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On Behalf of The National Association of Manufacturers

Before the Senate Subcommittee on
Oversight of Government Management, the Federal Workforce,
And the District of Columbia

Hearing On

Fair or Foul: The Challenge of Negotiating, Monitoring, and Enforcing
U.S. Trade Laws

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Mr. Chairman and Members of the Committee:

I am pleased to testify today on behalf of the National Association of Manufacturers (the NAM) regarding the federal government's ability to negotiate, monitor, and enforce trade agreements. I want to commend the Chairman for scheduling this hearing, for the subject is a particularly important one in view of the changes affecting U.S. trade policy. As requested, I will focus my testimony on the implications of the trade relationship with China, the resource needs of U.S. trade negotiations, and how to get U.S. manufacturing jobs growing again.

In presenting my testimony, I would like to draw not only on my experience in the NAM and the views of many of our member companies, but also on my years at the Commerce Department, including my own role in monitoring and compliance. I would like to express particular pleasure at being able to testify before the Subcommittee along with Dr. Thomas Duesterberg, a former Assistant Secretary of Commerce who was my direct boss for several years – and one of the best bosses I ever had.

MONITORING AND ENFORCEMENT

There is little benefit in negotiating measures addressing trade barriers without ensuring that the agreements are honored and that American firms and workers obtain the benefits and opportunities intended. Trade agreement compliance cannot be taken for granted, and ensuring we get what we bargained for is important to create confidence among business, labor, and the general public that trade agreements actually work and benefit the U.S. economy.

In the last half dozen years or so the U.S. government has been devoting increasing attention to monitoring and enforcing trade agreements. An important factor behind this was the creation of the World Trade Organization (WTO) as the replacement for the previous General Agreement on Tariffs and Trade (GATT).

The WTO included, for the first time, an enforceable dispute settlement system, whereas the GATT had no enforcement ability. This had significant implications for the U.S. Trade Representative's legal office and for the other agencies, particularly Commerce and State, that provide legal and analytical assistance in developing U.S. cases for dispute settlement.

Additional factors demanding more attention to monitoring and compliance included the growth of a variety of bilateral agreements covering specific issues, the spread of bilateral investment treaties, and the rise in the U.S. trade deficit -- which led to increasing concerns that trade be conducted fairly and that other nations live up to their obligations. Largely in response, the Commerce Department created the Trade Compliance Center and then converted its entire country operation into what is now known as "Market Access and Compliance" (MAC). USTR strengthened its Enforcement Office, and understandings were reached between Commerce and USTR regarding the respective monitoring and enforcement responsibilities of each. An interagency process including the State Department and other agencies was created.

CHANGED SITUATION

The situation facing monitoring and enforcement, however, has shifted dramatically in the last year, because of two major changes in trade policy. The first is the entry of China into the WTO, and the second is the initiation of comprehensive bilateral free trade agreements. These two developments are placing very significant new demands on Commerce and USTR, with major implications on staffing and budgets.

Fortunately, both the House and the Senate authorization and appropriations committees have recognized this, and the omnibus appropriations bill now before the Senate includes the House-Senate conference report for the Commerce, Justice, and State (CJS) appropriation that contains significant added resources for both USTR and the Commerce Department's International Trade Administration (ITA). Representative Frank Wolf of Virginia, Chairman of the House Commerce, Justice, and State Appropriations Subcommittee, deserves enormous credit for his vision and tenacity in achieving this result. The NAM urges final passage of the omnibus bill this week and seeks prompt implementation by the Executive branch.

The appropriations would provide an additional $7 million to USTR, $2 million of which are expressly focused on monitoring and enforcing China's commitments under the terms of its accession to the WTO. The balance of the added resources are for the purpose of strengthening USTR's ability to negotiate the growing range of bilateral and other trade agreements.

Commerce's ITA would obtain an additional $27 million and would reorganize its functions to more clearly concentrate export promotion resources in one place and to create a new organizational structure to focus on strengthening America's vital manufacturing sector. Importantly, ITA would receive resources for creating both a Middle East Business Information Center and a China Business Information Center. We hope these will be patterned after the widely-praised Business Information Center for the Newly Independent States (of the former Soviet Union) – known as "BISNIS." Additionally, Commerce would expand its export promotion efforts in China, and as I will explain later in my statement, the NAM believes a truly massive increase in such efforts is needed.

