CHINA AND THE WTO: ASSESSING AND ENFORCING COMPLIANCE

HEARINGS

BEFORE THE

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

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The Commission's Statutory Mandate begins on page 410.

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

MARCH 18, 2005

The Honorable TED STEVENS,
President Pro Tempore of the U.S. Senate, Washington, D.C. 20510
The Honorable J. DENNIS HASTERT,
Speaker of the House of Representatives, Washington, D.C. 20515

DEAR SENATOR STEVENS AND SPEAKER HASTERT:

On behalf of the U.S.-China Economic and Security Review Commission, we are pleased to transmit the record of our February 3–4, 2005 public hearing on "*China and the WTO: Assessing and Enforcing Compliance*."

The Commission used China's accession to the World Trade Organization as the hearing's frame of reference, considering both the obligations it placed on China and the trade remedies it provides for U.S. parties. Commissioners heard from senior Administration officials, industry groups, labor organizations, economists, and trade law experts. The Commission was also honored to receive the perspectives of ten Members of Congress representing bipartisan concerns in both the House of Representatives and the Senate about this subject.

There was a general consensus in the testimony that China remains in violation of its WTO obligations in a number of important areas. Witnesses highlighted China's undervalued currency and lack of protection for intellectual property rights and expressed the view that U.S. Government efforts to move China to address these serious problems have not achieved satisfactory results to date and should be reconsidered. The hearing also dealt with the application of U.S. trade remedies. The Commission heard testimony concluding that the Administration has not effectively utilized antidumping duties and the China-specific Section 421 and textile safeguards to offset China's unfair trade practices. What follows are our key findings in these areas along with a number of recommendations designed to improve the use of U.S. trade remedies and encourage China's compliance with its WTO commitments.

Key Areas of China's Non-Compliance

Exchange Rate Practices

The Commission found in its 2004 Report to Congress that "China is systematically intervening in the foreign exchange market to keep its currency undervalued" and that "the undervaluation of the Chinese yuan has contributed to the U.S. trade deficit and has harmed U.S. manufacturing." To date, despite high-level dialogue between United States and Chinese officials, there has been no concrete movement by the Chinese government to address the undervaluation of its currency. The bilateral trade deficit reached $162 billion in 2004, an expansion of 31 percent from 2003. The deficit has increased an average of 25 percent per year since 2002, the first year of China's membership in the WTO. A similar increase in 2006 would put the bilateral trade deficit over $200 billion.

The Commission received a written statement from Assistant Secretary of the Treasury for International Affairs Randal Quarles detailing the Administration's position on China's currency regime, which indicates that the long-term goal of U.S. policy and negotiations with China should be a market-based exchange rate system for the Chinese currency. We agree with this goal; however, we do not share the Administration's view that progress toward this goal is proceeding at a sufficient pace to rectify current economic problems. Moreover, structural factors in China's financial system preclude the possibility of near-term success in achieving a stronger yuan and a more balanced trading relationship through increased exchange rate flexibility. Instead, the Commission continues to advocate an immediate significant upward revaluation of the Chinese currency against the U.S. dollar as the necessary near-term objective.

Recommendation 1: The Commission recommends that Congress pursue a three-track policy to move China toward a significant near-term upward revaluation of the yuan by at least 25 percent.

- Congress should press the Administration to file a WTO dispute regarding China's exchange rate practices. China's exchange rate practices violate a number of its WTO and IMF membership obligations, including the WTO prohibition on export subsidies and the IMF proscription of currency manipulation. Congress should press the Administration to respond to China's violation of its international obligations by working with U.S. trading partners to bring to bear on China the mechanisms of all relevant international institutions.
- Congress should consider imposing an immediate, across-the-board tariff on Chinese imports unless China significantly strengthens the value of its currency against the dollar or against a basket of currencies. The tariff should be set at a level approximating the impact of the undervalued yuan. The United States can justify such an action under WTO Article XXI, which allows members to take necessary actions to protect their national security. China's undervalued currency has contributed to a loss of U.S. manufacturing, which is a national security concern for the United States.[1]
- Congress should reduce the ability of the Treasury Department to use technical definitions to avoid classifying China as a currency manipulator by amending the 1988 Omnibus Trade Act to (i) include a clear definition of currency manipulation, and (ii) eliminate the requirement that a country must be running a material global trade surplus in order for the Secretary of the Treasury to determine that the country is manipulating its currency to gain a trade advantage.

Intellectual Property Rights

China improved many of its laws regarding intellectual property rights (IPR) following its accession to the WTO. However, there are still significant shortfalls in both the legal regime and the enforce-

[1] Commissioner Reinsch dissents from this portion of Recommendation 1.

ment structure. One example is high monetary thresholds that must be crossed before an IPR violator is subject to criminal punishment. China's use of such thresholds is inconsistent with the provisions of the WTO's TRIPS Agreement, which calls for criminal treatment of IPR violations on a commercial scale irrespective of value. Moreover, notwithstanding legal improvements, violations of IPR in China continue virtually unchecked. Witnesses at the hearing cited piracy rates above 90 percent across all copyright industries. China's WTO commitments include effective enforcement of IPR. Therefore, statutory changes without enforcement are not sufficient.

Counterfeit products from China threaten markets for U.S. products in China, in the U.S., and in third countries. Counterfeit goods from China entering the U.S. market also pose a risk to U.S. consumers because they are not likely to meet commercial or government safety guidelines. Often, regulatory seals of approval are falsified along with the product itself. There is a self-evident danger in unsuspecting consumers using sub-standard products in any number of categories, from pharmaceutical products to automobile parts.

China pledged to enact a specific plan for protecting IPR during the April 2004 meeting of the U.S.-China Joint Commission on Commerce and Trade (JCCT). The Office of the U.S. Trade Representative (USTR) is conducting an out-of-cycle review of IPR protection in China to determine whether commitments made by China at the JCCT meeting have been carried out. Early indications from industry groups suggest that China has not met those commitments.

USTR maintains a watch list of countries with the most egregious failings in IPR protection that is updated annually in a Special 301 Report. Those countries that have the most onerous acts of IPR violations and "are not engaged in good faith negotiations or making significant progress in negotiations to address these problems" are deemed Priority Foreign Countries and face the possibility of U.S. sanctions. Priority Foreign Countries can move to Section 306 monitoring if they enter into good faith negotiations or make significant progress in addressing the problems. China was labeled a Priority Foreign Country in 1996, but is now only subject to Section 306 monitoring. The Commission believes that China's participation in negotiations regarding IPR issues has not been in good faith to date, as evidenced by unabated IPR violations.

Recommendation 2: The Commission recommends that Congress urge USTR to immediately file one or more WTO disputes pertaining to China's violation of IPR obligations, particularly China's failure to meet the requisite standards of effective enforcement, including criminal enforcement, explicitly imposed by the Trade Related Aspects of Intellectual Property Rights (TRIPS) Agreement. Moreover, USTR should be pressed to move China from the status of Section 306 monitoring to that of a Priority Foreign Country in reflection of its lack of good-faith negotiations or progress in confronting IPR violations.

