that this issue is dealt with properly.

Senator LINCOLN. Well, in addition to ensuring that our trade laws and agreements are enforced, you suggest, and I agree, that there are some new tools that may be necessary, that some loopholes may need to be fixed.

I have certainly talked at great length about expedited remedy and some of the opportunities that we have there that actually the Commerce Department could do on their own without legislation, and maybe that is what we need to do here again. Maybe you could be a little more specific, maybe to the extent of going after repeat offenders under trade laws, how we would accomplish that.

Mr. DIMICCO. Well, certainly the legislation that you have put together would be very helpful in dealing with the situation where either we have repeat offenders or we have repeat offenses on similar products. I mean, how many times do you have to bang your head into the same wall to know that next time maybe you ought to walk through the door?

Senator LINCOLN. Well, one of the unfortunate things is, many of our competitors know our trade laws better than we do.

Mr. DIMICCO. Absolutely.

Senator LINCOLN. And they wait us out, to the point where they know, if they can hang on for 3 years without having to go to the courts or without our courts exercising what they need to exercise, they can pretty much demolish an industry and take over. The idea of expedited remedy, in my opinion, is a move in the right direction.

Just one last thing. Mr. DiMicco, in your testimony you described the build-up of the Chinese steel industry with government subsidies. Clearly, the U.S. is not doing enough to address the subsidies that the Chinese government is giving its steel industry and the threat to the U.S. market.

How long would it take for a deluge of subsidized Chinese steel to land on our shores and really hurt the U.S. industry and workers?

Mr. DIMICCO. The reality is, it has already been happening for a number of years. You mentioned the carbon pipe case, the welded pipe case.

Senator LINCOLN. Right.

Mr. DIMICCO. In the 421, the ITC said there was a problem here, so you need to do something. The President walked away from it. Wire rod is another steel product line that has been decimated, along with welded pipe and tube.

China, in the last 2 years, has built more steel capacity than the United States and Japan combined. Today they have over 500 million tons of steel capacity in a world that only consumes 1.2 billion tons.

It is an example of non-market forces, or market forces not being able to operate to control overcapacity and excess building. This issue needs to be dealt with. Just this past summer, now that they have built more and more capacity in the different product lines, galvanized steel—which is a very high value product for the steel industry—went from 2,000 tons a month of imports from China for the last umpteen years to 80,000 tons a month, in 1 month, followed by 70,000 tons.

The same thing has happened in cold-rolled steel. The only reason why it has not happened in rebar and in hot-rolled strip is because we have trade cases against China that are coming up for sunset review this year, so you will see me in Washington again on those issues.

The day of reckoning is here. We have been talking about it for 5 years. We have gotten no support out of Washington on these issues, out of the administration. It is time for Congress to take the action that needs to be taken to level the playing field.

Senator LINCOLN. We appreciate it.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. Thank you very much.

Senator LINCOLN. And I would like to tell Mr. Chu that I will have some questions for him on another day.

The CHAIRMAN. You bet.

Senator LINCOLN. Thank you.

The CHAIRMAN. Senator Bunning?

Senator BUNNING. Thank you, Mr. Chairman.

Mr. Chu, I was amazed at some of the answers you gave Senator Bingaman on energy, the fact that the United States of America has squeezed our producers of coal and the opening of new plants to the point where they have to squeeze the CO_2 emissions down.

I can give you chapter and verse if you would like to go into it. The fact that the Chinese government is going to build 90-plus coal-fired generation plants with no—zero—capture of CO_2 emissions, and you think that we should sign on the dotted line before the Chinese are—we should do it jointly when they have no recompense to actually lower their emissions because they say they are a developing nation? I think that is the most unreasonable thing I have heard any panelist before us ever say.

Mr. CHU. I think you might have misunderstood what I was saying.

Senator BUNNING. Well, I may have misunderstood it, but I listened carefully.

Mr. CHU. All right. Well, let me repeat what I thought I was saying. I was actually, in response to Senator Bingaman's question, saying that there was a point of view out there that the United States should not capture carbon, for example, and worry about CO_2 emissions unless China does, because unless China does that, since China——

Senator BUNNING. But that is totally false.

Mr. CHU. No. I am saying——

Senator BUNNING. Since we have bills right now for carbon sequestration on almost every new plant that is going to be built.

Mr. CHU. It is my understanding that the carbon sequestration bills are not to require that we sequester carbon.

Senator BUNNING. They have been changed. Some of them have been changed to require it.

Mr. CHU. They are now requiring them to be carbon sequestration-ready. That is the issue.

Senator BUNNING. Well, it is something that we have not been doing, so, to do it, is it going to take some reasonable research to get it done, and then to learn how to store it, and then where to store it?

Senator Salazar and myself have a bill to study the geology of the United States of America to find out where we can store the sequestered carbon underground.

Mr. CHU. I am very supportive of all the research that is being done, and research supported by the United States for carbon sequestration. Do not get me wrong on this one, that is very important. But as far as I know, aside from a few test pilot plants in the world, we, the whole world, is not really sequestering that much carbon. There are megatons worth of sequestration going on today, megatons per year.

Senator BUNNING. But any new plant, coal-fired generated plant in the United States, that comes under licensing and everything else has to meet certain standards that are not in effect anywhere in China.

I can tell you this. Two in Kentucky specifically could not get permitted because they were not going to sequester the carbon and cut the emissions of all the other oxides that come out low enough to fire the generation of electricity with coal. So, I can tell you a personal experience with two plants that I know of.

So, zero sequestration in China. We can get to zero in the United States as far as carbon sequestration, and China is still spewing it all over. If you have been to Beijing, you know exactly what I am talking about.

Mr. CHU. I have been to Beijing. The U.S. Clean Air Act, actually, is exemplary. And I agree with you in regard to sulphur dioxide, nitrous oxides, particulate matter, that we are far better than China. There is a disconnect here about the carbon sequestration part.

We are beginning to pass legislation that says they should be carbon sequestration ready. Maybe I am ignorant of this, but I do not know of laws that say all new coal-fired plants are required to sequester carbon today.

Senator BUNNING. Well, that may be the case in some. It is not the case, particularly in my bill and Senator Barak Obama's bill on coals to liquid. We are going to require that all carbon be sequestered or you are not going to be able to build the plant.

Mr. CHU. All right. Then now we are shifting. I thought we were talking——

Senator BUNNING. No. I am just talking about general reductions compared to China.

Mr. CHU. Right. I think, again, it is commendable. I think if we do do coal-to-liquids, we have to do it with sequestration. What scares me in China, as I just noted in my testimony, is they are not talking about sequestration when they do coal-to-liquid.

Senator BUNNING. That is correct.

Mr. CHU. That is very scary. So we do not disagree about that.

The CHAIRMAN. Thank you, Senator, very much. Your time is expired.

Senator Rockefeller?

Senator ROCKEFELLER. Thank you, Mr. Chairman.

When China joined the WTO and then we granted PNTR, they accepted a set of rules. They accepted a set of rules. That is not incidental. That means you follow the rules or you should not be in the organization. Now, nobody is perfect, but it appears to me that they are not living by those rules.

The whole question—Dr. Bhagwati, I am not going to ask you a question. I just cannot bring myself to do it because your statement and your attitude is just so far from what some of us experienced in the steel industry and the whole concept of taking somebody who has been working for several generations, who is 48 or 52 years old and saying, well, now we are going to train you, you go get another job, that is not understanding what is going on in America. I mean, we have lost 10,000 jobs in West Virginia in the last 10 years. And that is not a question, so you do not have to say anything.

My point is on 421. I would like to ask this to Mr. DiMicco, and I think we agree. I do not think there is probably any Senator who has testified before the ITC—in fact, so often as I have when I go down there, they say, oh my God, here he comes again.

But that is what my job is, because I have to fight for my steel industry, and I have to fight for what others have called fair play, which is a fairly decent concept in the world, as it is within families, as it is within countries.

Debbie Stabenow pointed out those four cases. The two that, when the President said it was not in the national interests of the United States, those do not exist any more. Those industries do not exist any more.

I have a bill where I think that 421 cases have to be an effective buffer, and I do not think that the President should be given the discretion of taking a quasi-judicial group—which most of us take very, very seriously, they have an enormous amount of testimony and information, more specific understanding of trade matters than anybody else in Washington—and I do not think that we can allow the President to simply walk away from that.

That is like a signing statement on a bill that he does not like. He signs the bill, but then puts a little statement on which negates it. In this case, he does not worry about that. He just goes ahead and does not support it because it is not in the national interest. Well, I think you and I would describe "in the national interest" with manufacturing, and in the case of steel, as huge.

So I have a bill which would in fact require him to not be able to ignore ITC rulings. That is a lot of folks. They have a lot of trade experience. They have heard a lot of testimony. That is all they do, all the time, and I want you to be for that bill.

Mr. DIMICCO. We are. We are.

Senator ROCKEFELLER. The other question I have had is, it seems to me that, if we do not follow up on remedies that the ITC recommends, what we are fundamentally saying to China—and this chart, which is just extraordinary, of their increase from 1995, we had a trade deficit of minus $33 billion to $232 billion. It has gone up every single year. That is very large.

We used to worry about Japan. That has settled out as we came to be able to talk with each other. Talking with the Chinese at the WTO is a far more difficult situation than talking with the Japanese. The Japanese tend to accommodate. They resist until the very end, but they tend to accommodate, particularly us, on these matters.

The Chinese do not care because they are on their path. They are the middle kingdom, the center of the world, and I admire them enormously. I have studied their language. I have been there a great deal. I applaud what they are doing, except for not playing by the rules.

So when we do not enforce 421, it has really encouraged them in a sense to wait us out, to bypass our rules, because they know that nothing is going to happen.

Mr. DIMICCO. Absolutely.

Senator ROCKEFELLER. My final point would be to Mr. Chu. I have promoted this for years with no result whatsoever, but I think that one of the ways that you can help the Chinese deal with their emissions problems in the coming years is something which could not possibly be done under the present circumstances, but may be the way to work our way out of a very difficult hostility between China and Japan.

Japan, obviously, is the first to receive China's air pollution in Hokkaido and a number of other ones, they are seeing tremendous differences already from that. They also have the money and the technology, as I think you pointed out—or maybe it was you, Mr. DiMicco—to do a great deal of this.

I think they have the money to be able to go to the Chinese and say, we will help you retrofit your plants with modern technology, and they will get rejected. But China, sort of closing down with the Olympics, is a vast humiliation for China. China does not like to be humiliated.

This whole idea of the Japanese and the Chinese kind of teaming up, one helping the other, strikes me as a really good international solution, which may take a long time.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. Thank you, Senator, very much.

Senator Snowe?

Senator SNOWE. Thank you, Mr. Chairman. I thank all of you for being here today. Mr. DiMicco, I could not agree with you more. My State has been decimated over the years with the loss of manufacturing jobs. We have lost more than 21,000 since 2000, most recently Moosehead Manufacturing that has been around for a very long time in Maine.

Frankly, it is disconcerting. I could not agree with you more about the fact that we certainly do have the ability to maintain a competitive edge in the manufacturing sector of our economy.

I have seen it as examples in my State, but it becomes overwhelming to most industries, given what they are standing against, with respect to China.

The question is enforcement. I think it is sending a lot of messages, but we have to get beyond the dialogue, as you indicated. That has been my experience over 30 years in both the House and Senate. That is exactly correct.

I have dealt with many trade-related disputes before the International Trade Commission and legislation and so on and so forth, but, in the final analysis, it has come down to sending a message to the strength of enforcement and through change in statute.

Even in free trade agreements that we have established with other countries—we do not have one, obviously, with China—the fact is, we do not require them to meet minimal standards.

China now has been able to escape the ability of meeting certain standards when it comes to environment, when it comes to minimum wage, the labor exploitation issue that I know that Senator

Dorgan raised in his testimony prior to yours, and, of course, currency manipulation.

I guess the real challenge is, what steps do you think we should take here and now? We can obviously strengthen our enforcement through statute, but secondly we have the renewal of the trade promotion authority that is set to expire this spring in June.

That is going to be a critical debate that is obviously going to, I think, be a pivot point on many of these questions, including China in many ways, because I think we do have to strengthen our enforcement statutes.

I have joined Senator Rockefeller in his legislation because I do think we should limit the USTR's ability in certain instances. I have been there on behalf of industries in the State of Maine.

There is always a reason why they do not bring a claim for dispute to be resolved, and I think we ought to limit their ability in certain instances so that industries can bring their petitions before the International Court of Trade.

But what other steps do you think should be taken that you think are going to be useful in this process?

Mr. DIMICCO. Well, one that immediately comes to mind when you mention the free trade authority of the President, any President, it should not be granted unless there is a strong agreement to enforce the laws, the trade laws that are on the books, the trade agreements that we have with our trading partners.

If an administration, Democratic or Republican, refuses to apply the laws of the land or refuses to deal with the issues of the WTO on a global basis, they should not have free trade promotion authority. So that is the first thing that should happen before any approval is given to this President, or the next President, that they be held accountable for enforcing the laws that are on the books.

As I have mentioned before, this whole thing of currency manipulation: people underestimate the power of this thing. The Japanese did it, but China is a thousand times bigger. When they do it, it has a thousand times the impact. It took a Plaza Accord, with Ronald Reagan and his folks, to get Japan to rescind the manipulation of their currency.

Ever since then, you have seen a host of Japanese companies come here and build plants. Automobile manufacturing has not died. Unfortunately it has died for our domestic producers, but it has not died overall. Manufacturing jobs can be here, can be competitive if we enforce the laws, enforce the rules and hold people accountable.

China is a big boy. They understand how to play the game. They understand how to separate the geopolitical from the business side. It is we who do not understand that, and we let them get away with it and embolden them every time we walk away from enforcement of the laws that are on the books, like a 421 or anything else.

Senator SNOWE. Yes. And also that we had failed to bring disputes before the WTO, whether it is on currency manipulation, or intellectual property rights, or labor exploitation. So there are ways and means by which we can do it, but we have failed to do so.

Mr. Chu, I know you have engaged in herculean efforts when it comes to anti-climate change technologies, so I really appreciate your being here today as well.

The administration has said that it will continue the policy of conducting environmental reviews on its trade agreements, and yet, as we have seen, even with free trade agreements, those reviews have not occurred.

Frankly, we never require countries to adhere to their own standards and environmental standards, even to the minimal requirements. So that is really, I think, a vexing challenge that we face in dealing with free trade agreements.

But when it comes to China, obviously, as Mr. DiMicco said, using pollution to enhance a competitive position, what would be the leverage, what would be the incentive to encourage China to engage in strong environmental standards?

Obviously it could overtake us in greenhouse gas emissions next year, given the pace at which they are expanding and through their construction, and also because they are increasing their pollution exponentially. So how do we engage them in this process? What would you think would be the best way to do it? What other factors should we use in order to engage them?

Mr. CHU. The central government, I think, wants to do the right thing, as I mentioned, but it is when you actually go to enforce it at the local level, this is where, it seems to me, things break down. If one goes to Beijing, Beijing's air is now the deadliest in the world by some official reckoning.

The people in Beijing, Shanghai, and other areas in China are really feeling this on a yearly basis. It really is getting perceptively worse on a yearly basis, and people are going to be dying by the tens of thousands, or millions.

So there is tremendous pressure on the Chinese government itself. What breaks down is at the local level, as I mentioned, you have this gross polluter, and they know a small fine is a part of doing business, almost.

How do we get people at the local level to—sometimes they do not even have the capital, quite frankly, to modernize, to put on controls, to close down a gross polluting plant to put in a much more modern one.

So I think, as I talk to the Chinese in trying to help themselves, is it possible—for example, they are seeing a lot of cash. Can they make low-interest loans to themselves at the local level at the rate of Treasury notes to say, all right, we will give you the money because you do not have the money to make these investments to modernize your plants to stop the pollution? And you start with that and then you go, next, towards CO_2 emissions. I do not know if this is going to have any traction, but any cooperation, let us say, as mentioned by the Japanese and Chinese in dealing with this, part of it is a matter of capital at the local level.

Do they have the capital to actually say, we know we have to get rid of this, and this is a way out? So it is at that level, I think that—if applying pressure only at the central government is not going to solve the problem because there is a breakdown as you go to provincial and local governments—I think that is where we have to focus our attention.

The CHAIRMAN. Thank you.

Senator SNOWE. Thank you very much.

The CHAIRMAN. I thank the Senator very much.

I, regrettably, have to leave and I have lots of questions, and I do not have time to ask them all. But I am going to try to figure out a way to do so. I will turn the hearing over, if you do not mind, to Senator Cantwell, and she can finish up the hearing.

But some of the questions I am going to submit in writing, basically for you, Mr. DiMicco. How can we improve section 421 and make it work better, and other ways to make our laws work better, and how to deal with import surges. You already mentioned some thoughts on that subject, but I would encourage you to take a look at it.

Mr. DIMICCO. I certainly will.

The CHAIRMAN. And also, for Dr. Chu, with China's growing energy needs and demands, just if the administration, the Congress, were to give you a carte blanche and say, Dr. Chu, you develop our energy policy with respect to China, I would like for you to tell us what that would be, the top three components of a strategy of encouraging China to make the right decisions on energy use, with respect to the environment, clearly. What new tools, maybe, do we need? I might also ask your view in the role of international institutions.

Is there a role there or not that you see? You keep talking about the mistake we made in this country to focus on the central government as opposed to the provinces, and I would like your thoughts on what we do about that.

Do we send missions over and go to the provinces? There is a problem, and we need to figure out some way to deal with it. I am just curious what your thoughts might be.

I might ask Mr. Sorensen, too, what can we do in the United States to help China strengthen its financial services industry? What expertise is needed, where, how? Who can best provide that? Questions like that. That would be very, very helpful.

In addition, I might ask any of you about what roles these international institutions can better play, whether it is WTO or the IMF. How do we deal with the stakeholder question?

On the one hand, we want to give China at least the recognition that it deserves as a large country and encourage them to be a stakeholder and make responsible decisions. On the other hand, we cannot roll over and play dead here. We have to encourage China to be responsible if it is going to be a stakeholder, and your thoughts on how we can help accomplish that.

I do not have time to sufficiently formulate my question, Dr. Chu, about China's energy growth. I think you said last year that China's growth is equivalent to two Californias, or something along those lines, or one U.K., that is, increased demand in Chinese energy consumption.

And your thoughts on what is the significance of that continued growth in the United States. What are the practical implications of all that in various ways, climate change, technologies, and so forth?

I would ask all of you, for the record, any other thoughts that you might have as we advance the ball here. Thank you very, very much. This has been very, very interesting, and I really appreciate it.

Senator Cantwell?

Senator CANTWELL. Thank you, Mr. Chairman. And thank you for this opportunity. And if I could thank you before you leave for also signing a letter that Senator Smith and I are sending to the administration, asking the President to form a China-U.S. energy policy as a way for our Nations to work together on energy issues. I thank the Chairman for signing that letter.

Gentlemen, thank you for your testimony. My perspective on these issues may be a little different than many of my colleagues' here. Let us just say that I believe in enforcement of trade agreements. I definitely believe that TAA ought to be on steroids, that as far as the globalization of an economy, that more trade adjustment assistance should be bolstered many times as just a basic economic strategy for the American workforce to be competitive in changing dynamics, where we are not going to produce the cheapest products or have the cheapest services.

But the Northwest looks at China a little bit more not just as a competitor, but as a market opportunity. We sell them airplanes, we sell them software, and we sell them coffee and many other products.

So, it came as not a lot of surprise to people, when the President visited Seattle last year, that our Governor said that we actually think that we as a State have a positive trade balance with China.

That is not to say that we do not look at them as competition. We are, I think, a little more interested in the dynamics in a global economy of "coopetition," where you figure out where you are going to compete and you figure out where you are going to cooperate to secure your economic opportunities, which brings me back to this U.S.-China energy policy that I feel so strongly about.

Several of you have commented on this issue, both in response to questions and in your own remarks. That is this. If we are looking at the IEA, the International Energy Agency, estimates of $50 to $70 billion a year is what the Chinese economy is expecting to keep pace with energy investment, $50 to $70 billion a year, what do we need to do to be a deliverer of those services, particularly given, whatever it is, the 13 most polluting cities in the world I think are in China, and the fact that that pollution does impact us. So how do we get at this opportunity?

So Mr. Chu or Mr. Bhagwati, to me there always is anxiety and confusion when you talk about technology. I think you are trying to articulate that that technology is something that is already there. We are not talking about technology that the United States wants to hold onto. You are referring to it as technology that would actually make the United States money and help us in energy efficiency.

So my question is, is the energy sector not the biggest economic opportunity for the United States to basically decrease the trade imbalance that exists with China and the biggest economic opportunity for the United States if we exert our leadership in getting U.S. technology adopted right now with China?

I will just throw in, I do definitely believe that they ought to be part of the IEA, the International Energy Agency, so that we can get better planning and measuring. But Mr. Chu or any of the other panelists?

Mr. CHU. Yes. I think a number of companies, GE and Dow, in particular, that I know of, do see China as an opening market to sell their energy technologies. Dow, for example, has in the U.S. reduced its energy consumption per product—it is a chemical company and makes mostly plastics—by about 25 percent.