Commerce would also focus on improving its administration of import laws related to the entry of China into the global marketplace. An Office of China Compliance would be established, and would look particularly at the needs of smaller and medium-sized U.S. firms impacted by imports from China. Such an organization is extremely important since most small U.S. firms simply cannot afford the formidable costs of bringing trade cases. Commerce would also establish a new office of enforcement within the Market Access and Compliance unit.

Mr. Chairman, the NAM was among the strongest advocates for these added resources and for a focus on China and on new trade negotiations. We believe that with these new resources, staffing levels should be adequate for now – though we want to watch the demands of new bilateral negotiations and the related enforcement needs carefully. It is important to understand that trade negotiation and enforcement resources have been inadequate for a number of years, and the added staffing and funding just brings levels up to where we need to be now. Thus we should not preclude the need for yet more resources in the not too distant future.

For example, given the complexity of issues in trade agreements and the highly technical nature of monitoring and enforcement in areas such as telecommunications, intellectual property protection, investment, etc. I could easily foresee the need for future staffing and funding increases. Moreover, the proliferation of trade agreements will place added pressures to litigate trade violations – an absolute necessity if we are to prevent further erosion of support for trade

For now, though, we believe the challenge will be to staff up quickly to the new resource levels, to adopt an aggressive stance and a pro-active approach, and to further increase interagency cooperation so as to avoid any duplication of effort among the new functions and organizations being created.

THE CHALLENGE OF CHINA

Let me, in this context, turn to the challenge of China. I want to stress that the NAM seeks a positive and balanced trade relationship with China that reflects market forces as closely as possible. The Chinese economy poses huge opportunities for U.S. exporters and investors, and these will grow rapidly. We need to nurture these opportunities as we simultaneously deal with the fact that so many import-competing U.S. firms are challenged by China as never before.

It is also important to recognize that while the rising trade imbalance with China is a growing factor affecting U.S. manufacturing production and employment, it is far from the only factor. Domestic costs, falling U.S. exports, a generalized dollar overvaluation that is only now ending, regulatory pressures, and other issues are also at work. China must not be a "scapegoat" and an excuse for not tackling the other problems. Nonetheless, the economic imbalance with China is growing so rapidly that it must be addressed quickly and vigorously.

The U.S. trade deficit with China is by far the largest in the world, standing at $103 billion last year. Its rapid growth is continuing, and the NAM expects it to be around $125 billion this year. China now accounts for close to one-third of America's total deficit in manufactured goods trade, and through mid-2003 China was accounting for 40 percent of the entire increase in U.S. manufactured goods imports from the world. The NAM hears more from its member companies about China, particularly from smaller and medium-sized companies, than all other trade issues combined.

Imports from China are six times as large as exports to China, a fact which makes correction of the bilateral deficit extremely difficult. Exhibit 1, attached to my statement, shows alternative U.S. trade balances with China in five years under various import and export growth rates. A continuation of existing trends would result in a tripling of the trade deficit, to more than $330 billion. There is no question that such a level would result in calls for wide-spread protection. We have already seen some congressional proposals for across-the-board tariffs on China, and a worsening of the trade deficit will only increase these pressures.

The NAM opposes such an approach. Protectionism must be avoided. We cannot reverse the open trading system that has been such a source of growth for the United States and the rest of the world, and risk a downward cycle of global trade deterioration. We must pursue approaches relying on market mechanisms and take actions consistent with the rules-based trade system. NAM member companies have a variety of views on China, but they all agree that the playing field has to be level and trade should follow market principles as closely as possible -- very importantly, including market-driven currencies.

CHINA'S WTO COMPLIANCE

The first step in putting our trade relationship with China on a sustainable basis has already been taken: getting China into the WTO. China's accession to the World Trade Organization in December 2001 was vital, because China has now committed to abide by the same international trade rules that apply to the United States and most other countries. For the last quarter century, we have allowed China to have open access to our market without insisting on reciprocity. The result was the trade deficit we now have.