Structural Issues

Uncollected Anti-Dumping Duties

The Department of Homeland Security's Bureau of Customs and Border Protection ("Customs") failed to collect $260 million in anti-dumping and countervailing duties in 2004. Of that amount, $224 million related to Chinese imports, with $213 million of that amount pertaining to Chinese agricultural imports.

Importers of some Chinese goods are circumventing dumping duties by exploiting a loophole known as the "new shipper bonding privilege." Importers of a product subject to an anti-dumping duty are usually required to make a sufficient cash deposit to cover the estimated duty. Pursuant to a 1995 law, importers who receive such products from a new shipper are permitted to post a bond with Customs in lieu of the cash deposit. The bond or cash deposit is intended to function as a guarantee that Customs will be able to collect the requisite dumping duties. The exact duty owed is not determined until one to two years after the importation has occurred. The importer is then either refunded or billed for any difference between the estimated duty and the exact duty. In the case of the uncollected duties, when the exact dumping duty has been determined, the party responsible for payment of the bond often is bankrupt or has "disappeared" and no recourse is available.

Recommendation 3: The Commission recommends that Congress repeal the "new shipper bonding privilege" that has allowed many importers of Chinese goods to avoid payment of anti-dumping duties. Importers of goods subject to anti-dumping or countervailing duties should be required to deposit in cash the amount of any estimated applicable duty.

Transitional Review Mechanism

China agreed, as part of its WTO accession commitments, to submit to a specific annual review of its compliance with WTO obligations during its first ten years in the organization via the Transitional Review Mechanism (TRM). WTO member countries sought such an annual review because China did not meet many of the basic requirements of a market economy. As the Commission has reported in the past, China takes the position that the review is discriminatory and has therefore acted to frustrate the intent of the TRM by refusing to answer questions in writing posed by trading partners during this process and preventing production of a meaningful report. Because of China's initial success in obstructing the TRM, USTR has recently dedicated less effort to making the TRM a consequential forum for raising and resolving issues regarding areas of China's noncompliance, preferring to devote more time to bilateral discussions. For instance, the Government Accountability Office (GAO) reports that USTR submitted questions to China's representative an average of nine days in advance of meetings in 2003, compared to an average of 34 days in 2002. China excused itself from answering some questions by noting that it did not have adequate time to prepare a response.

Market Economy Status

China is currently and properly labeled a nonmarket economy by the United States, a designation made by the Department of Commerce pursuant to factors set out under law. China is actively seeking market economy status from the U.S. and other countries as a matter of prestige, and because having that status will make less effective anti-dumping remedies applied by trading partners against Chinese goods. The factors to be considered in removing nonmarket economy status include the extent to which the country's currency is convertible, the extent to which wage rates are freely determined by negotiations between labor and management, and the extent to which the government owns or controls the means and decisions of production.

At the JCCT, the United States agreed to establish a working group to help China move toward market economy status designation. The Commission is concerned that the decision by Commerce on whether to designate China a market economy will not be made pursuant to an economic analysis using the above criteria, but rather that political considerations will be given greater weight.

Recommendation 4: The Commission recommends that Congress require that the Department of Commerce obtain Congressional approval before implementing any determination that a nonmarket economy has achieved market economy status. Congress should ensure that China continues to be treated as a nonmarket economy in the application of anti-dumping and countervailing duties through 2016, as is explicitly permitted by China's WTO accession agreement, unless China clearly meets the statutory requirements for market economy status.

WTO Dispute Resolutions

The Commission heard testimony that, in resolving disputes between members, WTO panels and the appellate body often liberally interpret the text of WTO agreements to fill gaps in agreements negotiated by member governments. This is beyond the jurisdiction of the WTO, which should confine itself to arbitration based on explicit agreements among members. In this regard, Article 3 of the Dispute Settlement Understanding establishes that: "Recommendations and rulings of the DSB [Dispute Settlement Body] cannot add to or diminish the rights and obligations provided in the covered agreements." The WTO's handbook on dispute settlement further clarifies: "The rulings of the bodies involved are intended to reflect and correctly apply the rights and obligations as they are set out in the WTO Agreement. They must not change the WTO law that is applicable between the parties or, in the words of the DSU [Dispute Settlement Understanding], add or diminish the rights and obligations provided in the WTO agreements."

Any subjects unaddressed by international agreements must be left to definition or clarification by further negotiations among members. The Commission believes that the United States consented to be bound by explicit obligations as a member of the WTO, in return for which it gained explicit privileges, but did not agree to subject itself to new international obligations created by the dispute resolution process.

Recommendation 5: The Commission recommends that Congress establish a review body of distinguished, retired U.S. jurists and legal experts to evaluate the dispute resolution mechanism at the WTO. The review body would consider all decisions made by a WTO dispute settlement panel or appellate body that are contrary to the U.S. position taken in the case. In each instance, a finding would be made as to whether the WTO ruling exceeded the WTO's authority by placing new international obligations on the United States that it did not assent to in joining the WTO. This information would be very helpful to Congress and other public officials in ongoing evaluations of the benefits of U.S. membership in the WTO. If three affirmative findings were made in five years, Congress would be prompted to reconsider the relationship between the United States and the WTO.[2]

Effectiveness of U.S. Trade Remedies

Section 421 Safeguard

China agreed as part of its accession to the WTO to allow trading partners to use a product-specific safeguard in cases of market disruption. The United States implements this safeguard through the petition process codified by Section 421 of the Trade Act of 1974, allowing aggrieved U.S. companies to petition the ITC when they believe imports from China have caused market disruption and material injury. After the ITC makes its determination as to whether market disruption has occurred, an interagency group chaired by USTR considers the ITC recommendation and makes its own recommendation to the President.

The Commission heard testimony that the Chinese government employs U.S. lobbying and legal firms to make its case to the interagency group, or members thereof. Since the government of China has greater financial resources than individual U.S. firms seeking relief under Section 421, the Chinese government may be more effective in such lobbying processes. To date, the International Trade Commission (ITC) has rejected two petitions and found that market disruption had occurred in three other cases. In each of these three cases, the President rejected the ITC's recommended relief, exercising his statutory authority to waive relief when the "provision of such relief is not in the national economic interest of the United States or, in extraordinary cases, that the taking of action . . . would cause serious harm to the national security of the United States." Witnesses told the Commission that these actions have made firms reluctant to pursue Section 421 actions and thereby undermined its effectiveness as a trade remedy. If early petitions are consistently rejected, other companies will not spend the resources to seek such relief, and China's government will have effectively voided implementation of the China-specific safeguard which it already agreed to but complains is discriminatory.

The Commission believes that the intent of the 421 safeguard includes a presumption of relief, but that cases to date have displayed a predisposition against any relief. No new petitions have been filed in over a year, and industry representatives note that

[2] Commissioner Reinsch dissents from this recommendation.

the legal fees involved are unjustifiable given an expectation that the President will deny relief even if the ITC recommends it.

Recommendation 6: The Commission recommends that Congress authorize compensation to petitioners in the Section 421 safeguard process for legal fees incurred in cases where the ITC finds that market disruption has occurred but the President has denied relief. Congress should also consider eliminating Presidential discretion in the application of relief through Section 421 petitions or limiting discretion to the consideration of non-economic national security factors.