It has done so well, it sees this as a business. They want to go to China to show the Chinese how to build plants, factories, plastic plants that consume far less energy. The Chinese say, this is great, because if we consume far less energy, looking forward, we have this huge energy deficit in the country and we are choking on the coal. So those are two examples where there is a business opportunity that U.S. industry is realizing.

With regard to clean air, we are very good at making scrubbers and things that actually get, besides CO_2, all the gunk out of coal-burning plants that should be a business opportunity in China. I think the issue there is——

Senator CANTWELL. I guess I am asking, how much would an aggressive government strategy help slingshot us ahead of the existing technology relationships that they might be developing with other countries who either have fuel efficiency on cars, or wind, or solar, or in our case in the Northwest, hydro? How much do you think we really could slingshot ahead in securing an economic relationship?

Mr. CHU. I think the way to do it, if I look—and again, I am not a real expert on this—at what inroads the industry has made, what China actually seeks are partners. They look to Volkswagen and say, you come in, you build us a Volkswagen plant in China, and then we have an arrangement. I think there is going to be this, do not make it in Germany and ship the cars over.

So I think, with regard to the energy industry, there has to be a kind of a sharing in order to really get China—they are going to look for other companies outside the U.S. Do you understand?

Senator CANTWELL. I understand very well. I mean, Boeing has managed to sell them a lot of planes over the years. And, yes, manufacturing of aerospace has now been sourced around the globe and final manufacturing still in the Northwest. But I think they sold a lot more planes than the actual jobs that were created there, so I think that it was a positive.

Mr. Bhagwati, did you want to comment on this? Do you think that it is the biggest economic opportunity for the United States?

Mr. BHAGWATI. Oh, I totally agree with you, Senator, on that. I think I was a bit disappointed in Dr. Chu's remarks that we had sort of fallen behind on developing this kind of technology. I mean, that is clearly an area where any U.S. Government help which can be provided is useful, because it is clearly an area where we should have comparative advantage.

I think we really ought to be ahead of the curve. I hope he is wrong and that we, in fact, can really go ahead and do it. I mean, for years we have known that you are going to get environment-friendly technologies being increasingly adopted worldwide.

China is clearly waiting for us to do that. So I think that is an area where we certainly want to push all our resources into pushing our comparative advantage to go from second gear to fourth gear, whatever you can work out. Clearly, this is a priority area in my view.

Senator CANTWELL. Thank you.

Mr. Chu, did you want to respond to that?

Mr. CHU. Yes. Actually, unfortunately I will stand by what I said a minute ago. But I think I see billions of dollars per year now being invested in the venture capital area in new energy technologies, and so I think a lot of the intellectual property and things, this should really come from the United States.

I mean, we are still the technology science leader of the world. But I draw a distinction between being the technology science leader and owning the intellectual property rights.

And by the way, I concur with the sentiment of the Senate. We have to enforce these piracy actions of China. But what I was talking about was manufacturing of big things, not really high-tech things like airplanes, but a coal-scrubbing thing is not quite as high tech. China would say, let us share in that.

Senator CANTWELL. Well, I see my colleague has arrived, and I want to give him a chance. But I think what I was trying to draw out from you, Mr. Chu, was your earlier comments about the development of technology.

Everybody gets anxious about the Chinese in a purchase of a particular energy resource in the United States, but what you are talking about is technology and patents and efficiency that might be the standard that might help the United States establish a standard in China for energy efficiency that would be different than some other country that might come along.

If we can get that first-mover advantage in helping the Chinese solve their energy problems, all the more technology that they may end up buying eventually from the United States.

So, I was trying to draw that comparison so that people understood what the opportunity is with technology that the government might license to them, as you were referring to, for financial purposes.

Mr. CHU. Yes. I agree with that.

Senator CANTWELL. Thank you.

Senator Schumer?

Senator SCHUMER. Madam Chairwoman, it is a pleasure to be here under your chairmanship, your first one in the Finance Committee, as I recall. And by the way, thank you for keeping the hearing open.

My first question. I am going to save most of my questions on currency for tomorrow, because that hearing is on currency, so we will talk about those tomorrow. I am working, along with Senator Graham, who will be here tomorrow, and Senator Grassley, and Senator Baucus, trying to come up with legislation that will deal with currency.

My first question comes from Professor Bhagwati, who—I do not know if I am paraphrasing here—who seems to think the Chinese never do anything wrong. Here are a couple of questions I want to ask you.

How about allowing American financial services, banks, securities companies, insurance, much greater access? Is access to China now restricted to those companies?

Mr. BHAGWATI. Those are things you negotiate.

Senator SCHUMER. No, no, no. I did not ask you that. I asked you, is access restricted?

Mr. BHAGWATI. Yes. But we have a whole lot of restrictions ourselves.

Senator SCHUMER. Do you think they are equal?

Mr. BHAGWATI. We have $20 billion worth of trade-distorting subsidies.

Senator SCHUMER. Do you think——

Mr. BHAGWATI. So does that mean you are not open?

Senator SCHUMER. No, no. Sir, please answer my question.

Mr. BHAGWATI. Senator, of course.

Senator SCHUMER. Do you think that the restrictions that America places on foreign financial institutions are as great as the Chinese restrictions on foreign——

Mr. BHAGWATI. No, of course not.

Senator SCHUMER. All right. Thank you. All right.

Mr. BHAGWATI. And that is where we are stronger, actually.

Senator SCHUMER. Yes. All right.

Do you think that, for instance, it has taken too long for Citibank to buy Guangdong Bank? It has taken, now, 3 years. It is the Chinese rules. You do not know about that case?

Mr. BHAGWATI. No, no. I do know. I do know.

Senator SCHUMER. Do you think it has taken too long?

Mr. BHAGWATI. I know about the service sector, Senator.

Senator SCHUMER. Do you think it has taken too long? Sir, I go to upstate New York and I find tens of thousands of industrial workers who have lost their jobs. Many of them, the head of a steel company—not Mr. DiMicco's, which is very prosperous, and I welcome him here and welcome him to open more steel mills in New York State.

I have been to two of them—said to me, I could compete with China, I could compete with their lower labor costs, I could compete with everything. But when their currency is under-valued by 30 percent, that is something I cannot compete with, and they laid off hundreds of workers.

Do you believe the Chinese currency is under-valued? Do you believe it floats to market?

Mr. BHAGWATI. Floats to market is not a correct question to ask. The question is, what is the optimal——

Senator SCHUMER. Sir, I am asking the question, do you believe it floats to the market?

Mr. BHAGWATI. Yes, because two of the best macroeconomists in the world, my colleague Robert Mundell at Columbia, who was a Nobel laureate——

Senator SCHUMER. Yes.

Mr. BHAGWATI [continuing]. And Ron McKinnon of Stanford, are way better than any macroeconomists I know. Both think it is correct for China to have a peg with the dollar.

Senator SCHUMER. I did not ask that. See, you do not answer my questions.

Mr. BHAGWATI. No. But I am saying, yes, I——

Senator SCHUMER. Do they allow it to float to market?

Mr. BHAGWATI. No, they do not.

Senator SCHUMER. All right. They do not, right?

Mr. BHAGWATI. Because the best economists in the world say that they should not be floated. So, I will vote with them.

Senator SCHUMER. All right. Sir——

Mr. BHAGWATI. I will vote with them, just like——

Senator SCHUMER. Sir. Sir. Sir. Sir, all I know is, you do not answer the questions. I did not ask you Mr. Mundell's opinion as to whether it is right or wrong. I asked you whether it floated and you, twice, quoted to me Mr. Mundell and Mr. McKinnon who have views that agree with yours. There are lots of economists who have views that disagree with yours.

Mr. BHAGWATI. No. No, no. You have completely—sorry, with due respect, Mr. Senator——

Senator SCHUMER. Did I ask you, does China allow the currency to float to market?

Mr. BHAGWATI. And I am telling you why I do not agree with you——

Senator SCHUMER. That it should.

Mr. BHAGWATI. It should float because——

Senator SCHUMER. But it does not float. Right?

Mr. BHAGWATI. Because, being an economist, I pay attention to the best economists on the subject. Like, I do not know every subject in full depth. I mean, that is what we teach in our classrooms to our students

Senator SCHUMER. Yes. The vast majority of economists, including many Nobel prize winners, think they should let it float. All right? So you can cite two. Yes, they do. Yes, they do.

Mr. BHAGWATI. But, I mean, there are Nobel laureates and Nobel laureates, Senator.

Senator SCHUMER. Oh, I see. [Laughter.]

Mr. BHAGWATI. And there are people who—I mean, I may be a Nobel laureate in one area, but I may not know anything about another area. That is often the case, Senator.

Senator SCHUMER. Yes.

Mr. BHAGWATI. So I think all I am saying is, the people who are most knowledgeable in this field will not agree with you.

Senator SCHUMER. You think it would be better if China reduced its restrictions on American financial institutions?

Mr. BHAGWATI. Oh, yes, I do agree with that.

Senator SCHUMER. All right.

Mr. BHAGWATI. But for China, too.

Senator SCHUMER. I understand. All right.

Let me go on and ask a second question to Mr. Sorensen. Last year, I watched the difficulties with Citigroup, that Citigroup faced while attempting to acquire a stake in Guangdong Bank, and eventually they closed the deal. But China still continues to throw up barriers.

That is one American bank taking over one Chinese bank. What are some of the barriers that financial services firms are facing in trying to do business with China? This is the life blood of New York.

As you know, I worked hard to open up Japanese financial markets about 20 years ago, and it resulted in greater free trade and greater transparency, and there were many Bhagwatis out there who said the sky will fall, they should not do it, et cetera, et cetera, et cetera, and it worked out for the best. So that is sort of my experience. But in any case, can you give us your assessment of how well China is living up to the commitments it made upon WTO accession more than 5 years ago in terms of financial services?

Mr. SORENSEN. On a scale of 1 to 10—and by the way, Senator, the Principal Financial Group's life blood is also financial services and access to China for us, as I indicated in my testimony.

Senator SCHUMER. Yes.

Mr. SORENSEN. That is also very important.

On a scale of 1 to 10, China is probably, in our opinion, about a 6. They should be at about an 8 in terms of the financial services area, which is my expertise.

Senator SCHUMER. Yes.

Mr. SORENSEN. I think the strategic economic dialogue, Senator, that Hank Paulson is leading is going to be an instrument that is going to be very valuable for Congress and for the administration to advance that process.

Senator SCHUMER. Right. All right.

Just one final question to any of the panel. What do you all think of wage insurance as a way to help temper the blow to people who are displaced from technological trade change and technological globalization? What do you think of wage insurance as a possible answer? Anyone? Mr. DiMicco?

Mr. DIMICCO. Senator, thank you for being here today.

Senator SCHUMER. Thank you.

Mr. DIMICCO. As a matter of first resort, it should not be the solution that we have to these issues. As part of the solution, yes. When those things happen, there should be a way to deal with them to cushion that blow. But we are so far away from having a level playing field, dealing with all the other points such as currency manipulation and export subsidies of all types, that that would not be the first thing I would like to see people do.

Senator SCHUMER. Right. Understood. Anyone else? [No response.] All right.

Thank you, Madam Chairperson.

Senator CANTWELL. Thank you, Senator Schumer.

And thank you, gentlemen, very much for your testimony. I am sure the record will be kept open for other questions by members. If you can get us responses to those, we appreciate it. Again, thank you for being here.

This hearing is adjourned.

[Whereupon, at 12:06 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Senate Finance Committee

Testimony

on

US TRADE POLICY: THE CHINA QUESTON

by

Jagdish Bhagwati

University Professor, Economics and Law
Columbia University &
Senior Fellow in International Economics.
Council on Foreign Relations

March 27, 2007

Let me begin by saying how honored I am to have been invited to appear before your Committee, Senator Baucus. I have long been familiar with the leadership you have provided on trade issues in the Senate over many years, enabling the United States to be the major player in the liberalization of world trade that has brought so many indisputable benefits to us and to many nations around the world.

You have asked me to address the question of China and what it implies for US trade policy. China, of course, has long been an important source of controversy for US trade policymakers. The debates over whether to grant it MFN status were followed by whether, and on what conditions, it should be admitted to the WTO (World Trade Organization). I recall how USTR Charlene Barshefsky arrived from Beijing with an agreement on the terms of Chinese entry into the WTO just in time in Seattle in November 1999 for the WTO meeting which blew up in the face of President Clinton and the rest of us, postponing by two years to 2001 the start of the Doha Round of multilateral trade negotiations.

Many were certain that the focus on China had detracted from the US preparations and preparedness over the Seattle meeting, illustrating tangentially how multilateral trade liberalization is often handicapped, not advanced, by distractions over bilateral and plurilateral (i.e. with members exceeding two but less than all nations) trade negotiations.

Today, the issue of China is even more prominently at the center of a major debate over US trade policy. But the stakes in this debate are higher as the China question now is part of a substantive debate, especially after the last election, over the question whether further freeing of trade or a retreat (however slow) into de facto protectionism makes sense for the United States. More precisely, the China question is one of two issues today that must be addressed regarding our trade policy. So, let me say a few words about the other issue, and then turn more bodily to the China question which you are addressing today, Senator Baucus.

I: Inclusion of Labor and (Domestic) Environmental Standards in Trade Treaties: Case of "Export Protectionism"

The first relates to the fact that the New Democrats have been elected, with a Democratic majority, in the last Congressional election with promises to require labor and (domestic) environmental standards as central features of trade treaties. While there are groups that want to spread higher standards because of altruism and sympathy, the motivation that prompts the demands for inclusion of labour standards elsewhere as preconditions for trade liberalization by the United States --- these demands come from AFL-CIO and the new Democrats are reflecting for political convenience these demands while some share the AFL-CIO viewpoints independently of voting considerations, for sure --- is quite simply self-interest and fear.

The demands that labor and environmental standards, for example, must be demanded from others with low standards because otherwise free trade would be "unfair" have long been exposed as unpersuasive. Let me state here just a few of the counter-arguments against such demands: systematic analysis of the different rationales proposed for them is available in many other places and needs to be consulted for a fuller understanding of the protectionist dangers we currently face.[1]

First, if these demands take the common form that others must have similar "burdens" as our producers do, it is easy to see that standards, theirs and ours, are generally speaking different for perfectly legitimate reasons and that our objecting to others' standards is as right or wrong as their objecting to ours. Would we then let others exclude our exports simply because our standards are lower than those of Europe, even Canada's, in many areas? In case one doubts that US standards are lower, just think of the obvious examples. Almost alone in the world, we allow capital punishment, including the capital punishment of juveniles. Or take the several international reports on the state of our prisons, and our widespread use of prison labour to produce goods for sale by firms who are not required to pay minimum wage payments and offer labour protections. Then again, on the right to unionize, the Human Rights Watch (with whom I work on

[1] I, among many others, have written extensively on why the attempts to include labor and domestic environmental standards in trade treaties are misguided. Especially, exactly ten years ago, I and the late Professor Robert Hudec produced two substantial volumes on the subject; see Bhagwati and Hudec (eds), Fair Trade and Harmonization: Prerequisites for Free Trade?, MIT Press: Cambridge, Mass., 1996. I have also written extensively on the subject in the American Journal of International Law, in my Testimony to this Committee on the FTA with Jordan, and in many op ed articles in The Financial Times etc. I have not seen any persuasive response to my criticisms. My sense is that the AFL-CIO is no longer interested in arguments (where they cannot win) and have decided to go exclusively to the political route. Given their substantial resources, evidently, it is a smart strategy for them to substitute financial for human capital!

the Academic Advisory Committee on Asia) has produced a detailed analysis which concludes that this right is effectively denied to "millions" in the US, largely (but not exclusively) because the right to strike has been crippled by the Taft-Hartley provisions. Indeed, many abroad find it very hard to believe that, with little more than 10% of our labor force unionized, and with wide appreciation of the legislated difficulties faced by unions in organizing labor, we can claim that we have the higher moral ground in these matters. At a time when the Bush administration's unilateralism has provoked serious anti-Americanism, the self-righteous tone of our labor and environmental lobbies and the dissonance between our postures and our own practice are also not likely to make the United States any more likeable to the world.

Second, and equally important, our attempts at imposing such standards on the developing countries will not succeed with the larger and economically more important developing countries such as India and Brazil. These countries are fully democratic; they are neither more dictatorships nor violators of human rights than we are. In fact, India is a splendid democracy which has managed to manage multi-religiosity, multi-ethnicity and diversity within a democratic framework. Its unions are also free; and its environmental movement is strong. As for Brazil, President Lula has risen from the ranks of the trade union movement and has better credentials as a trade unionist than even John Sweeney! Yet, both India and Brazil strongly reject the inclusion of labor and environmental standards in trade treaties. In fact, India just recently told the EU that they could not have an FTA with it unless if non-trade issues were mixed up with it, causing EU to go back to the bargaining table; and the same can be confidently expected to be the case with the US. It is also noteworthy that no trade treaty purely among developing countries has these extraneous non-trade issues within it: it is a characteristic of bilateral trade treaties that hegemonic powers, with their lobbies, impose on lesser countries in one-on-one, unevenly-matched bargains. If the new Democrats want to go down this route, they face the prospect of confining their trade liberalization to weak, ineffectual nations which will roll over when faced with such demands. Some liberalization indeed!

Third, key political leaders in the US, until recently, were cognizant of the fact that it was more efficient to pursue labor agendas in the ILO and trade issues in the WTO and in other trade treaties and institutions. Senator Patrick Daniel Moynihan frequently wrote to me agreeing with this position, including sending me for my files a memo to this effect, based on an op ed of mine, signed by POUTS as "seen".

It has become fashionable for some commentators such as the political science Professor Mac Destler and the journalist Mr. Bruce Stokes to say that the US has become less protectionist in recent years. This is seriously wrong. Yes, we probably have less sectoral, import protection. But the protectionism we now face is across-the-board, export protectionism. The attempts at raising labor and domestic environmental standards as preconditions for trade liberalization are transparent attempts by a terrified labor movement, and sympathetic media personalities like Lou Dobbs, to raise the cost of production of rivals in the poor countries so that the force of competition is moderated. Imagine a beast charging at you: you can either catch it by the horn (i.e. conventional import protectionism) or reach behind it, catch it by the tail and break the charge (i.e. export protectionism). The forced raising of standards in the poor countries desirous of trading with us is "export protectionism": It is insidious because it is not transparent to the general public as such and partly because it can be successfully disguised as altruism and empathy for the people in the poor countries. It is also invidious because it is not confined to specific sectors but cuts across many sectors, indeed wherever the imposition of such standards by de facto exercise of political power manages to raise the cost of production of rival firms abroad.

It is a dangerous protectionist beast that the new Democrats, and several compliant Republicans who would rather advance business deals than stand for any principles, are therefore turning loose on the trade arena. But the other major threat comes form China today. Part of it is from China's low standards on human, and hence labor, rights and so what I have argued above holds *pari passu* in regard to China. But it comes from other China-specific factors, to which I now turn below.

II: China: Macroeconomic Red Herrings

I do not intend to pun; but the macroeconomic criticisms such as those advanced by Senators Charles Schumer and Lindsey Graham, threatening across-the-board tariffs against China if the Renminbi is not revalued sizably, are a red herring. Consider the following:

* There is an exaggerated focus on the Chinese reserves which are

currently at a trillion dollars. But the Japanese reserves are pretty close, at around 800 million. The rest of Asia, including Taiwan and India, add up to a similar sum. So, for Asia as a whole, the reserves are about three times the Chinese levels: so why pick just on China?

* Regardless, the accumulation of Chinese reserves has created a deep-seated concern that this is the cause of US payments deficit. But the US deficit is a reflection of US excess spending. In a multi-country world, if the Chinese currency were revalued, the US deficit with China would be reduced, the Chinese reserves would tend to fall, but the US deficit with third countries would increase. The only way to reduce the US deficit would be to reduce US aggregate excess spending. The fault lies within us.

* Many fear that the Chinese surpluses will continue growing exponentially and, since they are currently invested in US Treasury bills, will give the Chinese great power to disrupt our markets and will also give them political clout over us, in consequence. But almost nothing keeps growing exponentially. In the case of China, as much as for India, the pressures are growing to spend a large fraction of the reserves on infrastructure needs and on expanding education and health expenditures on the poor. We can confidently expect therefore that Chinese reserves will level off in the near future.

* The Chinese reluctance to allow the Renminbi to crawl up faster than the slow upward climb after the small revaluation in July 2005 , and thus to abandon the peg to the US dollar which she adopted in 1994, has to be understood in light of the fact that some of today's most profound international

macro-economists such as the Nobel Laureate Robert Mundlell of Columbia University and Ronald McKinnon of Stanford University have argued against China's abandoning the peg, even though economists such as Nouriel Roubini of New York University have argued for exactly the opposite.[2] Since such diametrically opposed recommendations are not uncommon in macroeconomics, and even the proponents of Chinese Renminbi revaluation divide into many camps on the extent of the desirable revaluation.

* Besides, these economists frame their analysis in terms of which exchange rate regime, pegged or flexible, is good for China itself, rather than for the rest of the world, including the United States. But the concern in the US must be over the implications for the US, not for China, unless we are going to be altruistic. How does one then asses the efforts of Treasury Secretary Paulson to ask for financial sector reforms in China? Frankly, while such reforms are likely to be good for China itself, I do not see our pressures for them as anything other than using our confrontations with China to open the Chinese market more rapidly and deeply to our financial firms on Wall Street: this is good for Wall Street but it is not clear how it will benefit the US in any other Chinese-macroeconomics-related benefit spillovers.