There is no question in my mind that if China had entered the WTO (or its predecessor, the GATT) a decade ago, we would not have a deficit with China anywhere near its present size. When China entered the WTO, the United States took no market-opening steps for China, for we were already fully open. China, on the other hand, had to reduce its tariffs, start eliminating a broad range of trade barriers, and begin adhering to international trade rules such as those prohibiting subsidized exports.

Administration Placing Priority on China -- The Administration has become very aware of the challenges posed by China, and I am impressed with the extent to which they are insisting that China move more quickly in complying with trade rules. For example, when the U.S. Trade Representative, Robert Zoellick was in China this October, he said his primary message was, " ... to keep U.S. markets open, we need a two-way street, to try to expand U.S. exports to China, and operate with fair, transparent, and predictable rules." Commerce Secretary Evans was even more direct when he was in China the following week. He said, "... This trading relationship needs work – a lot of work...China is moving far too slowly in its transition to an open, market-based economy ... We have been patient, but our patience is wearing thin. The American market will not remain open to Chinese exports indefinitely if the Chinese market is not equally opened to U.S. companies and American workers."

A healthy trade relationship based on a level playing field allowing workers, farmers, and companies on both sides to compete fairly and on the basis of their respective comparative advantage is in the interest of both countries, and is what we seek.

What we are seeing now is a shifting of gears. Business and government were willing to see a “honeymoon” when China first came into the WTO at the end of 2001, but the honeymoon is over and it is time to buckle down. The trade imbalance is too large to allow the playing field to remain tilted. The Administration’s determined words are very welcome, but now we must move to the next stage and begin to enforce our rights. Let me discuss some examples

Subsidized Exports? -- The NAM is receiving reports from different industries that Chinese products are being sold in the United States at prices so low they do not even cover the cost of raw materials much less than production and shipping costs. These reports suggest the possibility of widespread subsidies, either direct or indirect. Whenever Chinese companies have a genuine labor cost or other advantage under marketplace rules, that is something our companies have to deal with. But they should not have to deal with subsidized competition.

One of our member companies that makes hardware provides a typical example: Their large retail customers in the United States are able to purchase a particular pair of made-in-China pliers for 49 cents. The U.S. company makes identical pliers, but the problem is that the raw materials cost in these pliers is 61 cents. Note that this is not the sales price of the U.S. pliers -- just the cost of the raw materials before they are even processed. Since steel, plastic, and rubber prices are not lower in China than in the United States, how is it possible to take 61 cents of raw materials, process and package them, ship them across the ocean, and sell them for 49 cents?

I’ve mentioned only one item, but I could as easily show similar stories regarding mounting systems used to control vibration and noise on industrial machines produced by an Illinois company, brass screws produced in Ohio used in industrial equipment, commercial grade restaurant fish cookers produced in Mississippi, and many others as well. The range of products is broad and the conclusion inescapable that something is awry here. No matter how low labor costs are, it is very clear that the price of a product produced in China and shipped to the United States for sale should not be lower than the basic materials that go into that product.

Looking at the problem in another way: the average labor cost in an American manufactured good, including direct labor and benefits, is 11% of the total cost of the good. This varies by sector, but even at the high end, labor is still less than 30% of the total cost. So how is it that Chinese products imported to the United States are priced as much as 60% or 70% lower than those produced here? The Chinese still should have costs of capital, facilities, shipping, raw materials, etc. Or do they? This is the question that needs to be answered: Are there large-scale systemic forms of subsidization going on in China that make these products so cheap that our companies could not under any circumstances compete?

In order to make sure that our American manufacturers have a level playing field internationally, this issue must be addressed. Commerce’s new China compliance offices should start investigating this as soon as they open their doors. Commerce Under Secretary Aldonas has said he will establish a proactive Unfair Trade Practices Team to “track, detect, and confront unfair competition before it injures an industry here at home.” The pair of pliers I have mentioned today are as good a place to start as any. Commerce’s investigations should include China’s banking system, which is widely reported to be lending money to insolvent enterprises. Commerce Secretary Evans said in Beijing, “Non-performing loans to state-run companies are a form of government subsidy.” He is absolutely right, and in addition to bank loans that do not require repayment, other situations such as free or low-cost rent in government owned or constructed facilities and subsidized raw materials and energy supplies need to be explored.