Anti-dumping Duties and the CDSOA

The Continued Dumping and Subsidies Offset Act of 2000 (CDSOA, also known as the Byrd Amendment) transfers revenue collected through anti-dumping duties to U.S. producers harmed by the dumped imports. The WTO has ruled that the CDSOA violates U.S. obligations governing permissible responses to dumping and subsidies, and has authorized retaliatory measures by U.S. trading partners if the United States maintains the CDSOA.

Recommendation 7: The Commission recommends that Congress maintain the Continued Dumping and Subsidies Offset Act of 2000 (CDSOA), notwithstanding the WTO determination that it is inconsistent with the WTO Agreement. Congress should press the Administration to seek explicit recognition of the existing right of WTO members to distribute monies collected from anti-dumping and countervailing duties during the Doha Round negotiations and the review of the WTO's dispute resolution mechanism.

Textile Safeguard

China agreed as part of its WTO accession to allow its trading partners to exercise a textile safeguard whereby countries could place a temporary limit on textile imports from China when a surge in imports causes or threatens to cause a market disruption in designated product categories. Under U.S. law, the safeguard is implemented through consideration of petitions by the Committee on the Implementation of Textile Agreements (CITA), an interagency committee chaired by the Commerce Department. A number of petitions were filed in anticipation of a sharp increase in imports following the expiration of the Multi-Fiber Arrangement on January 1, 2005. The Court of International Trade (CIT) is currently considering a suit filed by U.S. textile importers alleging that CITA does not have the authority to consider threat-based petitions, but only petitions based on past and ongoing injury. The Commission notes that China's accession agreement clearly allows for threat-based safeguards.

Despite that, the Court has granted an injunction against consideration of threat-based petitions until the case is decided. All petitions for relief deriving their basis in an expectation of market disruption, including those filed prior to the expiration of the Multi-Fiber Arrangement, are currently suspended. The Justice Department has appealed to the Court of Appeals for the Federal Circuit to have the preliminary injunction removed.

Recommendation 8: The Commission recommends that Congress clarify without delay the authority of the Committee on the Implementation of Textile Agreements (CITA) to consider threat-based petitions.

Countervailing Duties and China's Subsidies

The Commission heard testimony that China's government is subsidizing a broad array of industries via direct and indirect methods. However, U.S. producers cannot seek protection through countervailing duty laws because the Department of Commerce, in a series of decisions finalized in 1986, opted not to allow the application of countervailing duties to nonmarket economies, such as China. Commerce's practice was upheld by the U.S. Court of Appeals, but is not required by law.

Recommendation 9: The Commission recommends that Congress direct the Department of Commerce to make countervailing duties applicable to nonmarket economies.

Recommendation 10: The Commission recommends that Congress direct USTR and Commerce to investigate China's system of government subsidies for manufacturing, including tax incentives, preferential access to credit and capital from financial institutions owned or influenced by the state, subsidized utilities, and investment conditions requiring technology transfers. The investigation should also examine discriminatory consumption credits that shift demand toward Chinese goods, particularly as a tactic of import substitution for steel, Chinese state-owned banks' practice of non-commercial-based policy lending to state-owned and other enterprises, and China's dual pricing system for coal and other energy resources. USTR and Commerce should provide the results of this investigation in a report to Congress that assesses whether any of these practices may be actionable subsidies under the WTO and lays out specific steps the U.S. Government can take to address these practices.

Thank you for considering these recommendations and the hearing record that they accompany. The Commission will continue to follow these important issues in its ongoing assessment of U.S.-China trade and economic relations.

Sincerely,

C. Richard D'Amato
Chairman

Roger W. Robinson, Jr.
Vice Chairman

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ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

CHINA AND THE WTO: ASSESSING AND ENFORCING COMPLIANCE

THURSDAY, FEBRUARY 3, 2005

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION,
Washington, D.C.

The Commission met in Room 124, Dirksen Senate Office Building, Washington, D.C. at 8:33 a.m., Chairman C. Richard D'Amato and Commissioners Patrick A. Mulloy and June Teufel Dreyer (Hearing Cochairs), presiding.

OPENING STATEMENT OF CHAIRMAN C. RICHARD D'AMATO

Chairman D'AMATO. The hearing will come to order.

We would like to welcome everyone to our two-day hearing evaluating China's progress in meeting its WTO commitments and how the WTO might be used to address continuing problem areas we have in trade with China.

And before we begin, I would like to welcome the newest Member of our Commission, appointed recently by the Senate Majority Leader, Mr. Frist, the distinguished Senator from Tennessee, Senator Fred Thompson. Fred is no stranger to this Commission. As a Senator, he was very helpful and testified in closed and open session at least three times on matters as diverse as nonproliferation and capital markets. We look forward to working with you, Senator Thompson.

The Commission has evaluated China's progress toward meeting its broad array of WTO commitments in our past report and has highlighted a number of key problems, particularly China's undervalued currency and poor protection of intellectual property rights, both of which are fueling a dangerous, ballooning trade deficit with the United States.

The viability of the WTO itself as the preeminent global trade organization depends on whether it can deal with issues of the magnitude of China's IPR and exchange rate practices. If the WTO is to serve as a steward of the global trading system, it must actively and successfully confront those practices that threaten the basic structure of the system.

Clearly, the United States must take the lead with the WTO, as nobody else, in our opinion, will, if these issues are going to be resolved.

Another key concern of the Commission has been the fate of the WTO's special oversight system for China, the so-called Transitional Review Mechanism. During China's accession negotiations, the U.S. pressed for the TRM in order to institutionalize a formal review of China's efforts to pull its economy and government in line with WTO standards.

The hope was that the TRM would expose key problem areas and put collective pressure on China to address them. Instead, China's failure to fully cooperate with this process has left the TRM little more than an information gathering session.

Outside of the WTO, China is pressing its trading partners to confer market economy status on this decidedly nonmarket economy. Obviously, this Commission would be pleased to see China actually move toward becoming a market economy. We are concerned, however, with the possibility that market economy status will be treated as a bargaining chip for political reasons and traded away as part of political strategies rather than granted only when warranted by economic developments. China is a far, far cry from a market economy today by any stretch of the imagination.

Also on our agenda today will be a discussion of the Continued Dumping and Subsidies Offset Act of 2000, also known as the Byrd Amendment. When the United States collects antidumping duties, the Byrd Amendment authorizes the government to distribute them to injured domestic producers, making it an important form of relief for U.S. firms.

The WTO has ruled, in a very controversial ruling, against the Byrd Amendment, and has authorized U.S. trading partners to impose retaliatory duties. This ruling is despite the fact that nowhere in the WTO treaty is such a practice referred to, much less prohibited. We would like to determine how the United States should respond to this ruling: repeal the provision, accept retaliation, or search for other options.

Additionally, data collected from the Byrd Amendment process has revealed that some $250 million in antidumping duties, nearly half of the total imposed, has gone uncollected, primarily related to imports from China. We hope to shed some light on this issue today during the hearing and examine ways to resolve this problem that undermines the effectiveness of our trade laws.