[2] Cf. Ronald McKinnon, "Why China Should Keep Its Dollar Peg", Stanford University, January 2007; and Nouriel Roubini, "Why China Should Abandon Its Dollar Peg", Stern School of Business, New York University, 2007.

III: Trade Policy Issues Raised by China: Unnecessary Alarm

So much then for macroeconomic issues and the confusions that characterize those who seek aggressive postures towards China in regard thereto. But there are also direct trade policy questions where aggressive actions are demanded today, principally because there is much fear of China's impact on our economic prosperity and on our workers' real wages. But let me say that these fears are, at best, seriously exaggerated, and at worst, unjustified. But first, let me make three general points.

First, as is now widely appreciated, China has played a helpful, not a disruptive, role at the WTO, fully justifying the arguments of those such as myself who predicted this outcome.[3] Those who feared that China, to mix metaphors, would be a bull in the WTO shop, have proven wrong.

Second, the complaint by some observers that China has not played a sufficient role in the ongoing Doha Round negotiations, ignores the fact that China was subjected to several WTO+ concessions barely before the Doha negotiations began: she has therefore, in the unfortunate language of negotiations, put down major down payments already.

Third, there is, as with Japan in the 1980s, continuous dissatisfaction with the Chinese implementation of their WTO obligations, especially in relation to intellectual property protection. But, as with the Japanese government, it makes no sense to keep pressuring China bilaterally. Few big powers give in to such pressures to the extent that would satisfy the complaining nations. Besides, while

[3] This is the unanimous view of many Sinologists who have written on the subject. For an excellent overview and synthesis, see the forthcoming book by Claude Barfield Jr., The Eagle and the Dragon, American Enterprise Institute, Washington D.C., 2007.

China is authoritarian, it is well established that domestic lobbies in shape of different ministries and regional authorities play a similar role and it is necessary for the central authorities to countervail their objections. This can be done more effectively when there are impartial decisions requiring corrective action, than if simply bilateral pressures, often triggering nationalist responses, are cited as a reason to take remedial action. Such impartial decisions are available from the WTO Dispute Settlement Mechanism. So, as we did with Japan in the end, it is best to ignore China's promises and sensitivities: let us use the DSM with increased frequency. More WTO cases by us will lead to less friction with China, and more satisfaction for the American private sector interests, than bilateral pressures.

But, even if China is behaving responsibly and differences in US and Chinese views of China's implementation of its contractual obligations can be resolved amicably and efficaciously through the Dispute Settlement Mechanism without raising temperatures in bilateral confrontations, the big question that dominates thinking about China and US Trade Policy relates instead to the fear of China's impact on our economic prosperity and on our worker's wages. Let me turn to these questions now.

First, in regard to the impact on our worker's wages, the pressure on them in the last two decades, if not a little longer, has been manifest. But the question is whether it has anything to do with China. This is, in fact, part of the broader question: has Globalization turned the heat on our worker's wages? This is certainly what many fear. But, as I pointed out in an op ed in The Financial Times

(January 4th, 2007), the evidence for such a link is pretty thin.[4] The fact is that many empirical studies of the effects of trade with the developing countries --- and that certainly includes China and India --- on our workers' wages have shown a rather small adverse effect; and my own empirical work even suggests a favorable effect that has moderated the fall in wages which would have occurred because of labor-saving technical change. [I also argued that Globalization has been feared to have adversely affected our worker's wages through the substantial influx of unskilled illegal immigrants, an issue that does not concern China and us, of course. But here too, the adverse effect is now estimated to be negligible and recent studies again suggest that the effect may even be favorable.]

I considered other possible links (such as the outflow of multinational investments and the weakening of labor power in wage negotiations due to Globalization) and found that they too yielded nothing significant, leading me to consider that the fear of Globalization, and hence of China, on our wages was unjustified and that the principal culprit was rapid and deep unskilled-labor-saving technical change. [This is a judgment that has recently been made also by Federal Reserve Chairman Ben Bernanke. But, of course, he is not an expert on international trade any more than his predecessor Alan Greenspan was. So while his views on the subject attract media attention, they carry for the knowledgeable scholars less weight than his views on macroeconomics, even though it is good to see that he holds the right views on the issue!]

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[4] I had dealt with the issue, with other empirical and analytical arguments, in Chapter 10 of my 2004 book, In Defense of Globalization (Oxford University Press), and I have also expanded on the themes of my Financial Times article in the Afterword in the new edition of this book, to be issued in June 2007.

Next, and finally, let me turn to the somewhat different question: can we compete with China (and India) or are we doomed to a gloomy prospect, with diminishing (aggregate) prosperity? Let me make a few important points, instead of offering an exhaustive analysis.

* China's size and also her rapid growth over two decades make many worried. But that is wrong. We are bigger in both GNP, and even more so in per capita GNP. China's huge geographical size, and its vast population, create unjustified fears.

And the assumption that he high growth rates will continue into the future ignores the fact that China has many economic problems that plague it, especially inefficient State Operating Enterprises, still much poverty, and a terribly weak financial sector. Its demographic structure, thanks to the draconian and effective one-child policy, also is lopsided, closer to that of Europe than of India. These problems cast a shadow over China's ability to sustain its high growth rate.

But the prospects of China registering "miracle" growth rates for much longer are also cast in doubt by her communist politics. China lacks currently the four elements of a functioning democracy: NGOs, a free press, opposition parties and an independent judiciary. The result is growing social disruptions as commissars and their cronies grab land, for example. No one can predict whether China's rulers will react to these disruptions by introducing democratic reforms or by repression. But the transition to either situation is not going to be easy. Then again, without NGOs, opposition parties and a free press to countervail gross abuse of the environment, China has been devastated by massive environmental neglect: this has not merely meant that China's effective growth rate, adjusted for the environmental damage, is probably 3 percentage points lower than estimated, but also increasingly handicaps future growth rates by saddling the authorities with gigantic clean-up costs, for example.

* Tom Friedman has also propagated unwittingly the myth that China and India will come down a "flat road" and, like Russell Crowe's Roman legions, assault us. He is dead wrong. He forgets that there are many potholes in this flat road and comparative advantage is not dead. Take, for instance, the fact that communist China, with its fear of samizdat, cannot promote software: this yields us and India a huge competitive advantage in the IT sector, on which much of modern technical change depends! Or recall the fears in the 1980s that Japan would take over everything, starting with our autos and semiconductors. Yes, they have remained fierce competitors in manufactures. But, for cultural reasons, they have been klutzes in the financial sector which requires rapid responses rather than the tender loving care and craftsmanship that have made Japanese a powerhouse in manufactures.

* Professor Paul Samuelson, some years ago, also created a stir essentially by noting that the accumulation of skills and capital by India and China would imply that they would be becoming more like us. By producing increasingly therefore the skills-intensive products which we had specialized in, they would drive down their prices and thus reduce our gains from trade. True enough, this can happen. But when the critics of Globalization like the famous journalist Robert Kuttner interpreted this as saying that we must then use protection as a

response, they were dead wrong. If Florida gets a hurricane that devastates Miami, Governor Jeb Bush would only add to that devastation by cutting off trade with the rest of the United States!

But Professor Samuelson was likely too pessimistic in thinking that the gains from trade would diminish as countries got similar in endowments. As countries get similar, trade in similar products, or what is sometimes called trade in variety, breaks out. Recent empirical studies by the economists Robert Feenstra and David Weinstein show that the gains from trade in variety are immense. If you doubt this, just walk down Madison Avenue in New York and you will see how men's and women's designers compete and flourish in the same "industry", none seeking protection and each (and their customers) enjoying the fruits of trade in variety. I wonder how many people really think that the United States, in putting Europe and Japan back on their feet, and thus making them again more similar to us in endowments, hurt the US. Equally, we need not fear that the rise of China and India will do us harm, instead of good.

* I should also add inn this context that the recent fears fueled by economists who write about how China's production of engineers, for example, already exceeds that of the United States, ignore two important problems with that argument. First, the quality of the Chinese engineers is not near that of ours. Second, the large number of engineers is required in China to repair roads, bridges etc. and to be engaged in internal non-traded sectors like construction, and will have no direct impact on the numbers available for the traded sectors.

Besides, the Cultural Revolution destroyed the stock of engineers and intellectuals in a very big way; and these decimated stocks will have to be depleted.

The "fallacy of numbers" is also evident in discussions of India. Thus, while many fear that outsourcing will take over most jobs in the US, the facts are that even call-answer personnel cannot be so readily multiplied. Thus, of the age cohort that can go to College, only less than 8 % does. Of this, a further small fraction studies in English. Of that, a further small fraction can speak English. And of that, a tiny fraction can speak English that you and I can understand! Yet, India's huge population is cited uncritically as implying a major threat to our service jobs!

<u>China: A Gulliver in a Lilliputian World Economy</u>

While therefore the fears of China, and the demands for us to reshape our trade policy in a protectionist direction vis-à-vis China, are mistaken, is there need for <u>some</u> response? I believe that the China phenomenon underlines dramatically the need to strengthen our adjustment assistance policies, something that we need to do in order to cope in any event with the <u>volatility</u> of comparative advantage in today's global economy and enhanced competition.

To see this clearly, remember that the recent China-bashing reflects only the third time that we have had to contend with the fears of the "yellow peril". The first was when Japan was exporting labour-intensive products, including the celebrated "one dollar blouses" worldwide in the early 1930s. The second occurred when Japan was crowding autos, TV sets, semiconductors etc. in the 1980s. The third is with China in the 1990s and now.

In each case, the problem has been an unusually rapidly growing economy, with substantial outward orientation on exports. The result has been an inability for others to absorb the resulting tsunami in trade: I call this the problem of Gulliver in a Lilliputian world economy. Mind you, when such nations export, they take away markets from others. But when they import, they create markets for others. The problem is that the markets created are not the markets lost. So, for those who lose markets to the exports from these Gullivers, the effect is dramatic. Overall, the numbers on trade are still manageable. But for specific sectors, they react as if they are facing a tsunami.

What China's exceptional growth and trade do in an exceptional degree therefore is to accentuate greatly for some sectors the problem of adjustment. This only reinforces the need to revamp and expand our adjustment assistance programs, building in new ideas like wage insurance as well. Since these are needed in any event to cope with the volatility introduced by modern Globalization, perhaps China is doing us a good turn by enhancing the need to adapt ourselves institutionally for the new Age of Globalization.

CONGRESSIONAL HEARING

Regarding

Opportunities and Challenges in the U.S.-China Economic Relationship

Statement of

Steven Chu
Director, Lawrence Berkeley National Laboratory

Before the

Committee on Finance
United States Senate

March 27, 2007

Chairman Baucus, Ranking Member Grassley and distinguished members of the Committee, it is my pleasure to be here today to discuss U.S.-China energy issues. Few topics have the broad impact on America's and the world's future as this one, and I applaud you for calling this important hearing.

I am Steve Chu, Director of Lawrence Berkeley National Laboratory. Because of its direct bearing on this Hearing, I wanted to let you know that I am currently serving as Co-Chair of an InterAcademy Council study panel on "Transitioning to Sustainable Energy". The InterAcademy Council was created by the world's academies of sciences to bring together the best scientists and engineers worldwide to provide high quality advice to international governmental and non-governmental organizations. It is the charge of our committee to provide a roadmap to scientists and policymakers on moving toward adequately affordable, sustainable and clean energy supplies. My Co-Chair is Jose Goldemberg, formerly the Secretary of Science and Technology and the Secretary of the Environment for Brazil, and an expert in sustainable energy technologies who helped to shepherd Brazil's sugar cane-based energy phenomenon. The panel has given me a broad and varied view of the many energy challenges and opportunities facing our world – including those in China. Our final report should be completed soon and I will make sure that a copy is transmitted to the Committee once available.

China is now the world's second largest energy consumer after the United States. Its emergence as a major player in the world energy scene is a result of its remarkable two decades of rapid economic growth, which has averaged approximately 10% per year. This tremendous growth has lead to remarkable socio-economic shifts, many good for China and the world, many which have created enormous challenges for China and the world. Clean energy is an issue with which the Chinese government and nations around the world must grapple collaboratively, with the understanding that progress in transitioning to a more sustainable energy future is the paramount task of the day.

As introduction, I would like to share a series of observations that clearly demonstrate both the challenges and the opportunities for the U.S.-China relationship on energy issues. My testimony will then go into a bit more detail on a few of these issues.

- China's and the United States' rapidly growing reliance on coal as the core energy source has substantially added to global emissions of CO_2 and the threat of yet greater climate change in the future.

- As with many countries around the world, China's desire to guarantee access to its future oil and natural gas supply could potentially lead to future conflict with the United States and the rest of the developed world. It has been suggested that China engages with "rogue" states to ensure access to these supplies. Alternatively, China may feel that the United States is trying to limit its access to a key resource. However, we both--as major importing countries--have similar interests in the stability of supply, particularly in the stability of the Middle East, and should aim for cooperation instead of antagonism.

- In the Western United States, Sierra Nevada Mountain Range monitoring stations have measured and identified particulates from north China as part of huge clouds of pollution that travel over the Pacific to the United States. California's mercury deposition is now increasingly from emissions from Chinese coal fired plants. The U.S. environmental technologies industry is well advanced and should assist China in identifying opportunities to help clean its air and water.

- China uses roughly 15% of total global energy while the US consumes approximately 25% of the energy. Almost half of the world CO_2 emissions are due to these two countries. While our energy efficiency, as measured by the energy consumed per GDP is significantly better than China, on a per person basis, the US consumes about 8 times the energy as China. As China's economy rapidly advances and begins to approach the GDP per capita of the OECD countries, it is essential that China improve its energy efficiency, defined as the GDP divided by energy use.

- Can the world sustain the level of energy consumption and carbon emissions per person enjoyed by the US? *As far as our stewardship of the environment is concerned, the carbon emissions per person are a more relevant metric than the carbon emission per GDP.* By comparison, the US energy consumption and CO_2 emissions per person is about twice as high as Europe and Japan. Just as the US must significantly reduce its carbon footprint, China must strive to achieve higher energy efficiencies as its economy grows.

- Between 1980 to 2000, the economy of China quadrupled while its energy consumption only doubled, twice the improvement of the US. However, as free-market forces were unleashed, the energy demand is now increasing at one and a half times the rate of economic growth. The central government of China has announced in 2006 an ambitious plan to decrease energy intensity by 20% by 2010, but it is already falling behind these goals. It is in the best interests of the US (and the rest of the world) to more aggressively help China achieve its goals. Why? In the next two decades, roughly half of the buildings in the world will be constructed in China. Between 300 - 600 million Chinese will move into cities. During this massive construction, it is vital that the new cities be designed to maximize energy efficiency.

I believe that China's leaders understand their dilemma and their opportunity. For China, especially Chinese government officials, the energy issue is most often cast in terms of access to affordable energy as paramount to it's economic future. Combating pollution and finding cleaner methods of powering its growth is key to the health of its citizens.

China plays a central role in the world's increasing concerns over global climate change. The reduction of carbon emissions pledged by the European Union will be outstripped by the growth of energy demand and production in China. For example, China's addition of 90 GW of coal-fired power plants installed in 2006 alone is expected to emit over 500 million tons of CO_2 per year for their 40 year lifetimes. This compared to the entire European Union's Kyoto reduction commitment of 300 million tons of CO_2. Coal has underpinned the majority of China's economic growth, and consumption is now nearly 80% higher than in 2000. This growth has heavily taxed China's entire energy supply chain, from mines to processing to transport, and has sharply increased CO_2, sulfur dioxide and other polluting emissions. I should also note that the US is also in the process of building an unprecedented number of coal plant; over 120 plants are being planned.

As was previously mentioned, China had managed to keep growth of energy consumption substantially below that of its economic growth. Between 1980 and 2000, China quadrupled the size of its GDP, while only doubling energy consumption. This remarkable achievement is unknown among other countries of its size or level of development. On the basis of this success, the Chinese government's long-term development plan laid out in 2000 set a similar target for 2020—another quadrupling of the GDP, with a doubling of energy consumption. Unfortunately, the experience of the past 5 years has completely stymied this ambitious plan. Energy consumption has been growing faster than the rate of economic growth and is already 75% higher than in 2000.

This growth has heavily taxed China's entire energy supply chain, from mines to processing to transport, and has sharply increased CO_2, sulfur dioxide and other polluting emissions. In response, the China's leaders declared a new short-term plan in 2006 to turn this trend around by reducing the energy intensity of the economy by 20% by 2010. This aggressive program has engaged the leadership of each province, who all signed a pledge in Beijing to achieve the target. In support of this pledge, the government has included success in increasing energy efficiency as one of the evaluation metrics for the provincial leaders and has announced a range of other policies to move in this direction, including efficiency gain requirements for China's top 1000 industrial enterprises, which collectively consume 33% of China's total energy consumption. If successful, this program would represent a substantial reduction in China's projected CO_2 emissions by about 1 billion metric tons. Already, at the recent G8 ministers meeting in Germany, China's environmental minister, Xie Zhenhua, included the 2010 reduction plan as part of China's upcoming national plan to combat climate change.

China's energy structure has been, and remains, dominated by coal. Coal provides over 90% of fossil-fueled power generation, and it is a key fuel to the steel and cement industries, now the largest in the world. It provides energy for cooking and heating in millions of homes. And increasingly, it is being looked to as a source of both chemicals and alternative fuels. In 2006, China mined and consumed nearly 2.4 billion metric tons of coal, more than twice the volume consumed in the United States. Just a few years ago China was a major exporter of coal, but since the beginning of 2007, has become a net coal importer.

China has few options to reduce the dominance of coal in its economy. Although natural gas supply has expanded rapidly in the past decade, domestic reserves are limited, and production is less than 10% of the volume produced in the United States. China has begun a program to import liquefied natural gas (LNG) to supplement its domestic supplies, but the recent sharp increases in world LNG prices and the costs of terminal construction have already curbed future expansion plans. Similarly, it has looked to neighboring countries—Russia and Kazahkstan, and Turkmenistan in Central Asia—for the possibility of pipeline imports of natural gas, but these projects have been hampered by uncertainties of resource availability and by unsettled issues of control by Russia. Domestically, high natural gas prices have stifled the expansion of natural gas use in the power sector, where now just 2% of total capacity is gas-fired. Although China hopes to quadruple the supply of natural gas to its economy by 2020, it is unlikely to exceed 10% of the total energy mix, and natural gas can do little to offset expected growth in coal demand.

Another daunting barrier to improving China's energy reality is its rapidly growing petroleum consumption. Although it has displaced little, if any, coal use (which would be positive development from a carbon emissions perspective), China's use of oil is skyrocketing. As in the United States, oil forms the backbone of China's domestic transportation system, powering trains, ships, planes, trucks, cars as well as a vast number of agricultural tractors. In total, transportation use of oil accounts for only about 40% of total consumption, compared to over two-thirds in the United States. While China presently accounts for just 9% of world oil demand, it is responsible for 30% of world demand *growth* – much due to the growth of automobile consumption and use.

As with natural gas, China's demand for oil has outstripped its domestic supply. Once Asia's largest oil exporter, China became a net importer in 1993, and is now the second largest oil consumer—and third largest importer—in the world. China is home to one of the world's largest super-giant oil fields—Daqing—which produced over 1 million barrels per day for over a decade. It is now in production decline, and within a few years, perhaps as early as 2007, China will join the ranks of 60 other oil-producing countries whose national production has begun to decline. Future growth in consumption, therefore, will rely entirely on imports, and oil security is of central concern to China's leadership. Their policy response to the issue of oil security has been multifaceted, yet at times inconsistent and at cross-purposes.

China's national oil companies have looked increasingly overseas to establish resource and production bases to supplement weakening domestic supply, at times bringing them into conflict with the established operational modes of international oil companies and with policy goals of other countries, including the United States. China has established a Strategic Petroleum Reserve for the purpose of stabilizing the domestic market, but the lack of transparency on fill rates and timetables has at the same time unsettled international oil markets unsure of what incremental demand this will bring. China has opened its domestic oil wholesale and retail markets to a limited extent in accordance with WTO agreements, but continues to control the price of gasoline and diesel to shield farmers, freight shippers, and other consumers from the full impact of high international crude prices. On the demand side, China has implemented strict automobile efficiency requirements on a per-car basis, yet has constructed the equivalent of the U.S. interstate highway system in little under a decade, and has let investment in its extensive rail system lag. The personal car—centerpiece of U.S. oil consumption—remains but a small fraction of the total vehicle stock in China but is already a major contributor to air pollution in cities such as Beijing and Shanghai.

Although the challenges are huge, China is committed to making progress and is implementing plans to do so. Some changes have been spurred by direct economic reasons and often do not address the issue in a climate friendly way. Other changes are made for political and policy reasons, such as to combat pollution and congestion, but are often negligible in their impact and efficacy for either global climate change or energy security.

On the economic side, high international oil prices have spurred development of domestically produced oil alternatives. Since 2001, China has expanded its grain ethanol production capacity to about 360 million gallons a year, providing 10% ethanol gasoline blends in 10 Chinese provinces and cities. In 2006, however, a surge in corn prices in the domestic market led to a moratorium—citing food security concerns—on the use of food-chain grains for ethanol production, and China is now looking to expand production of cassava and other starchy roots to substitute for grain. It has also declared intentions to plant an area the size of Delaware with jatropha and other oil-bearing plants to provide feedstock for the biodiesel industry.