There is a particular problem here that the Subcommittee may want to explore. A 1986 court case known as "Georgetown Steel," resulted in a ruling that one could not bring subsidies cases and apply countervailing duties against products made in non-market economies. It may be time for Congress revisit this issue and to determine if it should make it plain the countervailing duty statute applies to both market and nonmarket economies – such as China.

Counterfeiting and Ineffective Enforcement of IPR Protection -- While Chinese laws on intellectual property rights (IPR) have improved considerably, the lack of effective enforcement remains a serious problem. Product counterfeiting is occurring on a massive scale, including consumer hygiene and health care products, athletic footwear, pharmaceuticals, food and beverages, motorized vehicles, aircraft parts, windshield glass, brake linings, and thousands of other products. Many of these involve unauthorized use of U.S. testing and product quality marks. The brand name reputations and export and sales abilities of American companies are being affected in the billions of dollars – with an effect on U.S. jobs as well. China needs effective laws and enforcement to criminalize counterfeiting. It also needs to enforce existing commitments to stop the export of counterfeit goods.

I have attached to my testimony just one of many examples of counterfeiting – bogus sprinkler heads that are copies of a model made by the Toro company, a well-known U.S. manufacturer and a strong member of the NAM. Exhibits 2 and 3 show the blatant Chinese copying that deceives consumers into buying an inferior product and harming the ability of U.S. companies to sell genuine products – not just in China, but around the world.

I am impressed with the U.S. government's recent actions to begin moving in this area. Ambassador Zoellick met with the Advisory Committee on Trade Policy and Negotiations (ACTPN) on this issue before his October trip to China and moved counterfeiting up to among his top priorities – as has Commerce's new Minister-Counselor for Commercial Affairs at the U.S. embassy in Beijing, Craig Allen. I want particularly to single out the new Deputy U.S. Trade Representative, Josette Shiner, for how quickly she has moved to address the counterfeiting problem in China and for the innovations she is already beginning to put in place. Anti-Counterfeiting is extremely important to NAM member companies, both large and small, and for the first time we are optimistic that the problem can really be solved.

Now that U.S. officials have emphasized to the Chinese the imperative of acting, it is necessary to obtain results from Chinese officials. It is significant that Vice-Premier Wu Yi, who is well known for her ability to achieve goals, agreed to work with Ambassador Shiner to solve some counterfeiting cases quickly and obtain visible prosecutions. We know that the Chinese government has the ability to stop the actions that it wants to stop, and the time has come to stop counterfeiting. Should this fail, there would be no alternative but to press the U.S. government to pursue our rights in the WTO.

Manipulation of VAT Taxes -- Another serious matter is an apparent WTO violation that could threaten the existence of the U.S. semiconductor industry. The Chinese government discriminates against U.S. and other non-Chinese semiconductors by assessing them with a 17 percent Value-Added Tax (VAT), while only charging a 3 percent VAT if the semiconductors are designed and made in China. A 14 percent production cost advantage conferred by tax policy is an enormous incentive to move production.

The WTO (GATT Article III (2) – embodied in the WTO) states clearly that the products of any WTO member shall not be subject to higher internal taxes in another WTO member than that member assesses on similar domestic products. Yet China's VAT discrimination has been going on for three years. This is no trivial matter, for its continuation could well result in pulling from the United States not only semiconductor production, but also research and development and ultimately global leadership in microelectronics. USTR has raised the issue on several occasions with the Chinese government. China does not appear to concur this is a violation, and we are concerned that time not be wasted on further bilateral discussions if voluntary compliance appears unlikely. Hopefully, this issue can be better understood by Chinese officials during the current visit of China's Premier to Washington. If action to come into compliance with WTO requirements does not appear imminent, however, the Subcommittee may want to explore whether this instance is an appropriate one for dispute settlement case in the WTO.