After a statement by the Commission's Vice Chairman, Roger Robinson, to my left, we will turn the proceedings over to Commissioners Pat Mulloy, on my right, and June Dreyer, on my left, who will cochair this hearing. For myself and for the Commission, I thank them for the excellent work they have done in preparing this hearing today.

All written statements submitted to the Commission by Members of Congress and other witnesses will be part of the record in full and are available as they come on the table in the back. And I ask, without objection, that the statements submitted for the record by Senators Inouye and Craig be included in the hearing record.

Vice Chairman Robinson?

[The statement follows:]

Prepared Statement of Chairman C. Richard D'Amato

Welcome to our two-day hearing evaluating China's progress in meeting its WTO commitments and how the WTO might be used to address continuing problem areas.

The Commission has evaluated China's progress toward meeting its broad array of WTO commitments in our past reports and has highlighted a number of key problems, particularly China's undervalued currency and poor protection of intellectual property rights (IPR), both of which are fueling a dangerous, ballooning trade deficit in the U.S. The viability of the WTO itself, as the preeminent global trade organization, depends on whether it can deal with issues of the magnitude of China's IPR and exchange rate practices. If the WTO is to serve as steward of the global trading

system, it must actively and successfully confront those practices that threaten the basic structure of that system. Clearly the U.S. must take the lead with the WTO if these issues are going to be resolved.

Another key concern of the Commission has been the fate of the WTO's special oversight system for China, the Transitional Review Mechanism (TRM). During China's accession negotiations, the U.S. pressed for the TRM in order to institutionalize a formal review of China's efforts to pull its economy and government in line with WTO standards. The hope was that the TRM would expose key problem areas and put collective pressure on China to address them. Instead, China's failure to fully cooperate with this process, despite having agreed to it, has left the TRM little more than an information gathering session.

Outside of the WTO, China is pressing its trading partners to confer market economy status on its decidedly non-market economy. Not only would such a designation confer market legitimacy on China's economy, it would diminish the ability to bring antidumping actions against low-cost Chinese imports. In the U.S., the Commerce Department controls this designation, though U.S. law provides guidelines as to what constitutes a market economy. At high-level meetings in the spring of 2004, the U.S. agreed to set up a joint working group to help China understand the non-market designation and work toward achieving market economy status. Obviously, the Commission would be pleased to see China actually move toward becoming a market economy. We are concerned, however, with the possibility that market economy status will be treated as a bargaining chip to be traded away as part of a political strategy, rather than granted only when warranted by economic developments. China is a far, far cry from a market economy, by any stretch of the imagination, today.

Also on our agenda today is a discussion of the Continued Dumping and Subsidies Offset Act of 2000 (CDSOA), known as the Byrd Amendment. When the U.S. collects antidumping duties, the Byrd Amendment authorizes the government to distribute them to injured domestic producers, making it an important form of relief for U.S. firms. The WTO has ruled against the Byrd Amendment and has authorized U.S. trading partners to impose retaliatory duties. This ruling is despite the fact that nowhere in the WTO treaty is such a practice referred to, much less prohibited. We would like to determine how the U.S. should respond to this ruling—repeal the provision, accept retaliation, or search for other options.

Additionally, data collected for the CDSOA process has revealed that $250 million in antidumping duties—nearly half of the total imposed—has gone uncollected, primarily related to agricultural imports from China. We hope to shed light on this issue at today's hearing and examine ways to resolve this problem that undermines the effectiveness of our trade laws.

As evidenced in our agenda, the WTO is involved in a wide range of economic concerns that China presents to the U.S. In examining China and the WTO, we intend to maintain a sense of perspective, that we might improve our understanding of the broader trends in U.S.-China trade.

After a statement by the Commission's Vice Chairman, Roger Robinson, we'll turn the proceedings over to Commissioners Pat Mulloy and June Dreyer, who will co-chair this hearing. For myself and for the Commission, I thank them for the excellent work they have done in preparing this hearing.

All written statements submitted to the Commission by Members of Congress and other witnesses will be made a part of the record in full, and are available on the table in the back of this hearing room.

Vice Chairman Robinson.

OPENING STATEMENT OF VICE CHAIRMAN ROGER W. ROBINSON, JR.

Vice Chairman ROBINSON. Thank you, Mr. Chairman.

As the Chairman indicated, the Commission is holding this hearing as part of our continuing assessment of the U.S.-China economic relationship as we return to Washington, D.C. after two field hearings. In Akron, Ohio and Seattle, Washington, the Commission heard powerful testimony from manufacturers and other producers.

Our panelists at these hearings represent a substantial part of the base of the U.S. economy, and they are under considerable strain, as the challenges of China's economic presence multiply. They pinpoint some of the difficulties they face from China, some

of which, like the exchange rate and violations of intellectual property rights, can be addressed through the WTO.

We are using China's accession to the World Trade Organization as the hearing's frame of reference, considering both the obligations it has placed on China and the trade remedies it provides for the United States. We intend to not only evaluate China's record of compliance with its WTO obligations but also take a step back to review the manner in which the U.S. does and should respond to compliance shortfalls.

The Commission has made a number of strong findings and recommendations following past hearings in our annual report to Congress this past June. Our recommendations have been aimed at moving the ball forward on a number of key trade concerns, among them China's undervalued currency, intellectual property rights valuation, textile exports and agricultural trade.

We hope today to look at the specific mechanisms of our trade laws and the WTO as a means to redress problems in these and arguably other areas; for instance, in our 2004 annual report, which I might add was a unanimous report of the Commission, the Commission found that, quote, China is systematically intervening in the foreign exchange market to keep its currency undervalued, unquote.

On intellectual property rights, the report found that, quote, large-scale piracy at levels of over 90 percent, continues to characterize intellectual property rights protection in China and is a major concern for U.S. exporters of high-tech goods and services, unquote. In response, the Commission recommended that barring any progress U.S. trade officials should consider taking more aggressive means, including fashioning WTO cases.

Today, we have a distinguished array of panelists to help us evaluate the merits and methods of this approach. This will be the modus operandi of this hearing. In addition to cataloguing China's failures to meet WTO commitments, we want to examine potential U.S. responses to encourage China's compliance or ameliorate the effects on U.S. producers.

Where we have found previous shortcomings, we seek solutions. Where we have previously recommended action, we seek to hone implementation of these recommendations. In short, we want to build on our past work by exploring the options available to the United States to respond to the growing challenges of the U.S.-China trade relationship and its impact on the U.S. economy.

I would like to now turn over the proceedings to the Cochairs of this hearing, Commissioners Mulloy and Dreyer.

Thank you.

[The statement follows:]

Prepared Statement of Vice Chairman Roger W. Robinson, Jr.

The Commission is holding this hearing as part of our continuing assessment of the U.S.-China economic relationship, as we return to Washington, D.C. after two field hearings. In Akron, Ohio and Seattle, Washington, the Commission heard powerful testimony from manufacturers and other producers. Our panelists at these hearings represented a substantial part of the base of the U.S. economy, and they are under considerable strain as the challenges of China's economic presence multiply. They pinpointed some of the difficulties they face from China, some of which—like the exchange rate and violations of intellectual property rights—can be addressed through the WTO.