Ironically, and unfortunately from a climate perspective, China is also looking to coal as an alternative to oil, and proposals for over 60 million tons of coal-to-liquids (CTL) capacity (about 1.2 million barrels per day) have been submitted for review. The consequence of this program, if carried out, would be dramatic. Nearly a quarter-billion tons of additional coal would have to be mined for fuel and feedstock, and substantial new water resources found to supply the plants. Also, no plans for carbon capture have been announced, despite the fact that CTL-derived vehicle fuels result in three times the CO_2 emissions compared to petroleum-based fuels.

China is also looking at nuclear power as a means to reduce its dependence on foreign sources of energy. But, nuclear power remains a minor energy form in China. Currently, generation capacity totals 7.6 GW out of a total 622 GW nationwide, or just a little over 1% of the total. China has another 4.2 GW under construction, to be completed by 2012, and by 2020, China hopes to bring 40 GW total into operation, providing just 3 to 4% of electricity supply in that year. This very aggressive plan, requiring the commissioning of over 2 GW of new capacity every year to 2020, can do very little to offset the growth in coal use for power generation. In 2006 alone, China installed a total of 102 GW of new power generation capacity, of which 90 GW was coal-fired (mentioned earlier). In contrast, 2 GW of nuclear power capacity is expected to come online in 2007.

China's leaders and government bureaucracies have also looked to energy conservation and efficiency as a way to help address their energy challenges. China has strong efficiency programs in place for residential and commercial equipment, appliances, electronics, and lighting. Their program of minimum energy efficiency standards has been revamped and modernized since 1996, largely on the basis of the U.S. Department of Energy program, with broad support from the U.S. Similarly, China's energy efficiency labeling authority recently signed a Memorandum of Understanding with U.S. Energy Star to harmonize its own energy efficiency specifications with those in use in the United States. In contrast to the United States, however, the residential and commercial sectors account for only a small proportion of China's energy consumption: the industrial sector dominates, accounting for over 60% of all energy use. In this sector, efficiency programs are weak or non-existent, with only a few pilot programs developed with international assistance underway. The need for such programs is urgent, as progress towards the achievement of the 2010 reduction target will depend heavily on efficiency gains in the industrial sector.

In developing these new programs, China traditionally first looks abroad to survey successful programs in other countries, adapting as needed to suit the conditions in China. Technology is generally not the challenge: what is needed is a package of measures to encourage adoption of new technology, information dissemination of results and experience, financial or tax incentives, technical assistance in auditing and planning, backed up by leadership support at higher policy levels. These are areas in which the U.S. has extensive experience and could provide assistance to China for achieving its energy reduction goals.

China's reliance on coal also makes it urgent to accelerate research and development on techniques for carbon management, including capture and sequestration. As the United States and China are the two largest coal-consuming countries in the world, and the two largest CO2 emitters in the world, a partnership in this area could make progress towards offsetting the impact of the expected increased use of coal in both countries. Further progress on climate change mitigation also depends on the engagement of the United States and China.

Finally, China's size and rapid growth means that developments in every energy field—oil, coal, natural gas, nuclear power—will have global impacts. It is important, therefore, that the engagement with China on energy issues be strengthened and expanded, both bilaterally and multilaterally. Although the International Energy Agency has already established regular dialog with China on oil and other issues, full Chinese participation in the mechanisms of the International Energy Agency—particularly with respect to Strategic Oil Reserves management—may be appropriate. China's rapid rise into top global economic leadership may also suggest that full participation in global dialogs such as that of the G8 are warranted. Without engaging the developed world fully and at all levels of the energy issue, significant and long-lasting progress will not be realized.

COMMITTEE ON FINANCE
U.S. SENATE

OPPORTUNITIES AND CHALLENGES IN THE U.S.-CHINA ECONOMIC RELATIONSHIP

TESTIMONY OF DAN DIMICCO
CHAIRMAN, PRESIDENT AND CEO
NUCOR CORPORATION

MARCH 27, 2007

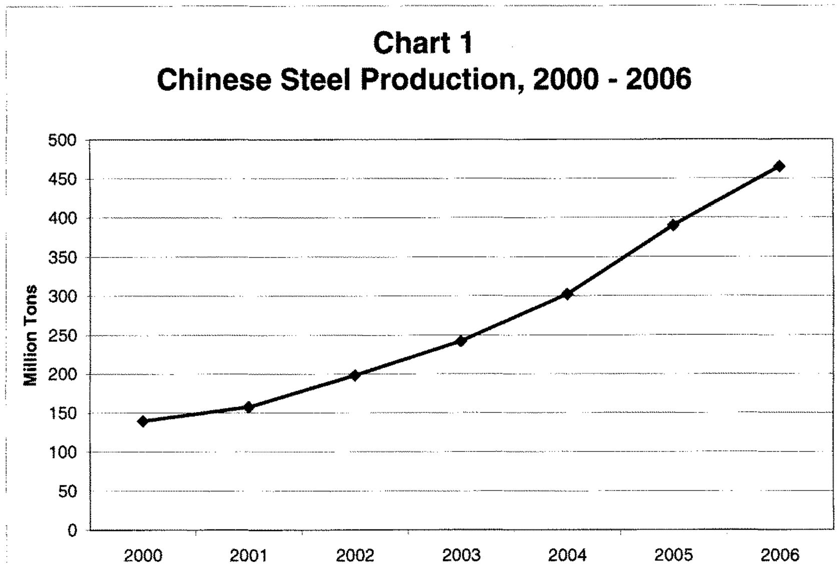
I am Dan DiMicco, Chairman, Chief Executive Officer, and President of Nucor Corp. In 2007, Nucor will be the largest steel producer in the United States. We are one of the most efficient producers in the world whether measured by raw material use, energy consumption, or labor per ton. We are also the country's largest recycler; in 2006, Nucor recycled over 20 million tons of steel. Thank you, Mr. Chairman, for convening this important hearing to address opportunities and challenges in the U.S.-China economic relationship.

President Ronald Reagan got it right over twenty years ago - "to make the international trading system work, all must abide by the rules." When it joined the World Trade Organization, China agreed to these rules. Quite simply, the U.S.-China economic relationship is not working today as it should because China is breaking the rules on every front -- from using massive subsidies, to the manipulation of its currency, to widespread violation of intellectual property rights -- all to give its exports an unfair advantage in international trade. This behavior has cost the U.S. economy hundreds of billions of dollars and millions of jobs. And we have let them get away with it.

Defending and enforcing the rules that are internationally agreed upon is not "protectionism." Shame on us if we do not make China live up to its commitments. It is time for Congress, the Administration, and the American public to make China abide by the rules – rules to which it agreed in return for access to our and world markets.

We have heard repeatedly that the U.S.-China economic relationship is complicated, and that we should "just let the market work." In fact, China is not letting the market work. And time is not on our side. We have been letting China get away with this behavior for the last five years – ever since it formally joined the WTO. We have a lot of catching up to do.

Our economic relationship with China can be explained in four simple charts. The first chart is of the growth in China's steel production over the last seven years.

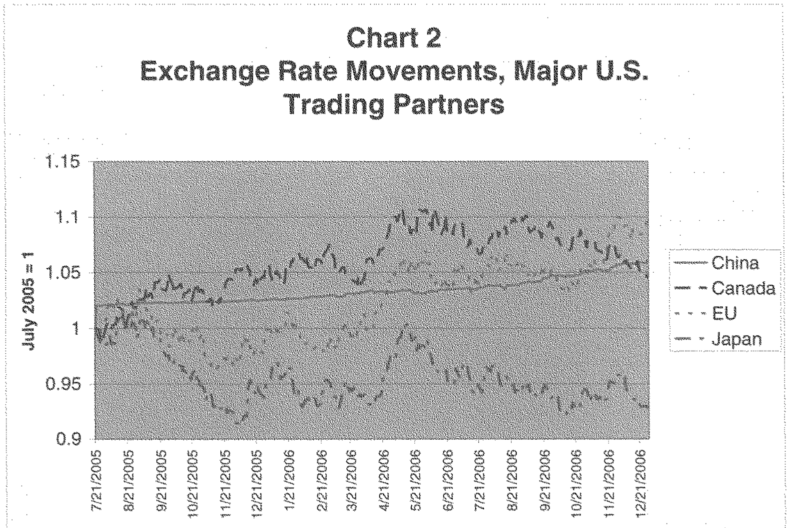


Between 2000 and 2006, China's steel production increased by *234* percent. In 2006, China produced nearly 465 million tons of steel, almost 35 percent of world production. It produced more steel than the next four largest producers – Japan, the United States, Russia, and Korea – *combined.* Yet China has no comparative advantage in steel.

No other steel industry in the world added remotely as much capacity as China over this period. This explosion of Chinese steel production was no accident. A huge steel industry is a vital component in China's plans to transfer the world's manufacturing capability from the rest of the world to China. Steel is an essential ingredient in many of China's major exports to the United States, including electronics, machinery, appliances, auto parts, and now automobiles themselves. To turn China into the "factory of the world," the Chinese government has funneled hundreds of billions of dollars in subsidies into a multitude of industries, including the steel industry and industries using steel. These subsidies take the form of equity investments, cash grants, and write-off of nearly a trillion dollars of loans by state-owned banks, among others.

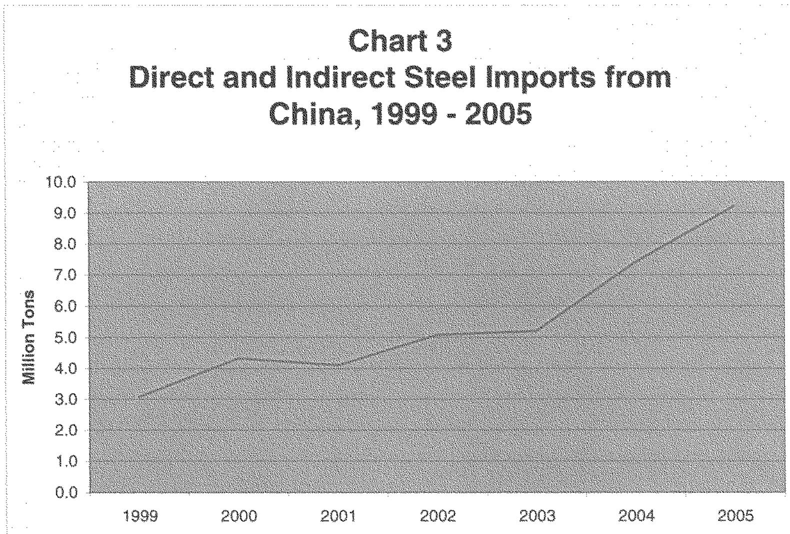
Another major "subsidy" is the non-enforcement of environmental laws. If China enforced its own environmental laws, it could not have permitted and built so much capacity in the last few years. China's export boom is based, all too frequently, on using pollution as a source of comparative advantage. Along with its manufactured products, China is also exporting its pollution with globally disastrous results.

The direct subsidization of manufacturing is only part of the Chinese government's plan to make China the world's factory. The Chinese government also consciously manipulates the value of the Chinese RMB, intervening in world currency markets to keep the RMB well below what I and many others believe is its true value. If you have any doubt that the Chinese government is tightly controlling the value of the RMB, look at Chart 2. It shows the changes in the value of the currencies of our major trading partners, including China, from July 2005, when China announced that it was revaluing the RMB, to March 21, 2007.



Currency manipulation provides Chinese exports with a tremendous advantage in international commerce. By keeping the RMB 50 percent or more below its true value, the Chinese government's currency policies make imports from China artificially cheap and exports to China artificially expensive. Our own Federal Reserve Chairman, Ben Bernanke, has recognized China's control over the RMB's value for what it is, a subsidy. He called China's currency manipulation, and I quote: "the effective subsidy that an undervalued currency provides for Chinese firms that focus on exporting rather than producing for the domestic market."

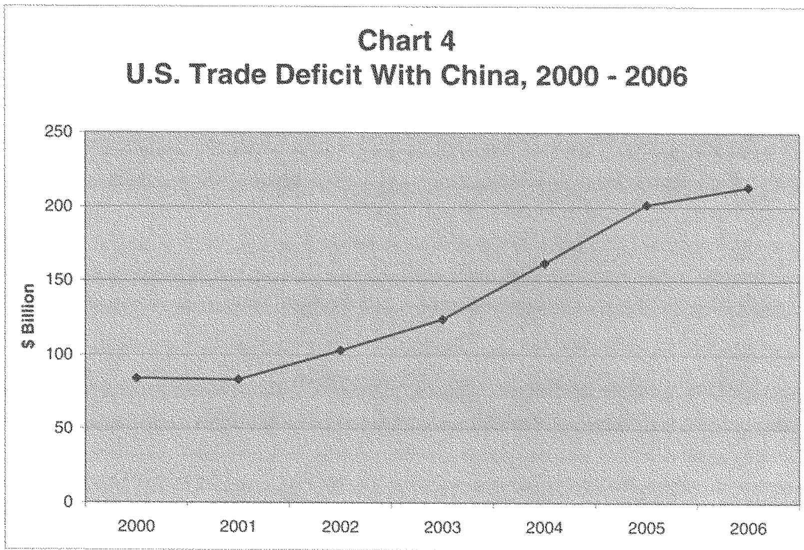
Subsidies and the deliberate manipulation of the value of the RMB have worked exactly as the Chinese government hoped. From 1999 to 2005, Chinese exports of steel to the United States, both as steel and in the form of products containing steel, increased by nearly 200 percent, as Chart 3 shows.



The metals industry is not the only manufacturing industry that has experienced this explosion in imports. From 2000 to 2006, imports of furniture from China rose by nearly 170 percent; imports of electrical machinery increased by 234 percent, while imports of other types of industrial machinery grew by 365 percent.

Normally, U.S. producers being injured by subsidized imports could seek relief through the subsidy laws. However, due to a misguided policy decision 20 years ago, the Commerce Department has chosen *not* to apply the countervailing duty law to imports from China and other "non-market" economies, even though the Department admits that the statute would allow it to do so. By continuing to exempt China and other non-market economies from application of the subsidy law, the United States sends the message that countries can violate international rules with impunity. A bill recently introduced by Senators Bayh and Collins, S.974, would clarify that the subsidy laws do apply to China and other non-market economies. As China has already agreed to be covered by the subsidy law, passage of this bill should be non-controversial. Let's get on with it – it would be a good start in holding China to their commitments.

My fourth chart shows the ultimate impact of China's policies of subsidization and currency manipulation. From 2000 to 2006, the United States' deficit with China in trade in goods grew by 155 percent, to more than $213 billion dollars. American exports to China grew over this period, by $37 billion – but Chinese exports to the United States grew by over $200 billion, more than five times as much. It is a cruel hoax on the American public to focus on the growth of exports to China while ignoring the massive and widening gap between exports and imports. In addition, because other Asian countries believe they have to manipulate their currencies to keep their exports competitive with China's, the U.S. trade deficit with Asia reached $344 billion in 2006 – nearly half our total trade deficit.



In a truly free market, trade deficits of this magnitude are unsustainable; exchange rates should adjust to bring the bilateral relationship into greater balance. This has not happened with China, precisely because the Chinese government refuses to let it happen. And, I regret to say, that the U.S. government has not been tough enough.

China's manipulation of its currency and its subsidization of export industries are undoubtedly the cause of a substantial portion of the three million jobs the manufacturing sector has lost since 2000. Prof. Peter Morici of the University of Maryland estimates that imports from China are responsible for approximately one million of these lost jobs. The damage to the U.S. economy is not limited to lost jobs; thousands of American companies lost sales and profits as a consequence of China's policy of currency manipulation, preventing them from expanding operations and investing in new facilities and technologies here in the United States.

Manufacturing plays a special, irreplaceable role in the American economy. Jobs in manufacturing have traditionally been the way for Americans who do not have a college degree to work their way into the middle class. Manufacturing jobs generally have higher pay and better benefits than jobs in other sectors of the economy. When we lose manufacturing jobs, we are losing a vital part of our middle class. Despite what some say, the loss of manufacturing jobs in the United States is not "inevitable."

While trade adjustment assistance can be useful, it is a band-aid, not a cure. Frankly, there are very few jobs for which Nucor employees could be retrained that would pay anywhere near what they are earning now. American workers would rather keep their jobs than retrain for new ones; above all, they want their government to stop the cheating and deliver the level playing field they have been repeatedly promised.

If this nation resolves to stop the hemorrhaging of manufacturing jobs by enforcing international rules of free trade, it will do much to erase the widening "wealth gap" that is so alarming. Taken together, declining employment in manufacturing and rising income inequality help explain the growing feeling of insecurity among Americans who do have jobs. Those who are working in manufacturing especially fear that their jobs could disappear overseas. The long-term implications of these developments are troubling. *What does it mean for American society if a person with a high school education can no longer aspire to a middle class standard of living, however hard they work?*

And what does it mean for our country if we no longer have the manufacturing base we need to protect our national security? Our national security requires that we be able to make critical products like ships, electronic equipment, machine tools, and textiles. Without these key industries in the United States, we will never educate the scientists and engineers we need to remain competitive in the world economy. We will lose the single largest source of research and development in our country. I do not believe anyone here thinks it is appropriate or realistic for the United States to depend on any other country to ensure our security.

Things do not have to be this way. We could eliminate much of our trade deficit with China and others, and save hundreds of thousands of American jobs, simply by enforcing the international rules of free trade, rules to which China has agreed. There is no reason to give China, or any other country, a free pass on its obligations. We must take decisive steps now to remedy currency manipulation, end massive subsidization, stop rampant theft of intellectual property, and eliminate the use of pollution as a tool of competition. In some cases, this may require the passage of additional measures to close loopholes in our trade laws and give us the necessary tools.

It is not "protectionist" for the United States to hold China to its trade agreements. Some have been fooled by the short-term advantages to consumers of allowing China to persist in these practices, while ignoring the long-term effects those practices are having on the United States, its workers, and our national security. The true protectionists are those who urge the U.S. government to do nothing, so that they can protect their ability to buy illegally subsidized Chinese imports.

More talk with China will not improve the situation. The Administration has engaged in a "dialogue" with China for years now, and China is simply gumming us to death. China will change its policies when it has to change. "Dialogue" will not accomplish this. Enforcing the rules of international trade will.

Ending China's currency manipulation and other forms of subsidization is in everyone's interest. China is and should be a major part of the global economy. It should be a major manufacturer with a large, well-educated work force. Forcing China to follow the rules of international trade will be good for the Chinese economy, by forcing it to submit to the healthy disciplines of the market. It will be good for the Chinese people, who can use the hundreds of billions of dollars such a move would free up for other, better purposes. It will be good for the global economy, by ending the distortions China's subsidies create. It will be good for the global environment. Finally, by saving thousands of American jobs and ensuring that the United States will continue to have a vibrant manufacturing sector, it will be good for the United States.

Senator Byron L. Dorgan

Testimony at Senate Finance Committee Hearing on "Opportunities and Challenges in the U.S-China Economic Relationship"

Tuesday, March 27, 2007
Senate Dirksen Building, Room 215

Mr. Chairman, I would like to thank you for inviting me to testify at today's hearing, with regard to S. 571, a bipartisan bill to rescind Permanent Normal Trade Relations status with respect to China.

It may surprise some members of this Committee to learn that in September 2000, I voted to grant PNTR status to China. I voted for PNTR because, on balance, I thought that it was important to engage with China, a country of 1.3 billion people that was at a crossroads in its relationship with the United States and the world. But I was under no illusion that the agreement with China would necessarily mean greater access to the Chinese market. And on the floor of the U.S. Senate, I made the following statement:

> ***"I want it to be clear that, if we accord Permanent Normal Trade Relations to China and we discover that they are not in fact complying with the terms of the bilateral agreement we negotiated with them . . . then I believe we must reserve the right to revoke China's Normal Trade Relations status."***

I am here today, nearly seven years later, to say that there is irrefutable evidence that China has not lived up to the spirit or the letter of the trade agreement that we signed with them, and that we need to rescind China's Permanent Normal Trade Relations status.

When the United States granted PNTR to China in 2000, our merchandise trade deficit with China, was $83 billion. By last year, that trade deficit had exploded to $233 billion.

For every six dollars of merchandise that we buy from China, the Chinese buy only one dollar of merchandise from us.

That is a staggering indictment of the one-way trade that we have with China, and reflects a wide range of problems. These include vast intellectual property theft and piracy, currency manipulation, unfair barriers against U.S. exports, and an unfair playing field in which U.S. jobs go to China because of sweatshop conditions there.

Now, I represent an agricultural state, and as I indicated, China is a significant market for U.S. agricultural products. But our exports to China would be greater by many orders of magnitudes if we could sell to China's 1.3 billion people without facing all kinds of non-tariff barriers. According to the Census Bureau, China is only the 15th largest export market for North Dakota. In fact, North Dakota exports nearly 10 times as much to Belgium as it does to China.