In short, then, we see a variety of unfair practices that are impeding U.S. exports to China or providing Chinese products with unfair advantages in the U.S. and global marketplace. On the other hand, China has implemented most of its required WTO changes, or at least has put laws into place – and should receive credit for that. China has cut tariffs when it was supposed to and has taken many other steps as well. The NAM recognizes that China is still in transition to a market economy and in the process of phasing in certain WTO market-opening commitments. However, because China is such an important global importer and exporter, it is vital that the United States work to ensure that China complies with all WTO obligations and particularly those that have a significant impact on U.S. economic interests.

The best approach is always a cooperative one in which both sides see their interests aligned in trade liberalization, and we want to see this spirit advanced. One positive step which could be taken would be for China to join the WTO Government Procurement Agreement (GPA). Given the huge purchasing role of the Chinese government, transparency and rules in this area could not only help improve trade between the two countries but also would set an example for further openness and liberalization in China. By joining the GPA, China would obtain the added benefit of gaining access to other WTO members' government procurement where such is open under the WTO.

Certainly joining the GPA would ensure that China did not develop a closed procurement policy. The transparency it would create would also be one of the best means of reducing corruption. Thus an open policy would benefit China as well as the United States, and we hope that the U.S. government and China will begin considering this possibility.

CHINA'S UNDERVALUED CURRENCY

One of the major factors contributing to our trade imbalance is China's undervalued and tightly controlled currency. China has maintained its currency at its 1994 level against the dollar for the last nine years -- despite a huge increase in production capability, productivity, quality, production range, foreign direct investment inflows, and other factors that would normally be expected to cause a currency to appreciate. Were it able to float, the degree of upward pressure that the yuan would feel is amply indicated in the amount of dollar reserves the Chinese government has to accumulate to prevent upward movement of its currency.

China's reserves at the end of August 2003 stood at $365 billion dollars -- 120 percent of China's annual exports and nearly one-third of China's $1.2 trillion GDP. China has added $110 billion to its dollar reserves in just the last 12 months. There are many estimates of where the currency would move if it were able to float. The NAM commends the work of Dr. Ernest Preeg, of the Manufacturers Alliance, as well as other economists' estimates – the bulk of which fall into a 20-40 undervaluation estimate. Would a considerably stronger Chinese yuan have beneficial effects? Absolutely. Many of our member companies tell us that a 20 percent or more price shift would change the competitive situation dramatically.

I want to compliment the Administration's recognition of the problem and the steps taken so far. Treasury Secretary Snow recently stated that the currency would be one of the issues discussed during the current Washington visit of the Chinese Premier. Secretary Snow said the Administration's goal is a Chinese currency whose value is determined by market forces, but that as an interim step he would be willing to see an upward valuation of the yuan to some level that more closely reflects its true exchange rate. We applaud this, and hope that Premier Wen Jiabao will understand the importance of action. China's rapid buildup of reserves are not good for the Chinese economy either, because for every dollar the Central Bank of China absorbs off the market, it is creating 8.3 new yuan -- with the consequence that China's money supply is now growing at an annual rate of nearly 25 percent. Revaluation is a win-win solution.

There is one issue the Subcommittee may want to consider in this regard. In October the Treasury testified to the House Ways and Means Committee that China is intervening "very heavily in the markets to prevent the yuan from appreciating" by buying massive amounts of dollars; but in the same month Treasury informed the Senate Banking Committee that China was not manipulating its currency as defined in Section 3004 of the Trade Act of 1988. A determination of manipulation would have initiated consultations with a view toward ending the undervaluation.

If China's huge one-way intervention in currency markets does not constitute manipulation, what does? I am certain that the Treasury followed the law scrupulously, but it strikes me that the Subcommittee may want to discuss the matter with the Treasury and other Senate committees and determine if Section 3004 is flawed and in need of amendment. This is an important question, since Treasury must report its currency manipulation findings to the Congress every six months.