We are using China's accession to the World Trade Organization as the hearing's frame of reference, considering both the obligations it placed on China and the trade remedies it provides for the U.S. We intend to not only evaluate China's record of compliance with its WTO obligations, but to also take a step back to review the manner in which the U.S. does and should respond to compliance shortfalls.

The Commission has made a number of strong findings and recommendations following past hearings and in our Annual Report to Congress this past June. Our recommendations have been aimed at moving the ball forward on a number of key trade concerns, among them China's undervalued currency, intellectual property rights violations, textile exports, and agricultural trade. We hope today to look at the specific mechanisms of our trade laws and the WTO as a means to redress problems in these areas.

For instance, in our 2004 Annual Report, the Commission found that "China is systematically intervening in the foreign exchange market to keep its currency undervalued." On intellectual property rights, the report found that "large-scale piracy—at levels of over ninety percent—continues to characterize intellectual property rights protection in China and is a major concern for U.S. exporters of high-tech goods and services." In response, the Commission recommended that barring any progress U.S. trade officials should consider taking more aggressive measures, including fashioning WTO cases. Today we have a distinguished array of panelists to help us evaluate the merits and methods of this approach.

This will be the modus operandi of this hearing. In addition to cataloging China's failures to meet WTO commitments, we want to examine potential U.S. responses to encourage China's compliance or ameliorate the effects on U.S. producers. Where we have previously found shortcomings, we seek solutions. Where we have previously recommended action, we seek to hone implementation of these recommendations. In short, we want to build on our past work by exploring the options available to the U.S. to respond to the growing challenges of the U.S.-China trade relationship and its impact upon the U.S. economy.

I'd like to now turn over the proceedings to the Cochairs of this hearing, Commissioners Mulloy and Dreyer.

OPENING STATEMENT OF COMMISSIONER PATRICK A. MULLOY
HEARING COCHAIR

Cochair MULLOY. I want to thank the Chairman and Vice Chairman for giving me the opportunity to pull together and cochair these two days of hearings with my distinguished colleague, Commissioner Dreyer. I will be chairing today's panels, and Commissioner Dreyer will chair tomorrow's panels.

We are very fortunate this morning to have a number of Congressional Members who are going to come and share their perspectives with us. This Commission was created to serve the Congress, and the presence and active participation of Members like Congressmen Levin and Brown who are with us now helps us better understand the issues in the U.S.-China economic relationship that are of most concern to the elected representatives of the American people.

We will begin our formal panels today with representatives from the Executive Branch, the Department of Commerce and the State Department, who are directly involved in monitoring and enforcing China's WTO commitments. We invited USTR to be here; unfortunately, their key officials had scheduling conflicts, and they were unable to attend.

Given today's hearing focus on China's exchange rate practices, we also invited the Treasury Department to send a representative. We hoped to receive an update on their progress in working with China to revalue its currency. Treasury, over the last couple of years, has repeatedly denied our requests to come and testify. This is very disappointing. We continually read in the press statements from Treasury officials lauding the, quote, progress, end quote, they are making in their negotiations with China.

At the same time, regular Treasury reports to the Congress on exchange rates that are required by the 1988 trade bill continually say China is not even manipulating its currency. They are out there negotiating with China to stop manipulating its currency, and in their reports to Congress, they continually say China is not manipulating its currency. We wanted them to come and say how they get to that conclusion. Unfortunately, they are not here.

When trying to join the WTO, its accession agreement included special provisions because China was a non-market economy. Most countries entered the WTO as market economies. China's accession agreement also permitted its trading partners to utilize China-specific trade safeguards to protect themselves from the nonmarket practices that they might encounter. This was very important in getting Congress to approve China's entry into the WTO, through granting them PNTR.

We are going to hear from two prominent trade lawyers on how those mechanisms are being utilized. We are also going to hear from manufacturers and exchange rate experts on how China is carrying out its WTO and IMF obligations not to manipulate its exchange rates. It has legal obligations not to engage in this practice. We are going to hear from a gentleman who has put together a brief explaining that China is violating its WTO and IMF obligations in carrying out its currency practices that it is carrying out right now.

We will close the day today with a panel on textiles. The global agreement to control textile trade was terminated this year, in January. We fully expect China's share of the global textile market to increase very quickly. We have China-specific textile safeguards built into China's WTO agreement. We want to see how our government is utilizing those safeguards.

Finally, tomorrow, we are going to look at China's lack of progress in protecting intellectual property rights, a paramount concern of U.S. exporters. We will also have a panel on U.S. agricultural trade. Commissioner Dreyer will introduce those topics and panels tomorrow in more detail.

I want to thank both Congressman Brown and Congressman Levin for honoring us with their presence, and we look forward to hearing from them both.

Congressmen?

[The statement follows:]

Prepared Statement of Commissioner Patrick A. Mulloy
Hearing Cochair

Welcome to our important two-day hearing looking at key aspects of the U.S.-China trade and economic relationship. I thank the Chairman and Vice Chairman for giving me the opportunity to chair today's hearing along with my distinguished colleague Commissioner June Teufel Dreyer.

I'll be chairing today's panels and Commissioner Dreyer will chair tomorrow's panels. We are fortunate this morning to have a number of Congressional Members sharing their perspectives with us. This Commission was created to serve Congress, and the presence and active participation of Members at our hearings helps us better understand the issues in the U.S.-China economic relationship that are of most concern to the elected representatives of the American people.

We will begin our panels today with representatives from the Executive Branch—from the Commerce and State Departments—who are directly involved in the our government's efforts to monitor and enforce China's compliance with its WTO commitments. As in years past, we of course also invited the office of the United States

Trade Representative to appear, as they are the agency on the front lines of this issue. Unfortunately, because their key officials had scheduling conflicts, they were unable to attend this session.

Given today's hearing focus on the issue of China's exchange rate practices, we also invited the Treasury Department to send a representative. We hoped to receive an update on the progress of their discussions with China toward revaluing the significantly undervalued Chinese currency, which is operating as a large-scale subsidy for Chinese exporters and an inducement for foreign companies to move manufacturing facilities to China. Treasury has repeatedly denied our past requests to testify, and did so again this time. This is very disappointing. We continually read in the press statements from Treasury officials lauding the "progress" they are making in their negotiations with China on the exchange rate issue. At the same time, regular Treasury reports on exchange rate practices deny that China is manipulating its currency at all. We would like to question Treasury officials on this matter, because from where we're sitting it doesn't look like there has been any forward movement. To use a football analogy in this week before the Super Bowl, if the U.S. has gained any yards, it's not apparent to us.

When China joined the WTO, its accession agreement included provisions designed to compensate for the non-market elements of its economy. Most countries enter the WTO as market economies. China did not meet that test and thus its accession agreement included a detailed schedule of phased market access and market reform commitments. China's accession agreement also permitted its trading partners to utilize special China-specific trade safeguards.