Why are our exports to China as limited as they are? Take the case of wheat, for example. When they joined the WTO in November 2001, the Chinese agreed to significantly expand the amount of imported wheat that could come into China at relatively low tariffs, to 8.5 million metric tons per year. But in 2002, China allowed less than 10% of that amount to be imported. The Chinese government allowed only 10 percent of the import licenses to be available to private importers. The remaining 90 percent was reserved by the Chinese government itself, and they made sure that our wheat did not enter China.

In March of 2003, the USTR official in charge of agricultural trade with China stated that China has failed miserably to live up to the promises it had made on wheat trade, and said that the United States would be well justified in filing a WTO case against China. But the official said that the Administration was reluctant to do so, because a WTO case would be seen as an "in-your-face" thing to do to China, so soon after China joined the WTO.

Well, we held a hearing in the Commerce Committee on the issue of trade with China, at which I complained forcefully about this. And we were able to export a little more wheat to China in the couple of years that followed. But in 2006 we exported less wheat to China than we did in 2002. And the Chinese government is incredibly inventive in finding non-tariff barriers to our products.

This is what the USTR report on Chinese trade barriers had to say last year:

> ***". . . Agricultural trade with China remains among the least transparent and predictable of the world's major markets. Capricious practices by Chinese customs and quarantine officials can delay or halt shipments of agricultural products into China, while sanitary and phytosanitary (SPS) standards with questionable scientific bases and a generally opaque regulatory regime frequently bedevil traders in agricultural commodities."***

Why do we keep tolerating this from a county with which we have a $232 billion annual deficit?

I could testify at length about the currency manipulation that China is engaged in, but my colleagues Senators Schumer and Graham will be testifying to that issue tomorrow. Suffice it to say that after several years of raising this issue with the Chinese, the manipulation of the Chinese currency continues unabated.

I could also testify at length about the issue of intellectual property violations, which USTR has described as reaching "epidemic levels," and costs our producers an estimated $200 billion a year.

And I could testify at length about the issue of rampant sweatshop production in China, taking place in blatant violation of China's own labor laws and right under the noses of multinational companies that claim to have effective monitoring systems. BusinessWeek magazine, which is a conservative publication, devoted an entire cover story to exposing that issue just last year.

The article described how on three separate occasions, Wal-Mart determined that one of its Chinese suppliers paying its 3,000 workers less than China's minimum wage and violating overtime rules. Wal-Mart issued warnings that went unheeded. When Wal-Mart issued a fourth warning, the Chinese company hired a consultant which, for a $5,000 fee, taught the company how to keep a double set of books and hide its workers during inspections. Problem solved.

I could give you a thousand more examples of ways in which China is not trading fairly. But I think every member of the Finance Committee, at least in private, would readily agree that China has not lived up to its promises when it obtained PNTR.

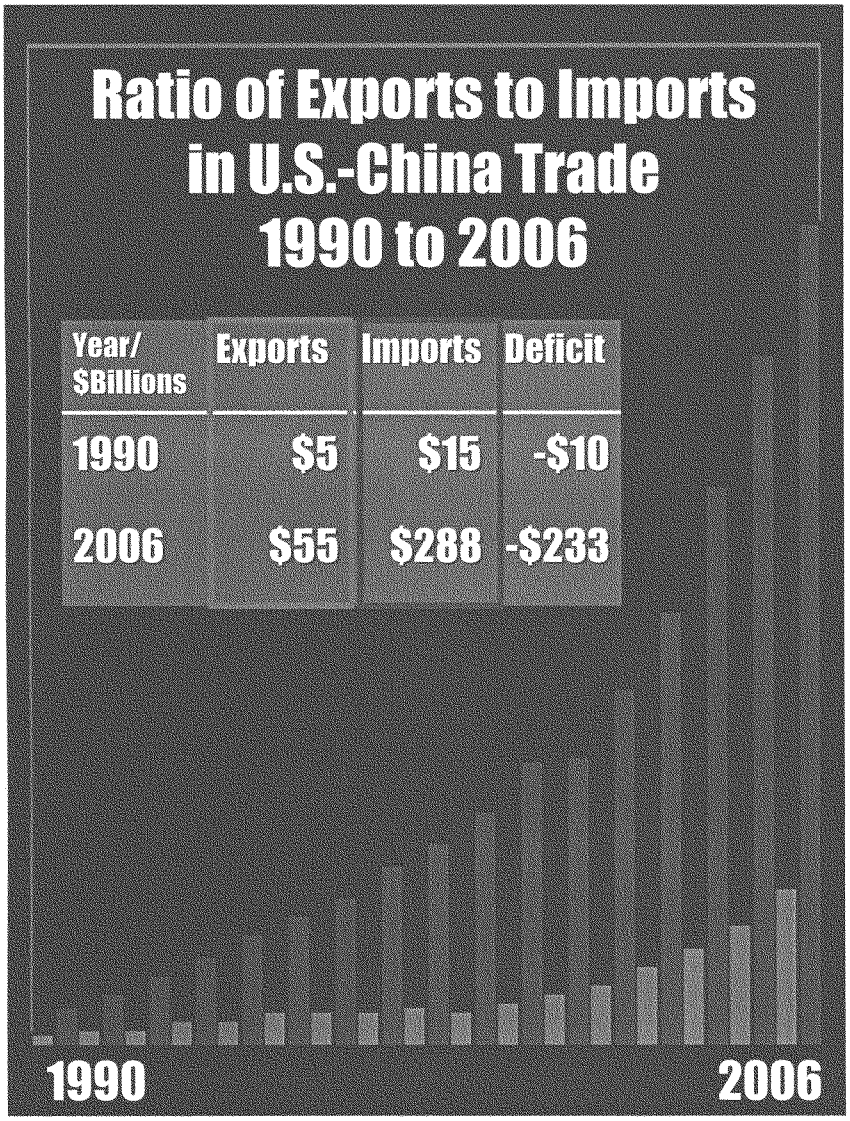
Last year, Senator Grassley, at that time the Chairman of the Finance Committee, described his feelings on the subject with some language that came right from the heartland. During consideration of the Vietnam PNTR legislation, Senator Grassley said that "We need to make sure that we aren't played for a sucker in the case of Vietnam, as we have been with China."

The Chinese don't take us seriously on trade issues. And a big reason is that China believes that it faces zero risk of losing their Normal Trade Relations Status.

Until October 10, 2000, China was subject to the provisions of the Jackson-Vanik amendment. This meant that China was granted normal trade relations only on an annual basis, and renewal was subject to Congressional approval. In turn, this gave Congress the ability to credibly demand that the Chinese abide by the rules of fair trade.

We gave away that leverage in 2000, and we need to reclaim it. I was joined by Senators Graham and Brown in introducing S. 571, a bipartisan bill that says, enough is enough. We need to rescind permanent normal trade relations (PNTR) with China. Our bill would instead require that China once again obtain annual approval for normal trade relations with the United States. Passage of our legislation will demonstrate to China that the U.S. Congress is serious about enforcing the rules of fair trade, and will ultimately lead to a much more constructive trading relationship for both countries.

I agree with the sentiment that Senator Grassley echoed last year: the Chinese have played us for suckers. And I think that we need to rescind PNTR, and send a message to the Chinese that will be heard loud and clear. I hope that this Committee will consider favorably the bipartisan legislation that I have introduced to do precisely that.


Ratio of Exports to Imports
in U.S.-China Trade
1990 to 2006
Year/ $Billions
Exports
Imports
Deficit
1990
$5
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1990
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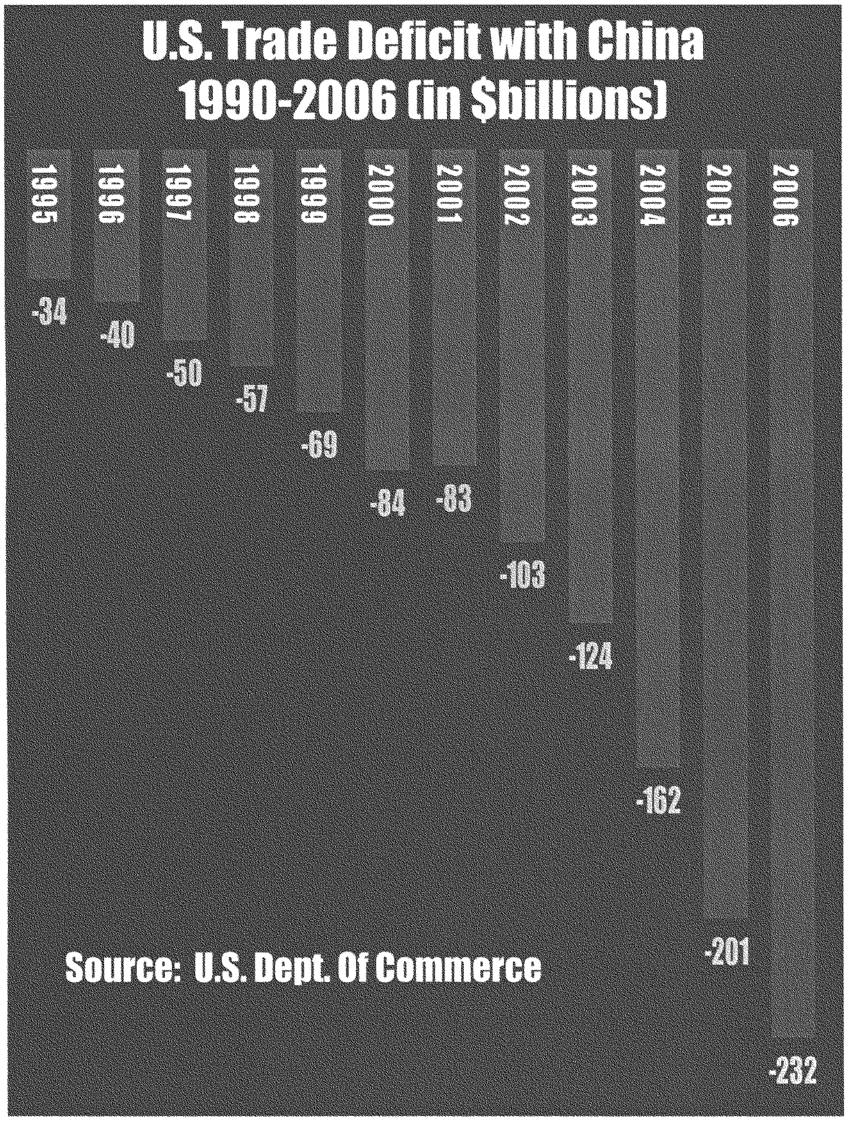
U.S. Trade Deficit with China
1990-2006 (in $billions)
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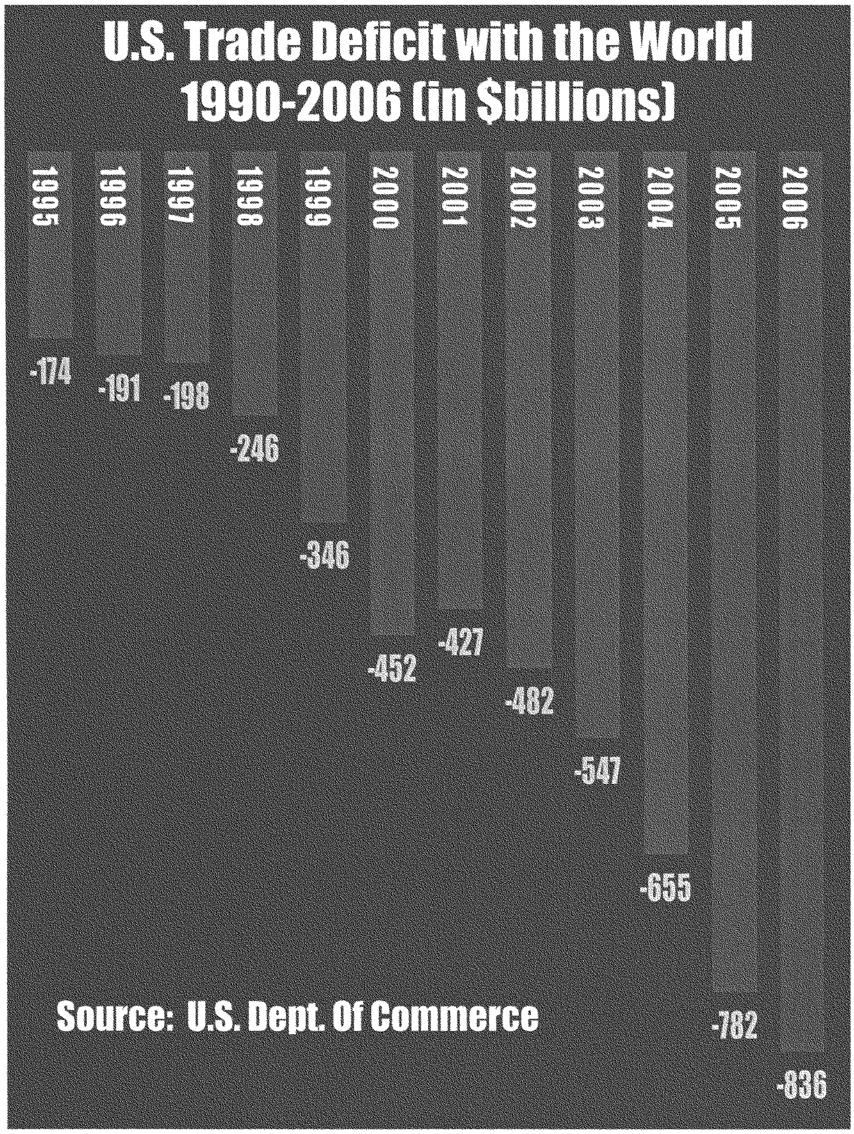
Source: U.S. Dept. Of Commerce


U.S. Trade Deficit with the World
1990-2006 (in $billions)
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-174
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-547
-655
-782
-836
Source: U.S. Dept. Of Commerce

Prepared Statement of Senator Pat Roberts
Opportunities and Challenges in the U.S. - China Economic Relationship
Tuesday, March 27, 2007

I thank the Chairman and Ranking Member for holding this very timely hearing. Our relationship with China is marked with remarkable growth in the global economic arena.

In a few short decades, we have witnessed market opening reforms on behalf of China that have elevated our trading relationship from virtually non-existent to becoming our fourth largest export market. As free and open market practices evolve in China, the opportunities for trade and economic development increase exponentially. Given that context, it is vitally important that we, as policymakers, fully understand the broader scope of our economic relationship with China in order to advance initiatives that foster economic stability and expand market opportunities.

This hearing provides such an opportunity to explore both the challenges and areas of potential cooperation. In regard to China, we must work to address the ongoing challenge of intellectual property rights infringement, undervalued currency compared to the U.S. dollar, and China's continued effort to meet their WTO obligations.

However, despite the challenges in our economic relationship with China, there are also opportunities. I've heard the terms "colossal" and "giant" used to describe the economic growth in China. Folks are looking at the 1.4 billion population and the rising standard of living as a golden opportunity. There could be significant opportunities for a number of industries, ranging from telecom to aviation. In fact, Boeing anticipates that over the next twenty years China will need 2,880 commercial aircraft, making it the world's largest aviation market outside the United States. There are clear opportunities to be developed and economic partnerships to be fostered.

While the statements made today do not directly highlight agriculture, as a Kansan with more than 6.65 million head of cattle in my state, it would be an oversight not to raise the issue of the China's continued block to U.S. beef. In 2003, China was our 9th largest market, importing nearly 26.5 million pounds of U.S. beef and beef products valued at over $28 million. The initial BSE case in December 2003 slammed markets shut around the globe. We have come a long way since the December 2003.

The aggressive response by USDA and the FDA has significantly reduced the threat of BSE in the United States. The OIE determination that BSE in United States is a "controlled risk" is further proof of the safety of U.S. beef. The full organization is expected to confirm this scientific conclusion in May.

However, U.S. beef continues to be blocked. Despite China's unilateral declaration last summer that they would lift the ban and allow boneless beef products, thirty months and younger, all evidence is to the contrary. China has twenty-two hurdles that exporters must clear before they will import U.S. beef products. China, as a member of the WTO, is obligated to observe international scientific standards.

I will continue to pound the desk and make this unscientific ban a topic at every opportunity. I know that reopening U.S. beef trade with China is a priority for both the Chairman and Ranking Member. I look forward to working with you both in normalizing beef trade with China, and other foreign markets that continue to used fake science to block safe U.S. beef products.

TESTIMONY OF NORMAN R. SORENSEN, PRESIDENT PRINCIPAL INTERNATIONAL, INC.

ON BEHALF OF PRINCIPAL FINANCIAL GROUP

BEFORE A HEARING OF THE UNITED STATES SENATE COMMITTEE ON FINANCE

ON

OPPORTUNITIES AND CHALLENGES IN THE U.S.-CHINA ECONOMIC RELATIONSHIP

Thank you, Chairman Baucus, Ranking Member Grassley, and members of the Committee, for the opportunity to testify today on "Opportunities and Challenges in the U.S.-China Economic Relationship".

I am Norman Sorensen, President and CEO of Principal International, Inc. a wholly owned subsidiary of the Principal Financial Group. I testify before you today in my current role at the Principal Financial Group, and with the perspective as Chairman of the International Committee of the American Council of Life Insurers. The Principal Financial Group is an Iowa-based financial services company focused on retirement benefits and asset management, both here in the United States and overseas. As the nation's 401(k) leader we have a particular interest in providing long term savings for employers, employees, and individuals which will benefit them during their retirement years.[1] A focus on pension products has served us well as we've accumulated over $250 billion in assets under management from 16 million customers, serviced by our 15,100 employees (9,396 staff in Iowa) in 11 countries.

The retirement savings vehicles that have been successful here in the United States have been emulated and modified in other markets as well. In newly developing countries in which the Principal Financial Group operates, savings have been significant and the seeds for wealth creation have been planted. In Hong Kong, the Mandatory Provident Pension Fund has reached 2 million participants and comprises 85% of all employed persons, all since 2000. In Brazil, the voluntary pension system has accumulated $49 billion from 8 million participants since 1994. In Chile, a country of only 7 million workers (or 16 million people), the assets accumulated in their defined contribution pension system have reached $89 billion, or 70% of Chile's GDP.

That level of success has not yet reached China. By way of support to China's economic development, I was honored to be able to render testimony on May 11th, 2000 before the Committee on Banking and Financial Services of the U.S. House of Representatives on the subject of granting Permanent Normal Trade Relationship (PNTR) status to China, which culminated in China being allowed to join the World Trade Organization. I was further honored to be able to render testimony on May 17th, 2005 before the Sub-committee on Trade of the Committee on Ways and Means of the U.S. House of Representatives on the subject of liberalization of financial services trade with China, and opening China's financial markets to U.S. companies.

In spite of the progress made by China in the past seven years in opening up its financial services markets, much still needs to be done to provide future financial and retirement security to Chinese households. China has a very basic social support program, which has been the

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[1] The Principal ranks number one in plans among companies that provide both administrative and investment services – 2006 Spectrem Group analysis of fully-bundled 401(k) providers.

predominant government vehicle for the provision of benefits for those who are able to work within a state-owned enterprise. Up until this year, there was no formal retirement savings program in China.

That is why the new Enterprise Annuity Pension System is so crucial for China and the support of their retirement social safety net. The Enterprise Annuity (EA), a program similar to our 401(k) system, is also critical for retirement benefits-focused companies like Principal Financial Group. In the spring of 2005, Chinese regulators started establishing an enterprise annuity system as a second pillar individual account, defined contribution retirement program. Conservatively, our estimates indicate that within 10 years the assets under management for this program should be close to $100 billion. Within 25 years they should reach $1 trillion, which is how long it has taken the U.S. 401(k) system to reach its current $3 trillion in assets. Participating in this type of growth is paramount for firms in worldwide retirement benefits leadership positions. The Principal has proven that it can successfully adapt to local market conditions and thrive.

From the Principal Financial Group point of view, we believe we have already developed a significant success story within China as evidenced by our robust asset management company, CCB Principal Asset Management Co., and yet we began operations less than two years ago. Evidence of this success includes the following milestones:

- Joint venture asset management partnership with China Construction Bank. This bank is the third largest in China and was ranked 11th out of the top 1,000 global banks by The Banker Magazine with respect to capital adequacy. The bank has 14,250 bank branches, 300,000 employees and over US$667 billion in total assets, as of June 30, 2006.
- Rolled out four mutual funds since November of 2005 with the most recent retail mutual fund accumulating US$1.25billion (RMB 10 billion) in subscriptions in a single day.
- The joint venture has also earned awards for most innovative fund and also awards for sales distribution excellence.
- The Principal has integrated some of its own staff and processes into the fund company in an effort to develop worldwide best practices within the Chinese asset management industry.

All of these accomplishments are significant and have come about within a relatively short period of time. We have become one of the major asset management players in China (20 out of 60), but there is much yet to achieve, and we hope that regulatory changes in China will make that possible.

The Principal, along with many other U.S. life insurance and financial services companies, sees great promise in the Chinese retirement security market. We believe that development of the Chinese EA market represents a fortuitous win–win opportunity for the U.S. and China – one which we should all work to expand.

It is in this vein that our industry has and will continue to encourage the discussion on "building the enterprise annuity market to support the Chinese social safety net" under the framework of the current Strategic Economic Dialogue (SED) led by Treasury Secretary Henry Paulson. This extremely broad and influential bilateral dialogue should be leveraged to support allowing U.S. financial service providers to access the Chinese enterprise annuity market on an unrestricted basis. Such an outcome would bring our world class products and expertise to meet China's need for increased private retirement savings products.