CHINA AS A MARKET

Before departing the subject of China, though, let me stress again that we are seeking a market-oriented approach to U.S. - China trade that will lead to expanding benefits to the economies of both nations. It is important to avoid viewing China in a one-sided manner. In addition to being a rapidly rising supplier of imports into the U.S. market, China is also a quickly growing market for foreign goods and services, and this must not be overlooked. Last year China was our fastest-growing export market. While our overall exports fell 5 percent, our exports to China were up 15 percent. Only 8 percent of China's imports come from the United States. The European Union sells considerably more to China than we do. We need to examine why the U.S. has such a small share of China's import market, and what -- in addition to a currency shift -- U.S. exporters need to do to change this situation and help boost two-way trade.

Exporting is not the only way American companies sell abroad. In fact, investing overseas to produce in markets abroad is the predominant way that American companies compete around the globe. These investments strengthen the competitive ability of American firms globally and allow them to increase their market position in countries all around the world. Less than 5 percent of U.S. global foreign direct investment in manufacturing is going to China. About 90 percent goes to Europe and other high-wage countries. Commerce Department data show that the bulk of the output of U.S. firms in China is sold in the local Chinese market. Commerce's data imply that only three percent of U.S. imports from China came from U.S. manufacturing affiliates there.

Overwhelmingly our imports from China come from Chinese, or at least non-U.S., companies. Nevertheless, it is certainly true that more U.S. companies are beginning to consider moving to China to stay globally competitive. The best way to ensure that investment flows follow economic fundamentals while maintaining growing manufacturing production in the United States is to have market-determined currencies and a better investment environment in the United States.

I want to conclude my China discussion by stressing that the NAM believes we must undertake a massive joint public-private export trade effort to increase U.S. exports to China. We believe that very rapid rates of U.S. export growth to China are possible – rates of 25-33 percent annually. We believe the time has come for a total revamping of the U.S. government's export promotion efforts in China. The stage is set. The House-Senate appropriations language calls for a huge increase in attention to China export promotion, including the development of American Trade Centers.

With China's market opening moves stemming from its WTO obligations, restoration of reasonable exchanges rates vis a vis our major competitors, and what we hope will be a Chinese currency that reflects a reasonable market valuation, U.S. export are set to boom. But they will not do so on their own. The Chinese market is too distant and unfamiliar to most U.S. companies, and they need a partnership with the U.S. government – and particularly the Commerce Department. We hope the Chinese government would work toward this goal as well.

NEGOTIATING AND ENFORCING TRADE AGREEMENTS

Let me now turn to the other new factor impacting Commerce and USTR trade resources: negotiating trade agreements. The need for these agreements is startlingly clear once one takes a look at Exhibit 4, attached to my statement. This exhibit shows the WTO bound tariff rates for various categories of manufactured goods maintained by most of the world's significant trading nations. What leaps off the page is how low our tariffs are and how high the tariffs are in many other countries. This is what we mean by the "unlevel playing field", and it is one of the reasons that our imports have tended to grow more rapidly than our exports over time. We have to get foreign barriers down to our level.

Until recently, the United States had very few free trade agreements – three, to be exact: the U.S.- Canada free trade agreement, the agreement creating the North American Free Trade Area (NAFTA), and the small and rather simple U.S. – Israel Free Trade Agreement. Other countries and trading areas, however, had been developing a proliferation of free trade agreements putting U.S. exporters at a disadvantage in many parts of the world.

The U.S. trade philosophy changed and with the passage of Trade Promotion Authority, the United States now has trade agreements with Chile, Jordan, and Singapore; and is negotiating with, or has announced an intention to negotiate with Australia, Bahrain, Bolivia, Colombia, Costa Rica, El Salvador, the Dominican Republic, Ecuador, Guatemala, Honduras, Morocco, Nicaragua, Panama, Peru, the Southern African Customs Union, and Thailand. And this is on top of the Doha Round of WTO negotiations and the Free Trade of the Americas (FTAA) negotiations.

That is a *huge* workload! The NAM supports those free trade agreements, and actually would like to see more. While we would like to see these barriers negotiated away globally in the WTO, we cannot put all our eggs in that basket. To date we have seen little willingness on the part of developing countries to make substantial trade barrier cuts in WTO negotiations. While we want U.S. negotiators to continue pressing vigorously, we need simultaneously to pursue regional and bilateral approaches.