Our second panel will feature two prominent trade attorneys and will examine the effectiveness of U.S. trade laws and WTO mechanisms for addressing our major trade concerns with China, including how we utilize China-specific safeguards. As part of this discussion, we will focus on the use of the Continued Dumping and Subsidies Offset Act (CDSOA), known as the "Byrd Amendment," as a tool for providing relief to U.S. firms injured by dumping from China and other countries. The Byrd Amendment has been struck down by the WTO, now the U.S. must decide how to respond.

The third panel will consider China's exchange rate practices. The Commission has clearly articulated its view that China's undervalued currency is acting as an unfair trade advantage. We have also noted that China is bound by WTO and IMF agreements prohibiting currency manipulation. We believe the time has come to explore how to address this problem through the WTO given the absence of any concrete movement by China from continual bilateral negotiations on this matter. This hearing will explore the possible options.

We will close the day with a panel on textiles. The global agreement to control textile trade was terminated at the beginning of 2005, and Chinese textile exports are expected to dramatically increase as a result. This panel will examine why a China-specific textile safeguard was included in China's WTO accession agreement and how it has been utilized.

Our hearing will continue tomorrow with panels on China's progress (or lack thereof) in protecting intellectual property rights, a paramount concern of U.S. exporters as it gets to the heart of U.S. competitiveness. We will also have a panel on U.S.-China agriculture trade, relating to market access in China as well as the dumping of Chinese agricultural products in the U.S. market. Commissioner Dreyer will introduce these topics and panels in more detail tomorrow, but it is important to note them here in the context of today's panels. Many of these topics overlap, and they certainly all fit together in building an accurate picture of U.S.-China trade.

CONGRESSIONAL PERSPECTIVES

STATEMENT OF SHERROD BROWN
A U.S. CONGRESSMAN FROM THE STATE OF OHIO

Congressman BROWN. First of all, thank you very much, Commissioner Mulloy and Commissioner Dreyer for cochairing this today. I thank the Commission especially for your visit to Akron, Ohio, and the field hearing that you did there. I know Mr. Wessel and Mr. Becker had a lot to do with that. Thank you for bringing the Commission there. That is my district. I was unable to be there because of business here, but thank you for that.

For better or worse, there is no denying that China is the great accelerator of globalization. The list of issues facing us with China,

as we know, is many, as outlined by the hearing chairs: currency manipulation, record U.S. trade deficits. China is America's largest creditor, the EU considering lifting its arms embargo, the IBM merger and sensitive technology, WTO compliance, as Mr. Mulloy just mentioned in textiles, intellectual property and agriculture, anti-secession laws and increased aggression towards Taiwan, the Byrd Amendment and illegal dumping into the United States.

Taken alone, any single one of these issues is of major concern. Taken as a whole, we should be alarmed. It's a bit like a five-alarm fire burning before our eyes; we've called the fire department, and nobody's showing up. Last fall, the administration gave senior Chinese officials a seat at the table with the most powerful G–7 countries without demanding much of anything in return.

The President missed an opportunity to stand up to China to demand they stop manipulating its currency. Such an action would be the most important immediate step the President could take to restoring U.S. exports and U.S. jobs. Instead, China gets to join the community of the world's most advanced nations without taking steps to move towards a genuine open market. When the administration allows China to break the rules, we are undermining U.S. jobs and U.S. competitiveness.

Last September, the administration failed to support a petition by industry and workers to bring a case against the Chinese for manipulating their currency at the WTO. These failures to stand up for U.S. workers are part of a broader policy of neglect where China is concerned. We are simply failing to use America's leverage of the most attractive market in the world, failing to use the leverage of being China's largest export market and the only nation with which the Chinese have a large trade surplus.

We have yet to see an effective plan from the administration to pry open the China market for our exports or a plan to combat the import surges from China or a plan to protect intellectual property of America's knowledge-based industries from Chinese theft. The trade deficit with China, as we know, has increased 91 percent since 2001. The 2001 trade deficit with China was $83 billion; last year, it is expected that when the final numbers come out, our trade deficit in 2004 may exceed $160 billion.

The U.S. trade deficit with China is soaring, in part, because the Chinese yuan is undervalued by 40 percent. Chinese leaders don't want the yuan at its real value, because they want to keep the cost of Chinese exports to America low and the cost of U.S. exports to China high. This Commission hit the nail on the head with your most recent annual report when you stated the U.S. trade deficit with China is a major concern, because it has contributed to the erosion of manufacturing jobs and jobless recovery in the United States.

In my state of Ohio, we have lost one out of six manufacturing jobs over the last four or so years. Think what that means to those families, think what it means to our communities, think what it means to our schools.

The European Union, as we know, is considering lifting its arms sales embargo to China. The EU imposed its ban on selling arms to China after the 1989 Tiananmen Square massacre. The 15-year-old embargo of arms sales to China is a clear gesture of Europe's

ongoing dissatisfaction with the pace of political reform in China and the Chinese government's continuing violation of human rights.

I hope the EU will take a broader view and reconsider efforts to lift the embargo. Lifting the embargo could very well alter the already fragile military balance across the Taiwan Strait and rapidly tip the balance in China's favor. Taiwan lives with the daily intimidation of its democratic institutions by the People's Republic of China. Lifting the arms ban could send only one signal: that a democratic Taiwan will be staring down the barrel of guns manufactured by EU democracies.

The USTR has said, quote, three areas of U.S.-China trade continue to generate significant problems: agriculture, intellectual property rights and services. Now, Chinese textiles will swamp U.S. producers and every other developing nation, since textile quotas expired for the first of last month. The U.S. says it is contemplating surge protection as provided when the Chinese were granted WTO accession. Again, our track record, though, is not encouraging.

The problem of Chinese piracy is increasing. The Chinese are pirating our technology as well as our music and our films. The value of counterfeit goods in China amount to about $19 billion to $24 billion annually, according to Beijing's own State Council. In reality, it's probably twice that much. Last fall, Josette Shiner of the United States Trade Representative's Office said we have negotiated some actions with them that will improve this, and if they don't, we will have the right to follow through eventually with trade retaliation. Eventually?

Previously, we took a tougher approach toward Chinese intellectual property violations. We signed agreements with China in 1992, 1995, 1996 that demanded progress from China and kept the pressure on. Over time, we have become more dependent on China's industries like its electronics and textiles and furniture; got swamped by Chinese imports in our auto, steel and even high-tech industries; and rely increasingly on imported Chinese components. Enough is enough.

I'd also like to congratulate newly appointed Commissioner Fred Thompson. In 2000, Senator Thompson introduced an amendment to H.R. 4444, the bill Congress voted on to extend PNTR to China. Senator Thompson's important amendment was titled the Chinese Nonproliferation Act. Unfortunately, the amendment was tabled.

In the years since PNTR, we are continuing to see a disturbing trend, the kind of trend that Senator Thompson's amendment could have helped curb. North Korea continues efforts to obtain increased nuclear capabilities. If China isn't directly responsible for North Korea's proliferation, they have certainly done little to discourage it. Why aren't we making that more of a priority? Why does the U.S. leave China responsible for negotiations on this matter when we know they simply aren't doing enough? Why haven't we stopped North Korea from obtaining nuclear arms? This is an issue that both parties agree on but the administration has failed to act upon.