As ACLI International Committee Chair, I was with ACLI's CEO, Governor Frank Keating in Beijing in January meetings with Chinese officials and U.S. insurers. The objectives of those meetings are included in a February 27th letter from Governor Keating to the Honorable Henry M. Paulson, Secretary of the Treasury. A copy of the letter is attached to my statement. We currently have a tremendous opportunity through the SED to elevate the importance of this issue in the minds of Chinese leaders. Doing so will empower economic reform in China, while simultaneously opening a vast market to U.S. Financial Services providers.

1. Enterprise Annuity

The Principal Financial Group and ACLI welcome the creation of the Enterprise Annuity Pension system. However, the rules and standards for the provision of EA services remain unclear. The regulations currently prevent one company from providing a comprehensive package of services (custodian, administration, asset management, and trustee). China should clarify the regulatory framework to authorize single provider plans under a single license, which would enable a "one stop shop" to improve cost effectiveness of the plans, particularly for small and medium enterprises in China.

The EA pension system needs changes and this is precisely the right time to implement them. The system is in a nascent stage and changes would not unduly harm or competitively impact either domestic or foreign providers. In fact, the changes identified would help to grow the market substantially, increasing the participation of employers and employees, and decreasing the future pension debt burden on the Chinese government.

EA System - Needed Changes:

Tax Incentives: A number of provinces in China have issued policies that provide various levels of tax incentives for corporate EA contributions, while many others do not have such policies in place. On the employee side, there is no individual income tax incentive for EA contributions. We believe that tax incentives are necessary for promoting private pensions and are crucial to the healthy development of the pension market. Therefore, we recommend that the State Tax Bureau and the Ministry of Finance enact unified national tax incentive policies for both employer and employee contributions to EA.

Foreign Participation Limit: Foreign participation in the enterprise annuity market should be encouraged in the interest of introducing tested professional pension management experiences from other mature pension markets in the world to the fledgling EA market in China. As pension is included in China's WTO commitments under the section covering life insurance, we believe that foreign equity ownership in all EA service provider entities should be allowed up to (at least) the same current limit as life insurance companies (50%).

This limit however should represent a floor and not a ceiling, and as part of SED and in support of building momentum for the WTO's Doha Round Negotiations, the Principal, along with ACLI, call for the Government of China removing this limitation and allowing 100% ownership, as further expressed in the ACLI SED priorities letter I have previously referenced.

Master Trust Plan: The EA rules as they stand now do not allow master trust plans, hence all EA plans have to be set up as individual trusts. This makes small plans unattractive to service providers. There is a strong need on the part of medium and small size companies for such plans in order to enjoy good quality service at a lower cost. Current rules effectively shut the small companies out of the enterprise annuity market. We encourage the Ministry of Labor and Social Security (MOLSS) to work with various other Chinese regulators to allow EA service providers to offer master trusts such that the medium and small size market can also be covered.

Pension Asset Investment: EA rules stipulate that no more than 20% of EA assets can be direct equity investments and no more than 30% can be investments in equity-related investment. This significantly limits the potential for higher long term returns for pension assets. In addition, the kinds of investment options allowed for EA assets are rather limited, too. We believe that a higher percentage should be allowed in equities, and that EA service providers should be allowed a broader range of investment options. This will help ensure a higher long term return for pension assets while at the same time allowing for prudent diversification to control risks. In addition, there should be a timeline for allowing pension assets to be partially invested overseas to further diversify their risk. Adding to offshore investments is a formula that has worked well for other markets, namely Chile where 30% of the assets can be invested offshore and the expectation is within two years to increase that level to 60%. It is a natural evolution in an effort to further diversify and insulate the system from local country risks as evidenced by Mexico enhancing their offshore allocations in the last two years.

In a recent global retirement benefits study, Principal Financial Group found that only 15% of Chinese respondents have tried to figure out how much money they will need to have saved by the time they retire so that they can live comfortably in retirement. Perhaps this poor planning is because almost half expect financial support from their families when they retire and almost a quarter expect to live with their children or relatives. Another reason may be that Chinese households receive advice about financial and retirement planning from magazines and newspapers (33%), television and radio (28%), or friends and relatives (17%), rather than banks (3%) or insurance or pension companies (2%) or other recognized sources of expertise.

Pension Regulator: While MOLSS (Ministry of Labor and Social Security) is the main regulator for EA, a lot of collaboration is needed between MOLSS and the other financial service regulators such as China Securities Regulatory Commission (CSRC), China Banking Regulatory Commission (CBRC), and China Insurance Regulatory Commission (CIRC). Further, it requires a lot of work and manpower to set up and run a well-regulated private pension market in China and much more dedicated and focused resources are needed at the regulator level, without which the policy making and approval process would naturally be slow. We believe that it is vital to have a fully staffed centralized decision-making pension regulator with dedicated resources so as to ensure that the EA regulatory system remains sound and healthy.

2. Financial Services Industry

We at Principal are very supportive of the objectives called for by the broad array of U.S. financial services companies for China and its financial services reforms. While the Chinese authorities agreed to wide-sweeping modifications in order to join the World Trade Organization, ACLI have outlined where some gaps still exist in the treatment of U.S. and global insurance companies.

Our objectives are simple and universal:

- Freedom to choose our juridical form of establishment (branch, subsidiary or joint-venture);

- The ability of a foreign financial firm to own 100% of its operations;

- Non-discriminatory treatment of foreign companies;

- Full transparency in regulation, supervision and establishment of a centralized administrative procedures process.

ACLI's highest priority for improved market access in China is the removal of equity limitations on foreign life insurance providers, and we believe China has the opportunity to show leadership by removing this restriction and allowing increases in the equity investment of foreign companies consistent with prudential regulation and the interests of current investors. Thus, we would urge China to remove the limitation on foreign ownership.

In conclusion, I sincerely appreciate the interest of the Committee, and ask for your support to leverage the Strategic Economic Dialogue to realize a positive outcome from the SED's next meeting in Washington in late May. Our industry and I are assiduously working with the Departments of Treasury, State, Labor, Commerce, and HHS, along with the Office of the U.S. Trade Representative to advocate for positive commercial outcomes from the SED, and I would be pleased to keep you informed of our efforts.

Thank you.

ACLI
Financial Security. For Life.

Frank Keating
President & Chief Executive Officer

February 27, 2007

The Honorable Henry M. Paulson
Secretary
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Dear Secretary Paulson:

To continue the expansion of the global economic relationship between the United States and the People's Republic of China, the American Council of Life Insurers (ACLI) requests that an important element be included under the newly-created Strategic Economic Dialogue (SED): the critical need to assure long-term financial security for the rapidly aging societies of both our countries, in the current Chinese lexicon "Supporting the Social Safety Net".

To achieve this we propose two issues be included under the SED Services Dialogue which we feel are optimally convergent with the broad range of topics to be included in SED and at the same time support U.S. financial services export priorities.

First, the U.S. financial services industry would like to see China increase its openness to foreign investment in its financial services sector. Greater foreign participation would advance China's goals of strengthening and modernizing its financial services sector and the U.S. goal of unlocking China's precautionary savings and stimulating domestic demand-led growth in China. Increased foreign investment also would allow U.S. providers greater opportunities to provide new and innovative products from life insurance to health insurance to pensions. To attract more investment, China will need to provide national treatment for foreign firms, transparent licensing procedures, and liberalization of corporate juridical form (branch, subsidiary or joint venture), including moves toward one hundred percent foreign ownership. The latter step is especially important in the current global trade environment as it would demonstrate China's positive leadership in the WTO Doha negotiations.

Second, as a specific example of new access that would advance the broad goals of the Strategic Economic Dialogue, the U.S. financial services industry requests that the Chinese Government complete and implement the new Enterprise Annuity (EA) pension regulations without delay.

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The Honorable Henry M. Paulson
February 27, 2007
Page 2

This new national pension program should be managed by private companies or Joint Ventures owned or controlled by domestic or U.S. insurers, asset managers or banks, with a simplified single license including asset management, record keeping, trusteeship and custodial services. The EA system should allow U.S. financial services companies to operate on a nationwide, unrestricted basis under reasonable minimum capital requirements.

ACLI and its members, all of whom are actively engaged in advocacy on Capitol Hill, believe that adoption by the Chinese Government of these measures within the scope of the Strategic Economic Dialogue would significantly advance the rapid progress of the SED and, equally important, would help remove structural impediments in China's financial sector that impede progress on other U.S. priorities.

ACLI along with our educational affiliate the International Pension Foundation, are prepared to organize academic and policy stakeholder forums in Beijing and Washington in advance of the next SED to lay groundwork in support of governmental discussion of these topics. I and our entire membership appreciate the Administration's leadership and are prepared to support in every way.

Sincerely,

Frank Keating

Norman R. Sorensen's
Response to Senator Baucus's Questions

March 27, 2007

1. Senator Baucus's question: What can we do in the United States to help China strengthen its financial services industry? What expertise is needed, where, how? Who can best provide that?

   The Engage China Alliance, supported by ACLI (enclosed website with full materials) has just put together a comprehensive set of answers to precisely these questions, which I believe is an excellent starting point.

   An additional step I would suggest, is the creation of a high-level U.S.-China Financial Services Business Group comprised of senior U.S. and Chinese financial services executives, which would meet twice yearly and report on their recommendations and their progress to the U.S. Senate's Committee on Finance and to the Secretary of the Treasury. (I discussed this with International Trade and Economic Advisor Janis Lazda after the Hearing.)

2. Senator Baucus's question: What roles can these international institutions play, whether it is WTO, IMF—maybe China should be a member of the IMF?

   The U.S. and European financial services business sectors, particularly ours, are the most competitive in the world. U.S. financial services companies can benefit enormously from rapid opening of China's financial services markets while significantly benefiting the Chinese economy and its citizens.

   Therefore, the IMF, the World Bank and the WTO, should play a much stronger role by encouraging China to rapidly open up its financial services markets. One suggested approach would call for the creation of a China Inter-Agency Financial Services Task Force (Banking, Insurance, Securities, Pensions, Asset Management) co-sponsored by the IMF, the WTO and the World Bank, with private sector financial services participation. This task force would engage Chinese officials on a specific, planned basis to encourage sustained further opening of its financial services markets, and report periodically to the Senate Committee on Finance. As a current member of the IMF and as an elected Board Member of the World Bank (IBRD), China could contribute greatly to the success of such an undertaking.

COMMUNICATIONS

AMERICAN MEAT INSTITUTE

Testimony of

J. Patrick Boyle
President and C.E.O.
American Meat Institute

Before the
Senate Committee on Finance

Regarding
Opportunities and Challenges in the U.S.-China Economic Relationship
March 27, 2007

Mr. Chairman, Ranking Member, and Members of the Committee thank you for allowing me the opportunity to submit this testimony. For more than 100 years, AMI has provided service to the nation's meat and poultry industry – an industry that employs nearly 500,000 individuals and contributes approximately $100 billion to the nation's economy.

AMI members include 250 of the nation's most well-known meat and poultry packers and processors. Collectively, they produce 90 percent of the beef, pork, veal and lamb food products and 75 percent of the turkey food products in the U.S. Among AMI's member companies, 60 percent are small, family-owned businesses employing fewer than 100 individuals. Some are publicly traded and employ tens of thousands. These companies operate, compete, sometimes struggle and mostly thrive in what has become one of the toughest, most competitive and certainly the most scrutinized sectors of our economy: meat and poultry packing and processing.

In recent years, the Chinese economy has soared at consistently astonishing rates. As their economy has grown, diversified, and generated greater household wealth, Chinese consumers have become some of the best new customers for the members of AMI. The Congressional passage of permanent normal trade relations for China and their accession to membership in the World Trade Organization (WTO) has compounded the economic emergence of China and their integration into the global economy.

Despite their membership in the rules-based system of the WTO, disputes and significant problems do arise such as the continued ban on U.S. beef. Prior to the ban, China was the ninth largest market for U.S. beef in 2003 with sales in excess of $27 million. But the real value of this market is their rapidly growing middle class. The average Chinese consumer's largest expenditure is food. A recent McKinsey and Company report estimated growth rate for Chinese household food expenditures will grow by 6.7 percent annually for the next two decades. The same report also estimated that slightly more than 700 million Chinese households will migrate from poor to middle class in the next ten years. This demographic shift will press greater demand for food and proteins as new middle class consumers seek to improve their diets.

In 2006, China imported more than $575 million in pork and poultry products, a 55 percent increase over 2005 values. For 2007, they are already importing 121 percent more pork and poultry products by value than by this same time in 2006. Compared to only four years ago, their exports of pork and poultry were approximately $100 million annually.

The protracted ban on U.S. beef has frustrated the beef industry – an industry that has taken great strides to ensure the health of our animals and the safety of our products. The U.S. has demonstrated its trustworthiness in food safety and animal health matters in accordance with internationally accepted scientific principles and should have access to the Chinese market.

Beef on the Menu for the Strategic Economic Dialogue

It has been more than three years since the trade ban was placed on U.S. beef. During this time many countries have resumed trade with the U.S., yet China has been reluctant to advance negotiations to restore full trade. As a member of the WTO, it is critical for China to appreciate the importance of trade based on adherence to the internationally developed and accepted guidelines of the World Animal Health Organization (OIE). The discussions surrounding the upcoming Strategic Economic Dialogue (SED) meeting provide a unique opportunity to resolve this matter and restore full beef trade (i.e all ages, all products).

Despite the overwhelming scientific evidence supporting the safety of U.S. beef, more than 17 years of BSE controls, and a preliminary OIE expert panel designation, the ban persists. Therefore, we urge you and your colleagues to press the Administration and the Chinese to include negotiations to resolve this ban as part of the formal agenda for the upcoming Strategic Economic Dialogue meeting set to occur in mid-May. This high level bilateral meeting will provide a unique opportunity to resolve this long standing trade ban benefiting U.S. farmers and processors and Chinese consumers. The resolution of this ban by the Chinese will signal to other trading partners and economic sectors of their commitment to adhere to internationally accepted scientific principles for trade and a rules-based system.

Recently, the beef industry sent the attached letter to Secretary of the Treasury Henry Paulson, as the lead U.S. representative to the Strategic Economic Dialogue, requesting that beef be placed on the agenda for the upcoming meeting of the Strategic Economic

Dialogue. This unique venue provides an opportunity for the most senior level and technical level trade negotiations to yield a mutually beneficial outcome.

Trade Ban Background

The trade ban followed the December 2003 diagnosis of a single case of BSE in an imported Washington state cow born before feed restrictions were implemented.

The case was detected through the U.S.' routine and aggressive surveillance program, which began shortly after the UK's BSE crisis and long before BSE was ever diagnosed in the U.S. In fact, the United States was the first BSE-free nation ever to launch a surveillance program for the disease.

It was just one part of our nation's extraordinary, focused, and disciplined steps designed to prevent a disease. These measures also included import controls and careful feed restrictions. The U.S. learned from the European BSE experience and pursued aggressive controls to address the disease.

After we detected the first of three total cases in the U.S., we enhanced our interlocking system of firewalls even further and today we can say with great confidence that our herd is healthy and our beef is safe. According to OIE data, the U.S. has the lowest rate of BSE per 100,000 head of any nation that has ever had BSE in its herd. This is testament to the effectiveness of our preventive measures.

The U.S. and Chinese governments have had a number of negotiating sessions over the past year in an attempt to reach an agreement on normalizing beef trade. The desired outcome is for China to adopt the OIE BSE's guidelines trade policy under the terrestrial animal code of the OIE.

In July 2006, after a number of negotiating sessions between USDA and China's Ministry of Agriculture and the Chinese Quarantine Service (AQSIQ), China unilaterally announced it would allow the resumption of U.S boneless beef from animals less than 30 months, but it was dependent on 22 requirements, some of which have no scientific rationale. During her 2006 visit, Vice Premier Wu Yi made a commitment to President Bush to open the Chinese beef market at the Joint Commission on Commerce and Trade (JCCT) principal level meeting last year. However, China made the July announcement unilaterally and included non-science-based conditions of trade in their proposal.

For the ensuing eight months, the U.S. and China no trade has occurred and negotiations have made minimal progress to resolve the issue.

On March 12, 2007, an OIE expert panel recommended a preliminary designation for the U.S. of a "Controlled Risk" country for BSE. This designation affirms the U.S.' proactive and effective commitment to preventing BSE and controlling it should it occur. Under such a designation, U.S. cattle and products from cattle of all ages can be safely traded in accordance with international guidelines, due to our interlocking safeguards.

The facts are indisputable. No nation acted with as much forethought as the U.S. to prevent a disease, detect it if it existed and control and destroy it if it occurred. Using a surveillance system that far exceeds international guidelines, we have detected three cases in a 100 million head herd. More importantly, no BSE-related human illness has even been associated with eating U.S. beef. It is imperative that the U.S. and China abide by the OIE's international animal health guidelines to facilitate trade between both nations.

Mr. Chairman and Members of the Committee, our industry, workers and producers that supply us livestock have been significant beneficiaries of trade agreements and China's accession to the World Trade Organization. Every billion dollars in meat exports adds 13,000 U.S. food manufacturing jobs. The USDA has reported that the income multiplier from meat exports is 54 percent greater than the income multiplier from bulk grain exports.

The prolonged trade ban China maintains on U.S. beef imports is frustrating to many of our members and cattle producers. For our members, it means fewer sales, less jobs, and a negative impact on the communities where we operate. For producers, the impacts are similar with less destinations and consumers to demand their product. Despite the overwhelming scientific evidence supporting the safety of U.S. beef, more than 17 years of controls, and a preliminary expert panel designation, the ban persists. Therefore, we urge you and your colleagues to require that the resolutions of the beef trade ban be included on the upcoming meeting of the Strategic Economic Dialogue.

Thank you for the opportunity to present these views before you today.

March 23, 2007

The Honorable Henry M. Paulson
Secretary of the Treasury
United States Department of Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Dear Secretary Paulson:

As you prepare your agenda for the upcoming U.S-China Strategic Economic Dialogue (SED) meeting in May, we urge you to press China on resuming full trade in beef and all beef products from animals of all ages in accordance with Organization of International Epizootics (OIE) standards.

It has been more than three years since the trade ban was placed on U.S. beef. During this time many countries have resumed trade with the U.S., yet China has been reluctant to advance negotiations to restore full trade. As a member of the World Trade Organization (WTO), it is critical for China to appreciate the importance of trade based on adherence to the internationally developed and accepted guidelines of the OIE. The discussions surrounding the SED meeting provide a unique opportunity to resolve this matter and restore full beef trade (i.e all ages, all products).

The U.S. economic relationship with China is one of great importance to Congress. This is also a relationship that must be based on trust and mutual respect for each others trade commitments. During more than three years of this beef trade ban and with very few steps forward, it seems that our interests have not been given due consideration. The attempt to restore trade with 22 preconditions presents a web of unworkable technical barriers to trade.

Therefore, with full restoration of beef trade as our goal, we urge you to include this topic on your SED agenda and advance negotiations immediately in anticipation of achieving our goal when the Chinese are in Washington in May.

Sincerely,

American Meat Institute
National Cattlemen's Beef Association
National Meat Association

CSI Coalition of Service Industries

March 27, 2007

Statement by the
Coalition of Service Industries for
Senate Finance Committee Hearing on
Challenges in US-China Economic Relations

Thank you, Mr. Chairman and members of the Committee, for the opportunity to express the views of the Coalition of Service Industries (CSI) on U.S.-China services trade and China's implementation of WTO services commitments. CSI is the leading business association dedicated to reducing barriers to U.S. services exports and mobilizing support for policies that enhance the global competitiveness of U.S. service providers. Our membership consists of U.S. corporations and associations engaged in many commercially important services sectors. Many of our member companies have significant presence in China and are deeply interested in China's full implementation of its WTO commitments and the continuation of its sectoral reforms.

Since WTO accession, China has conducted comprehensive trade reforms that opened key services sectors to foreign participants, improved trade policy predictability, and expanded China's foreign markets. According to the World Bank, Chinese global cross-border services exports grew from $5.7 billion in 1990 to $62 billion in 2004. China's exports in travel, IT and communication services were especially strong. U.S. cross-border exports to China also increased by 61% from $5.6 billion in 2001 to $9 billion in 2005. The U.S. services trade surplus with China now stands at $2.6 billion, and is based on strong U.S. exports in business, professional, educational, financial, and telecommunications services.

Despite the robust growth of U.S.-China services trade, China's economy is unbalanced, because its policies continue to favor export-oriented manufacturing sectors, as opposed to local consumption-generated growth based on demand. As a result of these skewed policies, Chinese services sectors have experienced lower growth than the goods sector, and comprise only 41% of GDP. This is less than the average services GDP in low and middle income countries, and much lower than in the U.S., where private services are 78% of output, and 80% of private sector employment.

The development of China's services sector is also hampered because U.S. companies are still unable to take full advantage of its WTO commitments due to erratic implementation. In our reviews of China's services trade record, we specifically stressed systemic, cross-cutting issues, such as market access and national treatment, poor services infrastructure, the lack of transparency, the lack of intellectual property rights (IPR) protection, and other challenges. We support the U.S. Government's decision to raise these overarching issues at the U.S.-China Strategic Economic Dialogue (SED), which we urgently hope will also create a solid foundation for solving many sector-specific trade impediments in other forums.