The negotiation requirements are quite sizeable. Teams of 50 or more U.S. negotiators from USTR, Commerce, and other agencies are needed as the details of tariff negotiations, intellectual property, customs, investment rules, government procurement, services, and many other aspects that go into a state-of-the-art negotiation proceed. Negotiating resources are already strained, and the ambitious schedule of negotiations is likely to stretch them even more. The expanded appropriation in the omnibus legislation will certainly help, but it may well develop that more will be needed.

The other resource implication of free trade agreements is that their dispute settlement procedures require significant time inputs on the part of the U.S. government. Each of the bilateral agreements has its own dispute settlement processes that require the time of compliance specialists and trade litigators. Certainly it is our expectation that trade cases under these agreements will be the exception, not the rule. The NAM fully believes that, overwhelmingly our trading partners enter into trade agreements with the expectation that they will live up to their obligations. Nonetheless, there will always be disagreements, differences of interpretation, and the like; and these will inevitably lead to trade disputes.

Given the existence of a dozen or more individual free trade agreements, monitoring and enforcement becomes a complex exercise – one that could well need added resources. While I think we are a way off from the first cases, it is not too soon for the Administration to begin designing the mechanism for dealing with these and to begin working with the Congress to consider whether added resources will be needed.

REVITALIZING MANUFACTURING AND JOBS

As the final topic of my testimony today, let me address U.S. manufacturing jobs. Manufacturing went into recession in 2000 and only now – three years later – is showing signs of a turnaround. Shipments of manufactured goods have fallen an astonishing $270 billion since 2000, and 2.8 million American factory jobs have been lost – about 15 percent, or roughly one in every six jobs. Manufacturing represents 14 percent of the American workforce, but has accounted for nearly 90 percent of all the job losses since total U.S. employment peaked in March 2001.

With the tax cuts that have been enacted, low interest rates, and appreciation of major foreign currencies from their previously highly-undervalued positions, the stage is now set for a turnaround in manufacturing. However, despite recent promising signs that the manufacturing sector is recovering from its three-year long recession, U.S. manufacturers continue to struggle in the face of weak demand and the most intense global competition in history. The NAM is pleased with the rising level of awareness on the part of the Administration and the Congress with respect to the need to revitalize manufacturing. Commerce Secretary Evans is expected to release the Administration's analysis of manufacturing and his recommendations for revitalization soon, and we are looking forward to a robust report with strong, actionable recommendations.

In looking at why the manufacturing recession is so sharp and why the sector is behaving differently from the rest of the economy, trade immediately stands out as a huge factor. Of the $270 billion drop in U.S. manufactured goods shipments since 2000 (through July 2003, at an annualized rate), $80 billion stems from a drop in U.S. manufactured goods exports -- accounting for roughly one-third of the fall in production. A one percent increase in import penetration of manufactured goods over that time accounted for a further $40 billion of the production decline, about 15 percent. All of the increase in import penetration came from China. Import penetration from the rest of the world has been flat since 2000 -- meaning U.S. imports from them grew no faster than U.S. consumption.

Thus, changes in exports and imports – predominantly the drop in exports – may account for close to half of the fall in U.S. manufacturing production. The other half must be attributed to the domestic economy. We are optimistic that the tax changes, the rundown of inventories, the need to begin expanding purchases of capital goods, and continued low interest rates already have the domestic economy turning around. Certainly the third quarter GDP growth, while not sustainable at that level, gives us great encouragement.

Fixing the trade half of the situation is something that is also underway. The fundamental cause of our trade difficulties has been the extreme run-up in the value of the U.S. dollar since 1997. At its peak the dollar rose about 25 percent over its early 1997 level according to the Federal Reserve Board's (FRB) trade-weighted broad currency index. Using the Institute for International Economics' rule of thumb that each one percent change in the value of the dollar leads to a $10 billion shift in the trade balance, the appreciation of the dollar could account for about $250 billion of the $350 billion increase in the deficit -- or about 70 percent.