The Byrd Amendment has played an important role in leveling the playing field on steel in the United States. If our steel industry is to survive, most of us in Congress believe the Byrd Amendment

is necessary. China's failure to comply with WTO obligations is having a serious adverse impact on U.S. manufacturers. China has an obligation to reverse this trend, and Congress has an obligation to reverse this trend and make China live up to its international obligations.

They manipulate currency policy; they subsidize industry; they restrict our products. Because of currency manipulation, China starts out with an immediate and artificially created roughly 40 percent advantage over their competitors. Then, throw in government subsidies that benefit Chinese producers, and the American iron and steel industries that almost 90 percent of Chinese steel production comes from state-owned enterprises.

Until and unless China plays by the rules, constructs such as the Byrd Amendment will be necessary to be fair. Unfortunately, I can't see that happening any time soon unless the administration makes real efforts to cure some of the larger problems.

Despite these dangerous trends, we continue business as usual. We allow the Chinese to buy our companies then move them there, although there are few, if any, cases of the Chinese opening up manufacturing in the U.S. The problem isn't that some things are being moved to China: our money, our factories, our credit, our industries, but that darn near all of those are moving to China.

President Bush vowed during his inauguration to end tyranny, a noble goal, a goal every Member of both parties in Congress and the American people, of course, support. But we won't reach that goal by empowering dictatorships. We won't reach that goal by allowing China to hold so much of our debt. We won't reach that goal by allowing theft of technology. We won't reach that goal by shutting down factories here to employ cheap labor there.

We end tyranny by making other nations play by fair rules. We end tyranny by stopping the threat of nuclear arms. We end tyranny by helping workers in autocratic countries. We end tyranny by rewarding countries that support universal goals and ideals. We don't end tyranny by strengthening the Chinese hand in order to turn a quick buck. We value in this country democracy and liberty. We value freedom of religion; China doesn't. We talk about mobility of labor and open markets when China has neither.

The short view on China is one of instant profits for investors but dangerous long-term consequences for all. We need to take the long-term view on China. It's a view of promoting freedom and democracy by using trade and investment tools that we, the wealthiest market, the most lucrative market in the world, have.

We're the world's most powerful economic nation, but we're clearly losing ground. If we don't do something now, we are going to be following the world economy rather than leading it.

Thank you again, Mr. Chairman, for allowing me to speak.

Cochair MULLOY. Thank you, Congressman Brown.

Congressman Levin?

STATEMENT OF SANDER LEVIN
A U.S. CONGRESSMAN FROM THE STATE OF MICHIGAN

Congressman LEVIN. And thank you very much for once again letting me come before you.

When we debated PNTR, and by the way, my statement has been distributed, and I ask that it be placed in the record, so I will spend a few minutes only; I'll try to hit what may be some of the more important parts of it. Both Congressman Brown and I are due across on the other side in about 15 minutes; so let me try to hit the highlights.

When we were debating PNTR, a number of us said it was vital to look upon China not only as a potential economic opportunity but also as a potential competitor, and the years since then have shown how true that is. Since the hearing that I was at here a year and a half ago, much has changed, but much has stayed the same.

There has been significant progress in certain areas, and the U.S.-China Business Council rated progress as satisfactory, and as I say in my statement, it is important to look at the areas where there has been progress, but in the government we have to have a higher standard than kind of a C or a D.

Our job is to make sure that there is full compliance all the time, on time, and not late or begrudging or a la carte, as I say here. A year ago, we reviewed a number of areas that were critical ones where China was out of compliance, and they are indicated in my statement: quota administration, import licensing, distribution rights issues, unreasonable regulatory burdens, and industrial policy that China has been using really to shut out us and to give a boost to their domestic production.

As I look back a few years, we had an opportunity to start right and for our government to establish, as I say here, a culture of strict compliance. But I think the record shows that culture was not embraced by the administration, and really, instead, there has been wavering back and forth, tough signals one day, weaker ones some other days, sometimes unrelated issues trumping issues of compliance.

And we put tools, tools were placed into PNTR to try to ensure strict compliance by China, and this administration has failed to use those tools effectively most of the time. Let me review them, just quickly: the Transitional Review Mechanism, the TRM, we were emphatic that the administration needed in WTO to make sure that this annual review mechanism was real, was significant, but it failed to insist on that, and instead, it has become, if not a nullity, pro forma.

You have referred to the special China safeguard that was placed in PNTR. The administration sent the wrong signals right away. The first three cases, as you know, and you have worked on this, the ITC found injury; the administration simply threw that aside. The special textile safeguard, and you are going to have testimony about that, right?

Cochair MULLOY. Correct.

Congressman LEVIN. It took 17 months for the administration to issue regulations, and then, they were unnecessarily restrictive. You may hear testimony about the threat issue, and essentially, the administration fumbled the ball, and the court now has tied our hands. The Section 301 process that is such an important one just hasn't been fully used, nor has the WTO Dispute Settlement Process, and I spell that out in my testimony.

You referred to currency manipulation. I don't know if anyone can describe what has been our country's approach to China's manipulation of currency. If anybody can, I'll be back in my office after the 9:15. It's 225–4961. But seriously, there has been rhetoric, no action, and usually, soft rhetoric, and in these semiannual reports that were required, there has been essentially a vacuum. So China essentially has gotten the message: don't worry about real pressure from the U.S. So I'll spell out some steps that need to be taken: make the annual review in the WTO real, and it's not too late to do that. Reinvigorate the China safeguard. It was fought for, and the administration just dropped the ball.

I met with some small manufacturers from Ohio and Michigan some six, eight, nine months ago. They are losing their family businesses because of subsidization by the Chinese because of currency manipulation. Some of them go back three generations, all of them small, in certain lines of business. And they said to me do something, and I said I could not agree more. So we have got to make these provisions real. I hope in the threat cases, there can be a reversal of the injunction.

There needs to be, and I guess you're going to help stimulate this, a comprehensive approach to the textile and apparel issue. Essentially, we shrugged our shoulders, and that wasn't the answer to the end of the quotas. We have to self-initiate some trade cases instead of waiting. Give life to Section 301.

I did not cover this in my testimony, maybe because it would have gone on too long, and it relates to core labor and environmental standards. We need to continue to press this issue, and now, developing nations that compete with China are beginning to see the merit in our position that we should begin to have enforceable international labor standards placed in our trade agreements.

It is not only our workers who are being hurt and very much so and our businesses, but also workers in other countries that have to compete with an economy that you talk about freedom, does anybody argue there is any freedom for workers in China to be represented? Not even when they are thrown in jail are they represented.

So this is an important hearing. Our relationship with China is an important one. There is no turning back on that. There is no denying it. We knew it was going to be large. It is probably even larger than expected. It has major ramifications for our nation, for our businesses, for our workers, for all of our citizens, and we need to focus on this relationship, and we need to set straight where it is out of kilter.

So thank you very much, and congratulations on doing this again. I hope your hearing will be heard not only within the halls of this distinguished Senate but over in the halls where Congressman Brown and I are now going. Thank you very much.