Structural and Systemic Issues for Strategic Economic Dialogue

CSI members support the objective that the SED process should remove structural barriers that impede both China's growth and U.S. access to its markets through trade and investment. Services sectors have become increasingly important to China's further infrastructure growth and global competitiveness. Therefore, we suggest that the SED forum focus on the following systemic issues:

I) Increased Regulatory and Licensing Transparency

It is in China's interest to fully embrace regulatory transparency. China made substantial WTO commitments to regulatory and licensing transparency, such as notice and comment requirements for new trade laws and regulations, improved licensing procedures, and judicial review. However, full implementation of these commitments simply has not taken hold in the Chinese bureaucracy. Chinese laws, regulations, and administrative practices frequently change without warning, and are frequently not applied uniformly. We are also concerned that China's rules often provide regulators with broad discretion, resulting in unpredictable rules and decisions.

A modern economy requires transparent government and regulation. Transparent rule-making and licensing are one of the best ways to fight corruption in China. Through consistent, adequate notice and comment periods and the involvement of key stakeholders in the regulatory development process, many outstanding specific trade and investment problems U.S. companies continue to confront might be eliminated.

We also encourage the Chinese Government to seek active participation by all stakeholders in regulatory reform. The review of the postal legislation, for example, would benefit from active consultation with the private express delivery industry. China should also consult with the private sector on its pending telecom bill, draft insurance law, and other important sectoral legislation. The opportunity for meaningful public comment on China's legislative measures is required by GATS rules on transparency and China's WTO accession commitments on notice and comment.

II) Strengthening Key Regulatory Institutions

Chinese officials acknowledge that their regulatory agencies for securities, insurance, and other services are not sufficiently developed. China's trade negotiators have repeatedly used this argument as a reason to deny better offers on services. We suggest that USTR, Treasury, and other agencies offer technical assistance to help the Chinese strengthen their regulatory institutions. For instance, the Chinese telecom regulator is not sufficiently independent in its functions and responsibilities from the state-owned telecom monopolies. Enactment of a Telecom Law that would establish an independent regulator could serve as the basis for a significant expansion of the telecom sector and those industries that depend on competitive telecom services. U.S. experience with telecommunication regulation could surely be useful!

III) Financial Sector Modernization

Opening the financial services sector is key to balancing the current account. Opening this sector would not only increase the surplus financial services currently enjoys, but also create the conditions that would allow China to re-value its currency.

China has made significant progress toward instituting measures for financial reform in the banking sector, including steps toward the elimination of the single-bank system, implementation of a viable commercial lending system and the establishment of interbank, equity and forex markets. However, for this sector to benefit China as it might, work remains to be done, particularly in the insurance sector where
long-standing commitments to reform seem to have stalled.

China's objective of modernizing its financial sector can be achieved by continuing to liberalize foreign investment policies in the financial services sector. China will need to redouble its efforts to increase regulatory transparency, permit full foreign ownership of investments, and offer a full choice of juridical form.

A more open market will allow foreign financial services suppliers to introduce new and innovative products that could serve as models for health insurance coverage, retirement savings, and accidental death and dismemberment benefit plans. This will require full national treatment for foreign firms in all areas affecting operation and expansion of business.

IV) Promoting Innovation and Technical Assistance

Because China and the U.S. share the goal of promoting innovation in services to secure economic growth, both countries should collaborate on research and development of the new field of "services science." Services science is a multidisciplinary field that combines training for technology, science, management and engineering skills. IBM is partnering with the Chinese Ministry of Education and leading universities to develop this new academic field of study, and collaboration between research universities in both countries provides an excellent partnership opportunity.

We support and encourage China's ambitious goal of developing a competitive IT and computer and related services sector. However, this requires the Chinese Government's strong commitment to preparing a globally competitive workforce. U.S. associations and their members have the necessary expertise in the training and certification of highly skilled IT services specialists, and can help Chinese authorities to meet their export and domestic IT worker development goals.

In its "Opinion on the Reform and Development of the Insurance Industry" of June 26, 2006, the Chinese State Council states that foreign insurers should be relied upon as a source of innovation and high standards, and that market demand should be the driving force in determining the need for new products. China Insurance Regulatory Commission (CIRC) leadership endorses these goals. Nevertheless, the current regulatory process does not allow for the rapid approval of new products and appropriate tax treatment to encourage the sale of sophisticated new policies. For example, CIRC has failed to allow foreign carriers to provide political risk insurance for Chinese companies with exposures in foreign markets, even though there is keen demand for this product. Additionally, the inadequate tax deductibility of producer commissions hinders the sale of sophisticated insurance products.

V) Increased Market Access in Sectors Dependent on Intellectual Property Rights (IPR) Protection

Elimination of China's trade barriers in audiovisual, software, and IT goods and services is one of the factors that can help solve China's piracy problem and foster sound investment and economic growth, benefiting both U.S. and Chinese producers. However, current trade barriers and regulations make it difficult for U.S. companies to enter the Chinese market to supply legitimate IPR products, thereby ceding the market to counterfeit and pirate products.

China's piracy and counterfeiting at the wholesale and retail levels, end-user piracy, Internet piracy, multi-channel signal piracy, and unauthorized access to 'overspill' satellite pay-TV programs remain rampant due to lenient penalties, uncoordinated enforcement among local and national authorities, and the lack of transparency in administrative and criminal enforcement. The piracy rate for optical media products and software is reported to be over 90 percent. China's law still stipulates inadequate criminal liability for copyright offenses, e.g., corporate end-user and Internet piracy, unclear protection for temporary copies, and overly broad exceptions to protection of computer software. Criminal prosecution of piracy remains restricted by the Chinese criminal code, which requires a demonstration that piracy is occurring for the purpose of making a profit.

Sector-Specific Issues for Joint Commission on Commerce and Trade

In addition to its overarching systemic issues, China should resolve the following sector-specific issues, which are addressed mainly at the Joint Commission on Commerce and Trade (JCCT). We appreciate that the U.S. Government also raises these sector-specific trade barriers at Transitional Review Mechanism (TRM) meetings in the WTO, but we are disappointed at China's lack of responsiveness to these efforts. It is essential that China honor its WTO services obligations and carry out its commitments in the JCCT.

Financial Services

CSI has been working closely with the U.S. Government to urge the Chinese leadership to implement its existing WTO commitments fully and liberalize China's financial services sector further. The Chinese Government should improve its WTO financial services commitments to reflect the following principles: the ability to own 100% of investments; establish in the juridical form of choice; enjoy non-discriminatory, national treatment in all aspects of business; have permission to supply services cross-border to sophisticated consumers; and rely on greater regulatory transparency with effective notice and comment periods. These principles would give U.S. financial firms new, commercially meaningful opportunities in China.

Insurance

After issuing the amendment to China's Insurance Law in 2003, CIRC followed with important implementing rules regarding the administration of insurance companies, asset management, risk control and other aspects of insurance regulation. We appreciate that CIRC also allowed interested parties to provide comments on the draft Insurance Law. Despite these developments, significant market access and national treatment concerns remain:

- Branching. The ability to grow business geographically through branch and sub-branch expansion is the most important issue for many foreign insurance companies in China. We are concerned that branch approvals for US providers are still being granted one at a time, while established and start-up Chinese companies receive approval to open multiple branches. This practice is contrary to international practice, impedes competition, and most importantly violates China's WTO national treatment commitment for insurance. Senior officials at CIRC have confirmed to USTR their commitment to allow foreign companies to establish multiple concurrent branches. We are pleased with this statement, and would call on CIRC to confirm this intention in an administrative clarification to all CIRC officials. Most important of all is a change in actual practice.

- Subsidiary Conversion Despite CIRC's effective requirement that foreign-owned insurers convert their Chinese operations from branches to subsidiaries (notwithstanding China's WTO commitment to allow foreign general insurers to operate on either a branch or subsidiary basis), the regulator continues to delay approval of companies' applications for such conversion. This delay contravenes CIRC's own regulation (Baojian Fa 45,page 3, section 6) that requires its response to applications within two months. The delay – over fourteen months for some companies -- has created uncertainty and confusion in corporate planning as insurers eager to expand can only apply for permission to open new offices three months after the conversion process is approved. Those few companies that have been granted subsidiary conversion approvals effectively have an unfair advantage over all of US firms, none of which have received approval, because they are able to move ahead to expand their Chinese operations.

- Capitalization Requirements. CIRC should confirm that the RMB 200 million capital requirement for initial establishment, whether as a subsidiary or a branch, includes the right to establish sub-branches without limitation on numbers, and without having to satisfy any additional capital requirements. The Chinese government has yet to provide its rationale for requiring additional capital of RMB 20 million for each additional branch, particularly given that any additional branches would still be backed by the full asset base of the admitted entity and have to comply with all CIRC solvency rules.

- Overseas Utilization of Insurance Foreign Exchange Funds. CIRC's Provisional Measures on the Administration of the Overseas Utilization of Insurance Foreign Exchange Funds establish a qualifying threshold (total assets of RMB 5 billion) for companies to invest their foreign exchange capital in overseas funds or equities. CSI members are concerned that even though this limitation applies to both domestic and foreign providers, only the largest insurers, i.e., mostly domestic companies, will have the necessary assets to qualify. Many foreign-invested insurers will not qualify unless CIRC recognizes the assets of the parent foreign company when determining the asset level of a foreign-invested company.

- Insurance Asset Management Restrictions. Under Article 8 of CIRC's Interim Regulations for Insurance Assets Management Companies, only providers that have held licenses for more than eight years are permitted to apply to establish an insurance asset management company. Although China previously stated that this limitation applies to both domestic and foreign providers, it effectively excludes all foreign companies entering the market since China's WTO accession in 2001.

- Reinsurance. Senior officials at CIRC have confirmed to USTR their commitment to allow foreign reinsurance and insurance companies to conduct cross border reinsurance with Chinese direct insurers or reinsurers on a national treatment basis. We applaud this action, and would call on CIRC to confirm this intention in an administrative clarification to all CIRC officials. This clarification should state that China will suspend implementation of the 2005 Regulations on Administration of Reinsurance Business, as the regulation discriminates against foreign reinsurance companies by requiring right of first refusal for 50% of each primary company's reinsurance program with domestically admitted reinsurers. CIRC should also clarify that for purposes of these measures a 100% foreign-owned insurance operation may cede to a parent or affiliate insurance company.

- Acquired Rights. Companies operating in China at the time of WTO accession are entitled to continue operating and geographically expand their business on the basis of their previous juridical form.

Asset Management and Securities

Foreign firms are currently permitted to own 49% of joint-venture asset management firms in China, consistent with China's WTO accession commitments. We strongly urge China to go beyond its WTO commitments by allowing foreign firms to choose their form of establishment and equity participation levels, and permitting competition on the same basis as domestic firms.

For asset management firms, the Chinese Joint Venture Rules require foreign firms to have at least RMB300 million (U.S.$39 million) in paid-in capital to qualify as a joint venture partner. This requirement is significantly higher than in other jurisdictions, and serves as a market barrier to U.S. companies. Asset management firms do not need large amounts of capital to protect investors because their business is not capital intensive, and client assets typically are not at risk if the asset manager experiences financial difficulties.

A high regulatory capital requirement disproportionately affects foreign asset managers because their operations are typically not as significant as their operations in their home country. As a result, domestic firms will be able to comply with a large capital requirement more easily than foreign firms. Additionally, while large banks or broker dealers may not find it difficult to meet high capital requirements, many smaller, independent firms are part of the highly successful asset management industry in the United States.

We are encouraged by recent developments that allow Chinese nationals and corporations to invest in overseas markets as qualified domestic institutional investors (QDIIs). We hope that the new rules will be implemented in a fair and transparent manner that allows all qualified asset managers—domestic and foreign—to participate on an equal basis.

Although we are pleased that China took steps to open the A-share market to foreign investors by adopting rules on qualified foreign institutional investors (QFIIs), the CSRC and SAFE have been slow to amend the rules to increase their practicality. We understand that anticipated revisions would address many of our concerns, including a reduction of the lock-up period from one year to three months and a simplified approval process for remittances, but these revisions have been delayed repeatedly. We urge greater liberalization of the QFII regime to remove restrictions on investment by QFIIs.

Pensions

CSI members are pleased that the Chinese government has issued its new enterprise annuity initiative to provide better retirement security for its citizens. However, the new regulations are incomplete and ambiguous. Thus, we suggest that the enterprise annuity rules be clarified further, and implemented in a transparent and predictable way. To ensure companies' compliance, China should specifically clarify the licensing process and procedures, and provide information on the regulatory and supervisory authorities, and operation requirements, with a view to securing a level playing field among the various financial services entities that offer such products. We would also suggest that pension providers be permitted to apply for a comprehensive license covering all required entities (Trustee, Custodian, Record Keeping and Fund Management), such that they can service all aspects, including a pension plan member's retirement plan.

In May 2005, it was reported that the Ministry of Labor and Social Security (MOLSS) had stopped accepting applications for enterprise pension funds. Although MOLSS has indicated that there will be future application periods, it has not identified the date when applications will be accepted again.

CSI members also suggest that China adopt a universal approach to taxation of pension plans and that its tax regime enable employers to make tax-favored contributions to employees' pension plans. Tax rules should provide tax deferral for individuals that contribute to defined contribution pension accounts, similar to U.S. 401(k) plans. As the U.S. experience shows, tax incentives are essential for strong and healthy development of private pension plans.

We also encourage the Chinese pension regulator to promote high sectoral standards and professional management by separating financial companies' pension operations from other businesses. This can be done through establishing pension subsidiaries, a trust entity, such as a master trust, which would provide for financial protection of pension plan members, or setting up a mechanism to better separate pension assets from other assets.

Electronic Payment Services

Although China represents an extremely large potential market for the vibrant U.S. electronic payments industry, U.S. electronic payments providers, global leaders in these services, have very limited market access in China. Currently, foreign electronic payments cards cannot be issued by any bank (local or foreign) unless they are co-branded with China UnionPay (CUP). CUP was established by the People's Bank of China (PBOC) in 2002 as a monopoly domestic electronic payments provider and processor. We believe these restrictions violate China's accession commitments in financial services, which came into force on December 11, 2006.

The PBOC has asserted that allowing foreign banks to issue CUP credit and debit cards to Chinese consumers by the December 11 deadline was all that was required for China to meet its WTO commitments. This is clearly not the case. China's GATS schedule requires that it provide for unrestricted market access and national treatment for "payments and money transmission services, including credit, charge, and debit cards." This means that China must allow financial institutions to issue payment cards of their choice and permit foreign providers to process both foreign currency and domestic currency transactions without CUP involvement. Banks cannot be required to issue only one brand or co-branded domestic payment cards.

In addition, China committed to unrestricted market access and national treatment for "advisory, intermediation, and other auxiliary financial services" for other financial services listed in its schedule, including payments. China also committed to open market access for the "provision and transfer of financial information, and financial data processing...by supplier[s] of other financial services," and took no exceptions that would allow any domestic payments processor to operate as a monopoly.

WTO also mandates that countries may not use standards to exclude foreign service providers in sectors in which they have made specific commitments. Thus, China must adopt standards for electronic payments processors that are neutral in law and fact.

Telecommunications

China's narrow interpretation of market access opportunities for foreign participants and lack of an independent regulator remain key outstanding issues, which contradict its WTO accession commitments. Specifically, foreign market entry is being delayed by the Ministry of Information Industry's definition of value-added services (VAS) for international value added network service licensing. The regulator has construed the meaning of VAS in China's WTO commitments so narrowly that any commercially important sectors, such as IP-virtual private networks (IP-VPN) services demanded by global enterprises, are excluded.

China's unreasonably high capitalization requirements for basic services and the prohibition on resale absent a basic services license have also greatly limited market access in both basic telecommunications and VAS. We believe that resale should be permitted, and subject to appropriately lower market entry requirements. Further, the requirement that foreign telecom service providers may only enter into a joint venture with one of the existing state-owned enterprise telecom providers is problematic.

Contrary to its claims, China has not implemented its WTO Reference Paper commitment to establish an independent regulator. The Chinese Government still owns and controls all major telecom operators, and the Ministry of Information Industry serves in the chain of command as a leader rather than a regulator of the sector.

Despite the WTO commitment to discuss further sectoral liberalization, China has yet to submit an improved telecom offer with broader market access, including higher foreign equity participation.

The industry hoped that the JCCT Telecom Dialogue would offer a useful vehicle to ensure China's WTO compliance and advance industry interests in liberalizing its telecommunications market. The Telecom Dialogue is already well into its second year with no tangible progress evident. At last year's JCCT Plenary meeting, the U.S. government was able to obtain China's commitment to address the capitalization requirement. We look forward to its substantial reduction, but there has been no progress to date.

Express Delivery

U.S. express delivery service (EDS) industry members are concerned that the Chinese government has not yet released the details of its plans for postal reform and that it has not taken into account the serious concerns that the industry has expressed about the draft postal law. The opportunity to review the postal reform plan and draft law, and the opportunity for meaningful public comment on China's postal measures are required by GATS rules on transparency and China's WTO accession commitments on notice and comment.

The current (eighth) draft postal law – which industry has not been allowed to see – reportedly attempts to narrowly define express delivery services contrary to China's WTO market access commitments, and includes national treatment violations for domestic delivery services. The law would grant China Post a monopoly on letter delivery with two exceptions. The first exception would allow for international express letter delivery, subject to a separate set of regulations. The second would apply to letters and certain official documents of more than 150 grams. However, the second exception is not available to foreign-invested EDS suppliers, and would explicitly prohibit foreign-invested enterprises from supplying domestic express letter delivery services in China.

China's draft law and postal reform plan would apply a tax on all entities operating under the expanded postal monopoly. The current draft does not include specific percentages for a universal postal service fund tax. We are concerned that this measure would result in millions of dollars of lost revenue for U.S. companies and would increase the cost of trade. At the same time, it is unclear how this fund would be used by China Post, so there is a possibility that it would be used to subsidize its express delivery services.

The draft would also grant new powers to the State Postal Bureau (SPB) to regulate the international express industry. This includes subjecting mergers and acquisitions of EDS companies' operations in China to review and approval by the SPB.

We understand that the eighth draft includes several articles that give state-owned China Post, its subsidiaries and branches, including its express delivery arm EMS, many competitive advantages against private companies. These advantages include exemption from traffic regulations; expedited priority dispatch ensured by other transportation companies; preferential access to air, rail and sea transport; as well as potential tax breaks and subsidies. In addition, postal enterprises that engage in competitive letter express businesses like EMS are not subject to the licensing requirements that other express delivery companies must follow.

China Post's Entrustments Issue

Despite Chinese government assurances and published regulations stating that entrustment certificates from China Post would be processed one time only and be valid for the duration of the firms' international freight forwarder licenses (i.e., several years), the SPB granted these certificates for a limited time only, most recently for the calendar year 2007. Although those same assurances and regulations state that firms would be granted one entrustment at the national level and the new branches would be "recorded" with the SPB, the SPB has directed companies to entrust locally. However, the local Postal Authorities in headquarters' jurisdiction claim that they lack the authority to entrust more than headquarters' operations. This entrustment regime violates China's WTO commitments not to roll back companies' market access rights and not to use licensing procedures to restrain foreign competition.

Freight Forwarding and Logistics Services

Revised international freight forwarding (IFF) rules issued on December 1, 2005, implement China's commitment to allow wholly foreign owned IFF ventures, but regulations published by the Civil Aviation Administration limit the ability of wholly foreign owned IFF enterprises to provide the full range of such services. To book cargo space on an airline in China, an IFF enterprise must obtain an Air Freight Sales Agency License from the CAAC. There are two categories of air freight sales agency licenses: Class A, which allows the holder to book cargo space on international flights; and Class B, which allows the holder to book cargo space on domestic flights. Wholly foreign owned enterprises are unable to obtain these licenses, which are available only to domestic firms and joint ventures.

We believe this restriction is a violation of China's WTO full market access commitments in freight forwarding agency services (CPC 748 and 749) under "Services auxiliary to all modes of transport." The explanatory note to the CPC system clearly and explicitly includes aircraft space brokerage services. If China intended to require licensing, and such licensing would have limited market access, such an exception should have been explicitly scheduled in the services schedule included in the Protocol of Accession.

Audiovisual, Publishing, and IT Products and Services

We encourage China to remove its limitations on foreign ownership in distribution and video replication, publishing, TV stations, and theater holding companies as one means to curb piracy. The elimination of market access barriers to distribute foreign pay TV programs and services, and an increase in the number of foreign revenue-sharing films allowed into the Chinese market are also important. Some of the piracy issues can be alleviated by allowing foreign media companies to have a greater stake in their Chinese investments.

China's WTO accession commitments in audiovisual services allow for foreign minority participation in cinema operations. However, China refuses to permit foreign majority enterprises, except in select cases that were grandfathered under a terminated experimental policy to allow up to 75% foreign investment in select cities. China also insists that the foreign partner cannot serve as Chairman of the cinema joint venture even if approved by its board. In addition, China does not permit the licensing of foreign pay television services, which stifles the growth of its cable and digital platforms.