With the restoration of the dollar to normal levels vis-a-vis major currencies such as the euro, the stage is set for U.S. export growth and moderation of import penetration. It is important to understand that the dollar is not "weak" or undervalued – just back to where it was before the trade deficit began to erupt. For example, last week the euro reached a value of $1.20; but this amount is barely at the level of the 1990's, when the currencies comprising the euro were worth an average of $1.21 -- and at times were nearly at a level of $1.40.

The remaining currency problem is in the Asian currencies that are being prevented from appreciating by heavy intervention in currency markets. Together, four Asian economies -- China, Japan, South Korea, and Taiwan -- hold $1.2 trillion of official reserves, up $600 billion in the last four years and up $250 billion in just the last 12 months as they have purchased dollars to prevent an excess supply of dollars from lowering the value of their currencies.

It should be pointed out that these four countries account for 60 percent of the entire global U.S. trade deficit in manufactured goods. China holds the key, for all the other Asian nations keep looking over their shoulders at China and its low export prices.

In addition to getting currencies back into line, we must also level the playing field by getting foreign tariffs and trade barriers down to our level, and this is where an aggressive trade negotiation program comes into play. The longer we wait, the more we will fall behind, which is why we should ensure that the necessary resources are available for the robust package of agreements we must have.

Most importantly of all, however, the United States must act on reducing the cost of producing in the U.S. by containing health care costs, enacting legal reforms, including asbestos litigation reform, ensuring adequate and affordable energy supplies, and reforming the regulatory process.

This is really the central issue. We will not succeed in preventing the migration of our manufacturing base if we do not address the high cost of manufacturing in the United States. It is that simple. U.S. industry is burdened by legal and regulatory systems that retard growth and destroy jobs. Unrestrained asbestos liability alone, for example, could cost U.S. industry $250 billion, resulting in the bankruptcy of even large corporations. Rapidly rising health care costs are a constant worry, particularly for small manufacturers. Uncertainty over sources of energy supply has led to price volatility. Lack of support for research and development threatens to undermine U.S. technology leadership. And shortages of skilled workers have many manufacturers wondering how they can expand in the future.

The National Association of Manufacturers and the Manufacturers Alliance jointly released a study this morning delving into the implications of these domestically-imposed costs. The combined magnitude of these domestic cost factors is staggering and goes a long way to explaining why manufacturing in America is at risk. Together, the various cost factors combine to create at least a 22 percent cost disadvantage to producing in the United States rather than abroad. Dr. Duesterberg and I have copies for the Subcommittee, and our organizations will ensure every member of the House and Senate receives a copy of this “must read” report.

Unless these cost challenges are addressed, frankly we can expect a growing erosion in the U.S. industrial base. Competition from China will only accelerate the trend. However, if we begin to act now, with both a refocused and positive trade policy toward China, an aggressive program of trade agreements, and a concerted strategy on economic growth and manufacturing renewal, we can restore the dynamism and competitiveness of U.S. industry and ensure the global leadership that is so central to our economic and national security.

Thank you, Mr. Chairman.

EXHIBIT 1

ALTERNATIVE U.S. TRADE DEFICITS WITH CHINA

20-Year Trend: Exports to china up 12% per year; Imports up 20% per year

IF THESE TRENDS CONTINUE FOR 5 MORE YEARS THE CHINA TRADE DEFICIT WILL TRIPLE, TO $330 BILLION

Projected 2008 Trade Deficits with China
Under Alternative Export and Import Growth Rates
(Billions of Dollars)

Import% \ Export%	12%	25%	33%
20%	($330)	($290)	($252)
15%	($246)	($205)	($167)
10%	($178)	($138)	($100)
7%	($144)	($104)	($66)

EXHIBIT 2

GENUINE TORO SPRINKLER HEAD – TOP VIEW

FAKE TORO SPRINKLER HEAD – TOP VIEW

EXHIBIT 3

GENUINE TORO SPRINKLER HEAD – SIDE VIEW

FAKE TORO SPRINKLER HEAD – SIDE VIEW