China increased the number of foreign revenue-sharing films allowed into the market each year to 20, a minimal market opening measure. The terms of the revenue-sharing contract are dictated by the Chinese Government, and are not commercially reasonable by any standard. China continues to disrupt orderly marketing by instituting blackout periods when foreign films cannot be shown, and by imposing revenue targets. The orderly distribution of home entertainment products is also impaired by the imposition of rules restricting the choice of business partners, and by the terms of commercial agreements. In addition, China maintains primetime broadcasting and foreign content restrictions in pay and non-pay television. All these restrictions, along with the lengthy approval process, only serve to expand the spread of illegal pirated content.

In the audiovisual distribution services sector, China is not abiding by its retail distribution services commitments, which are to allow foreign majority control with the ability to sell AV products. Contrary to this commitment, China has restricted foreign majority controlled retailers from securing AV retailing licenses.

In the publishing sector, control over content remains strict and China has stated that it will not approve any more foreign titles under Chinese publishing licenses except technical and scientific publications. We find this decision troubling and urge China to reconsider it.

Government Procurement of Software

We welcome China's commitment to begin formal Government Procurement Agreement (GPA) negotiations and submit its Appendix I offer by the end of 2007. In the interim, China should withhold implementing new procurement regulations that do not conform to GPA principles, including the Implementing Draft Measures on Government Procurement of Software of March 2005. CSI members are concerned that these draft measures provide for strong preferential treatment for Chinese suppliers by restricting government procurement to domestic software products. To qualify as "domestic," these products must be "manufactured" in China and the China-based development cost of the software must be at least 50%. The software copyright must also be owned by a Chinese entity or first registered in China.

China's draft measures also contain a procurement preference for open source software that is inconsistent with international practice, the WTO Government Procurement Agreement, and sound, efficient, and merit-based procurement policy. We believe that any procurement regime should be based on performance, and not favor any technology or licensing model.

The draft measures propose the possible purchase of foreign software only on the basis of product-by-product waivers, and only if the software provider satisfies unspecified requirements with respect to the level of the company's investment, R&D expenditures, outsourcing work performed, or taxes paid in China. Thus, this exception will benefit a small group of providers, and will not promote the ultimate goal of developing a competitive, advanced software industry in China, based on international best practice.

China's domestic preference policy contradicts the general trend in international trade and procurement law toward open, transparent, technology-neutral, and non-discriminatory access to global markets. The measures will severely limit market access of our members, especially software companies, to China's government procurement, and will create a dangerous precedent for other sectors. The rules also run counter to the spirit of openness China committed to when it became a WTO member and assumed observer status with respect to the WTO Government Procurement Agreement.

Conclusion

China's WTO accession opened a very important services market to U.S. suppliers, but China's services sector reforms must be fully implemented and, for maximal benefit, go beyond WTO commitments. As China's manufacturing experience shows, an open market provided many benefits to the Chinese economy. There is no reason why the same policy would fail in services.

China's full implementation of services commitments and continued services trade liberalization can promote the development of its services sectors, increase the inflow of services investment, and help resolve its complex economic and social issues. To build the infrastructure of a modern economy, China will have to rely on sophisticated services offered by foreign companies.

As a large exporter, China also has a significant stake in promoting globalization under the Doha Development Agenda. Despite its growing role in global trade, China has not been an active proponent of ambitious trade offers in services. The success of the Doha Round depends on constructive participation of key developing countries, such as China. We hope the Chinese Government will be a "responsible stakeholder" and step up its negotiating efforts by submitting a high-value services offer and encouraging other important developing countries to do the same.

USCBC
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Statement of the US-China Business Council

to the

Senate Committee on Finance's Hearings
"Opportunities and Challenges in the US-China Economic Relationship" and
"Risk and Reform: The Role of Currency in the US-China Relationship"

March 27–28, 2007

A BALANCED APPROACH

The US-China Business Council (USCBC) is the leading organization for US companies doing business in and with China. Founded in 1973, USCBC represents its more than 250 US corporate members by providing advocacy and information services through its offices in Washington, DC, Beijing, and Shanghai.

USCBC advocates a balanced approach to trade policy toward China—one that recognizes the tremendous benefits that trade and investment with China bring to the US economy, yet at the same time focuses on eliminating market barriers and other unfair trade practices that affect US companies doing business with China. We support the rules-based resolution of trade disputes in a manner consistent with our World Trade Organization (WTO) obligations, just as we expect China to abide by its WTO commitments.

The most obvious benefit of trade with China is the rapidly growing exports of US companies. In 2006, China and Hong Kong combined ranked as the third-largest US export market, with exports of goods totaling more than $73 billion.[1] US exporters sold more only to Canada and Mexico—neighboring countries with which the United States has a free-trade agreement. Furthermore, exports to China are growing far more rapidly than exports to any other major market. US exports to China in 2006 were 240 percent higher than in 2000, the last full year before China's WTO entry. Of the top 10 US export markets in 2006, the second-fastest-growing market for US goods during this time was the Netherlands, with cumulative growth of 42 percent.

The prospects for increased exports of services to China is also encouraging. In 2005, the United States enjoyed a services trade surplus with China of $2.6 billion—small, of course, when

[1] Individually, China is the United States' fourth largest export market at $55 billion, and Hong Kong is the 15th largest at $18 billion.

compared with the large goods deficit. As US companies take advantage of service sector openings mandated by China's WTO entry agreement, however, the US services trade surplus is projected to grow to $15 billion by 2015, according to *The Prospects for US-China Services Trade and Investment*, a report by Oxford Economics, published in 2006 by the China Business Forum.[2] If China were to open its service sectors fully to foreign participation, Oxford Economics projects that the US services trade surplus could be as much as $60 billion.

More broadly, according to research conducted in 2005 by Oxford Economics for the China Business Forum study *The China Effect: Assessing the Impact on the US Economy of Trade and Investment with China*,[3] US trade and investment with China will, by 2010, result in a 0.7 percent increase in US gross domestic product and a 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. Furthermore, by 2010, trade and investment with China will boost the productivity of US workers by 0.7 percent and that of the manufacturing sector by 0.3 percent annually. The commercial relationship with China clearly benefits the US economy as a whole.

PRIMARY CONCERNS OF US COMPANIES

National treatment

Since China joined the WTO in 2001, phased-in market openings have provided new opportunities for international businesses. Nonetheless, USCBC member company executives report departures from the WTO's national treatment principle, which requires non-discrimination against foreign companies exporting to or operating in, WTO member economies. These examples can generally be grouped into three areas.

- ***Administrative licenses and business approvals*** In the 2006 USCBC member survey, executives at USCBC member companies ranked problems encountered when applying for business and product licenses and other forms of government approval as the top hindrance to US companies operating in China.[4] In some cases, these problems simply result from resource and coordination challenges faced by PRC regulators that slow the processing of applications.

But in other cases, executives at US firms believe PRC officials may be using their regulatory authority to prevent or delay the entry of foreign competition into a market to protect domestic companies. Examples of sectors that have reported such practices include agriculture, banking, chemicals, construction, express delivery, insurance, retail, and telecoms. In these sectors and others, China appears to meet the letter of WTO-mandated market openings in certain sectors but establishes new barriers that, in effect, prevent foreign companies from participating in the sector—while at the same time facilitating domestic competitors.

- ***Discriminatory laws and policies*** Recent public policy debates in China have indicated a dampening of enthusiasm in some quarters for foreign participation in the economy. Some in China also appear to want to expand the government's role in directing the economy and in

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[2] See www.chinabusinessforum.org/pdf/us-china-services-trade.pdf
[3] See www.chinabusinessforum.org/pdf/the-china-effect.pdf
[4] See www.uschina.org/public/documents/2006/08/member-priorities-survey.pdf

developing internationally competitive Chinese enterprises, while also restricting the role of international companies in certain sectors.

Protectionist sentiments were evident in a series of policy notices China's State Council issued in 2006 regarding China's technological development through 2020. Separately, the State Council Opinion on the Revitalization of the Equipment Manufacturing Industry, issued in June 2006, envisions greater state intervention in a number of economic sectors and could create new hurdles for foreign acquisitions of domestic enterprises that build engines, power generating equipment, integrated circuits, shipping equipment, and in several other industries. In August 2006, the Ministry of Commerce released new regulations on mergers and acquisitions that would submit for government approval foreign acquisitions of "well-known" Chinese companies and brands, and give the ministry a broad authority to block transactions that adversely affect "national economic security," a term left undefined in the regulations. Statements in early 2007 from the head of China's State Asset Supervision and Administration Commission further echoed these themes.

- ***Unequal enforcement*** US businesses operating in China continue to describe an unequal enforcement environment that places them at a disadvantage to their Chinese competitors. For example, while US companies generally hold themselves to the highest environmental, health, workplace safety, and other standards—often going beyond what is required by PRC law—many Chinese competitors appear to fall short of PRC law in these areas, enabling them to minimize investment and other costs associated with full compliance. Enforcement authorities, mainly at the local and provincial levels, appear to focus more of their attention on US and other foreign companies. Similarly, while US companies in China typically comply with their PRC tax obligations, domestic enterprises appear to be able to avoid full compliance without repercussions. Looking ahead, a key concern of US companies regarding China's forthcoming Antimonopoly Law is that PRC regulators will target foreign companies that meet the law's criteria for market dominance more aggressively than domestic firms of similar size in China. Although it is difficult to establish with certainty the presence of a policy of unequal enforcement, the need exists to impress upon China the importance of equal enforcement of business regulations.

Intellectual property rights
Like all WTO members, China is required to provide legal protection against intellectual property infringement and to provide penalties for enforcement that are sufficient to deter future violations. Despite this obligation, inadequate protection for intellectual property continues to impede US companies in China.

It is important to point out that the term "intellectual property rights" (IPR) encompasses several distinct areas, including copyrights, trademarks, patents, and trade secrets. In each of these areas the nature and severity of the problem are different, as are the policy needs and protection measures available to companies. Accordingly, companies view the IPR problem differently depending on their industry. For some companies, particularly in the media sectors, IPR problems are aggravated by market-access restrictions that limit the availability of legitimate products to Chinese consumers. A differentiated approach to the IPR problem in China—one that accounts for the unique problems and solutions in the various areas—is the most productive way to achieve advances for US companies on this issue.

The ineffectiveness of China's IPR enforcement regime stems in part from China's primary reliance on administrative authorities, which are able to impose only very low penalties to enforce IPR laws, instead of the court system, in which civil suits and criminal prosecutions could lead to higher penalties on IPR infringers. While government agencies are generally responsive to the requests of IPR holders to take administrative actions against infringers, the low penalties these government bodies can impose without court authorization serve as only a minimal deterrent to future infringements.

China's central government has taken a number of steps in an attempt to address these and other issues in order to improve the effectiveness of its IPR enforcement. These steps generally have been in response to the US government's persistent pursuit of improving IPR protection via the Joint Commission on Commerce and Trade (JCCT) process. In March 2006, China's National IPR Working Group, an interagency body under the State Council that is chaired by Vice Premier Wu Yi, issued its 2006 IPR Protection Action Plan. Though much of the plan focuses on ways to promote innovation, it also expresses an intention to boost enforcement activities.

Stemming from the action plan, China's Supreme People's Procuratorate, the Ministry of Public Security (MPS), the Ministry of Supervision, and the Leading Group on National Rectification and Standardization of Market Order jointly issued an opinion in March 2006 to facilitate the transfer of IPR cases from administrative agencies to public security bureaus for criminal investigations. MPS and the General Administration of Customs in March 2006 also jointly issued rules to boost coordination in IPR cases involving products scheduled for export. The Ministry of Culture issued in November 2006 regulations giving local culture authorities more tools to address piracy of recorded music and cinema products. In December, the Beijing Number One Intermediate People's Court ruled that Pfizer, Inc.'s patent on the drug Viagra is valid, thereby reversing an early ruling that had revoked the patent and had allowed Chinese producers to legally manufacture what were, in essence, counterfeit pills. In early 2007, China's Supreme People's Court issued an opinion that could streamline judicial proceedings on IPR cases and make them more accessible and cost effective for companies that seek to protect their rights.

These are welcome steps, but China's legal capacity to effectively protect IPR remains limited. China's use of value thresholds to determine whether IPR infringers may face criminal charges reduces the efficacy of Beijing's recent steps to facilitate criminal prosecutions of IPR violators. These thresholds, although lowered in China's Supreme People's Court December 2004 judicial interpretation, provide a loophole for IPR infringers to escape criminal prosecution by, for example, keeping the value of inventory stored at any one location below the threshold level. Moreover, calculations to determine whether the thresholds have been met are based on the price of the counterfeit product rather than that of the legitimate—and higher priced—product it imitates. China's use of numerical value thresholds appears to be inconsistent with its commitments as a signatory of the WTO Agreement on Trade Related Aspects of Intellectual Property (TRIPS), which calls for criminal sanctions in all cases of IPR violations on a "commercial scale."

For its part, USCBC has urged the PRC government to take this course. In numerous meetings in 2006 with Vice Premier Wu Yi and other senior and working-level PRC officials in various agencies, USCBC advocated the abandonment of thresholds and the adoption of the "commercial scale" criteria. USCBC complemented these meetings with a written submission to several PRC government bodies suggesting detailed changes to PRC laws that would provide for an enhanced legal framework for enforcing IPR protection.[5] Adopting the "commercial scale" criteria and other changes to its laws governing IPR enforcement are important steps the PRC government can take to benefit companies in a broad array of sectors.

Transparency

Limited legislative and regulatory transparency creates uncertainty and confusion for US companies in China. There can be no question that China's legislative and regulatory processes are today far more transparent than ever before. Nevertheless, as US companies expand their business operations in China, the need to have a clear understanding of China's legal and regulatory environment has substantially increased.

Most of the problems in obtaining licenses noted above are exacerbated by the opacity of China's regulatory bodies. In addition, regulations affecting US companies sometimes come into force without the government seeking input. For example, in July 2006, the Ministry of Information Industry imposed without advance notice new rules for the value-added telecom service sector. The China Insurance Regulatory Commission issued in July 2006 qualification requirements for senior managers of insurance companies without soliciting public comment. In addition, the Ministry of Commerce imposed in August 2006 without prior notice requirements regarding the training and recruitment of direct sales agents.

There were some important instances of increased transparency in 2006. China's National People's Congress (NPC) solicited comments in March 2006 on the proposed Labor Contract Law and in June 2006 on the proposed Antimonopoly Law (although in the latter case only from members of the China Association of Enterprises with Foreign Investment, or CAEFI). In addition to the request for comments via CAEFI, the NPC has held an ongoing dialogue with foreign companies and experts on the Antimonopoly Law. China's government ministries and agencies also at times sought comments from international companies.

In a move that may in time help institutionalize the instances of transparency cited above, in April 2006, China's State Council issued a decree requiring all government bodies to report any regulations affecting trade to the Ministry of Commerce for publication in its official gazette. This is a welcome step toward a more transparent regulatory regime, but its immediate effects should not be exaggerated. First, the decree makes no stipulation regarding when government agencies must report their regulations. Second, the decree does not give the Ministry of Commerce the authority to ensure that other agencies are submitting regulations. To date, the gazette's scope appears far from complete. Finally, the gazette is intended for final regulations and not for drafts, so this development will not necessarily increase the opportunity for companies to provide input on policies that affect their operations.

[5] See www.uschina.org/public/documents/2006/08/irp-law-chnages-english.pdf

Standards
China's technical, safety, and product standards, as well as the procedures for establishing these standards and ensuring a product's compliance with them, continue to concern US companies.

China is seeking to encourage the development of domestically owned technical standards in an effort to reduce its reliance on foreign technology. It is natural that China as a large producer of and market for a wide range of goods should take an increased role in establishing new international technical standards. In doing so, however, China should abide by its obligations under the WTO Agreement on Technical Barriers to Trade to adopt standards based solely on scientific criteria and not as a tool of trade or industrial policy.

In some instances, China's "homegrown" technical standards appear designed to assist domestic companies at the expense of international competitors. The most prominent example of this has been China's attempt in 2004 to impose the wireless local area network authentication and privacy infrastructure (WAPI) standard as a mandatory national standard. Although this issue was resolved at the 2004 session of the JCCT, WAPI reemerged in December 2005 when Beijing announced that products using WAPI technology should be given preference in government procurement. The effect of this policy so far appears limited, however. China's designation in February 2006 of TD-SCDMA as the "national standard" for third-generation mobile telecom technology raises concerns that Chinese mobile telecom operators will face government pressure when deciding what technology to employ in their networks. China agreed at the 2004 session of the JCCT to adhere to "technology neutrality" and to allow mobile operators to choose independently which type of third-generation technology they would adopt. Unlike WAPI, however, the TD-SCDMA standard enjoys support from some international companies. China's interest in developing a native technology for radio frequency identification devices could also create significant challenges for US businesses producing in, exporting from, and importing to China if Beijing makes it difficult for companies to use the existing—and widely adopted—international standard for these devices.

Related to but separate from these issues surrounding the development of technical standards are concerns regarding safety and product standards and the means by which products are tested for compliance. China is implementing new standards governing hazardous substances in electronic products, energy efficiency, and others. Most concerns in this regard focus on limited transparency in the process of drafting standards and possible uneven enforcement for domestic and international companies. Medical device manufactures are particularly concerned about testing requirements. China partly addressed this issue in the wake of the 2006 JCCT, declaring that devices would be subject to just one test rather than two. But concerns remain, since two regulators will still need to certify a device's compliance. Raising more explicit concerns regarding China's adherence to WTO requirements, international companies may not participate in a program the Standards Administration of China announced in May 2006 to recruit a group of domestic companies to help draft new standards for household appliances.

Finally, US companies interested in obtaining the China Compulsory Certification (CCC) mark for their products continue to face delays, in part because of restrictions China places on foreign standards organizations to conduct CCC inspections and audits.

CHINA'S EXCHANGE RATE POLICY

One issue more than any other has captured the attention of Congress and much of the US 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.

China should indeed adopt a market-determined exchange rate. Toward this end, the focus of the United States should be on encouraging China to undertake the broad financial sector reforms that will allow market forces to determine fully the value of its currency. These include opening the financial sector to more competition, introducing more financial market products, requiring greater commercial accountability from existing financial sector companies, and, of course, allowing more foreign participation in China's capital and credit markets. USCBC understands that the Treasury Department has made these reforms a central part of its engagement with China's government through the Strategic Economic Dialogue (SED). USCBC fully supports these efforts.

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. The change in July 2005 in China's currency policy was a welcomed step. The movement of the yuan against the dollar since then has generally been consistent, albeit at a more tightly controlled pace than most would like to see.

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, however, about potential repercussions should the political dispute between the two countries over the exchange rate worsen. *The China Effect* study cited above indicates that even a 25 percent appreciation of the yuan against the dollar—far greater than expected—would decrease the total US trade deficit, which was more than $800 billion in 2006, by $20 billion.[6]

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

THE SED, JCCT & WTO

USCBC supports the administration's three-pronged approach to the commercial relationship with China through high-level exchanges at the SED, concrete negotiations to reach solutions to specific problems via bilateral mechanisms such as the JCCT, and the use of the WTO's dispute settlement mechanism to enforce US trade rights when solutions cannot be found through dialogue. USCBC believes this to be the most effective way to lower the market access barriers

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[6] See www.chinabusinessforum.org/pdf/the-china-effect.pdf

that US companies face in China, leveling the playing field between US and Chinese companies competing around the globe, and ensuring that China abides by its obligations as a WTO member.

The principal value of the SED is to provide a framework to guide the development of the most important economic and commercial relationship in the world. The United States and China will soon be two largest global economies and will remain that way for our lifetimes. Our two economies are already greatly intertwined. This is a relationship that both governments need to get right—and, for our government, a relationship that needs to keep moving forward in a way that meets US interests. This is especially true because the schedule for most of China's WTO market opening requirements reached its end last year, a schedule which in essence provided a roadmap for reforms and openings of China's economy. The SED can pick up where that roadmap ended and continue to propel the reform process and trade relationship forward. If done right, the SED framework should also provide positive momentum or "tailwind" for solving specific problems through existing forums such as the JCCT.

The first session of the SED, held in Beijing in December 2006, laid the foundation for frequent and wide-ranging, high-level exchanges between senior economic policy makers from China and the United States. The dialogue has the support and involvement of the presidents of both countries. The next session is scheduled for May 23-24 in Washington, DC. USCBC has encouraged both governments to find opportunities for members of Congress to engage with the unprecedented number of top PRC officials that will be in Washington for the SED. Such interaction would lead to a better understanding among PRC leaders of the role of Congress in US trade policy and among US lawmakers of the economic concerns and priorities of China's government.

At times, Beijing and Washington will be confronted with issues for which a mutually satisfactory solution cannot be reached through dialogue. Disputes are a normal part of a trading relationship, and the growth and complexity of the US-China commercial relationship means that such disputes will naturally increase in frequency. The WTO provides a nonpolitical mechanism for solving such disputes when dialogue fails. In these instances, USCBC supports the enforcement of US trade rights through the WTO dispute settlement mechanism, but urges our government to ensure that such cases are well-defined and focused on clear WTO violations.

CONCLUSION

US trade and investment with China clearly benefit the US economy, both through exports and through broader effects such as lower prices and higher productivity. Nevertheless, market access barriers and other problems exist in the bilateral economic relationship. USCBC supports efforts to find solutions to these issues that are focused and do not threaten the tremendous gains to the US economy that come from trade and investment with China.