Cochair MULLOY. Congressman Levin and Congressman Brown, thank you very much for sharing with your insights with us. It is good to hear from the elected representatives of the people. Too often, people here in Washington hear from lobbyists on one side or another. It is good to hear what the people are telling you, and that is why we are honored by your presence.

Congressman LEVIN. You have not heard the end of it.

[The statement follows:]

Prepared Statement of Sander M. Levin
A U.S. Congressman from the State of Michigan

Let me start by thanking the U.S.-China Economic and Security Review Commission for its active review of different facets of the U.S.-China relationship.

During the debate over granting China permanent normal trade relations (PNTR), I emphasized the need to think about China not only as a potential economic opportunity, but also as a potential economic competitor. Experience has shown that to very much be the case.

Improvement/Lack of Improvement

Today's hearing about China's WTO commitments is an important one. About a year and a half ago, the Commission invited me to testify on the same issue. Much has changed since that time, but too much has stayed the same.

China did make significant progress on WTO compliance in certain areas in 2004. Many U.S. businesses operating in China have been able to expand their activities there as a result of reforms brought about by China's WTO commitments. Overall, the U.S. China Business Council recorded "satisfactory progress" by China in the period September 2003 to September 2004, giving it a grade of five on a ten-point scale. It is important that we recognize the progress that China has made.

It is also critical not to overstate it, however. While some U.S. firms may acquiesce in a "C" from China—perhaps affected by their investments there—the role of U.S. policymakers is to pursue a higher standard. When China joined the WTO, we did not bargain for "just barely good enough." We bargained for China to follow the rules—every one, full compliance, and on time—not late, begrudging, and *a la carte*.

Strict compliance by China with its WTO commitments has become even more vital because of China's role in the world economy. When I testified before the Commission back in September 2003, I inventoried a variety of areas in which China was out of compliance with its WTO obligations:

- quota administration and import licensing rules;
- failure to fully live up to commitments in distribution rights;
- various unreasonable regulatory burdens for service providers;
- use of standards and technical product regulations;
- industrial policy that calls for WTO-consistent measures to promote domestic production.

In some of those areas, China made significant progress. In some areas, U.S. firms have expanded market access, but China is still not complying fully with its WTO commitments. In some areas, however, the same exact problems that existed in 2003 exist today. In other areas, China has found new and innovative ways to block trade and investment or to favor Chinese producers over U.S. (and other foreign) firms. So, while China has moved forward on some of its commitments, it has not on others, leaving significantly farther to go.

Administration Allowed Culture of Non-Compliance to Emerge

In the critical first years of China's WTO Accession, there was an opportunity to establish the basic attitude of China toward its WTO obligations. It was possible to establish a culture of strict compliance. Unfortunately, the Administration allowed a culture of "compliance-as-you-please" to emerge. The Administration was inconsistent and wavering; on good days it sent mixed signals to China; on bad days it sent the wrong signal. Sometimes the Administration made strict compliance seem like a priority; sometimes it indicated that un-related issues would trump; sometimes it sounded like it would be tough and aggressive; sometimes it looked the other way; sometimes it made clear that only real progress on the ground would be acecptable; sometimes it sent a clear signal that press events with no substance or follow through would suffice.

When granting PNTR to China, Congress took steps to make certain that the Administration would have the tools available to both engage and pressure China to ensure strict WTO compliance. At best, the Administration did not effectively use the tools at its disposal; at worst, it eviscerated some of them. The Administration's record on each of the tools Congress provided is, quite frankly, sorely lacking.

—The Administration fumbled the first year of the WTO's annual **Transitional Review Mechanism**, allowing China to dictate the terms of engagement, essentially making the TRM a meaningless exercise in that year and years after.

—On the **special China safeguard**, the Administration sent the wrong signal to the Chinese. After rejecting relief in each of the first three cases where the ITC found U.S. industries had been injured, the Administration cast serious doubt on whether U.S. industry could justify the expense necessary to bring such a case.

—The Administration failed even to issue regulations for the **special China textiles safeguard** until 17 months after China's WTO accession, while imports from China increased substantially. When the regulations were finally issued, they were unnecessarily restrictive. The Administration tried to backtrack and say the regulations were less narrow than they actually appeared, but a Federal court recently enjoined the Administration from taking this expanded view.

—The Administration failed to make good use of the **Section 301 process**—which has been used as an effective source of leverage by Republican and Democratic Administrations in the past. Last year, the Bush Administration rejected three separate 301 investigations—refusing even to begin a simple investigation—against China.

—The Administration barely used the **WTO dispute settlement process** against China. Although China filed its first WTO case against the United States in April of 2002 (less than four months after joining the WTO), the Administration refused to bring a WTO claim against China until after significant congressional pressure in 2004. The Administration's refusal to use the WTO dispute settlement system to enforce U.S. rights—not only against China but also more generally—is frankly baffling.

—Exemplifying its own failures, the Administration has **attempted to claim credit for antidumping cases** brought by U.S. industry. The Administration has repeatedly trumpeted the fact that half of all antidumping investigations involve China. But that is like a judge claiming credit for the work of the prosecutors—unlike a safeguards case, the Administration has no discretion to ignore an antidumping case that meets statutory standards. To the extent the Administration has a record in this area, it is also negative—the Administration has allowed over $300 million in antidumping duties to go uncollected over the past two years, most of which were due on Chinese products.

—While using tough rhetoric, the Administration has consistently given China a free pass on its currency manipulation in the semi-annual Treasury Department report. It has most often talked quite softly, and acted not at all. The result has been, as reported in a recent AP story, an economist from a major think tank in China "stressed that the Chinese government is under no pressure to revalue its currency."

Rather than helping to establish a culture of full compliance, the Administration's back-and-forth, its inconsistency, its mixed and wrong signals, its premature claims of victory, have helped produce the opposite.

Need for an Aggressive New Approach

We will never know whether the tools Congress provided to engage and pressure China would have been sufficient had there been a far more activist approach during the crucial first years of China's WTO accession. The question becomes, what do we do given where we are now; how do we change the culture moving forward?

The first step is for the Executive to change course and act in an aggressive, proactive and consistent manner to change the culture of non-compliance that they have allowed to build. This is critical in order to bring about real and lasting improvements in China's adherence to its international trading obligations.

Immediate steps include:

- Work with other WTO members to change the terms of the annual review within the WTO so that China can no longer dodge this process;
- Reinvigorate the special China safeguard by announcing that relief will be granted in future cases in which the ITC finds injury unless extraordinary circumstances exist (*i.e.*, correct application of the safeguard standard enacted by Congress);
- Obtain a reversal of the injunction on threat cases for the special textile safeguard or issue on an expedited basis new regulations that allow threat cases;
- Negotiate a comprehensive approach to the textiles and apparel issue;
- Self-initiate trade remedy cases, rather than waiting for U.S. industries to be injured;
- Give life to the Section 301 process by self-initiating cases against Chinese practices that have cross-cutting impact;
- More actively use the WTO dispute settlement process against China;
- Make sure that China is a full participant in the new WTO Round.

If there is failure to take these steps, Congress will need to establish more effective oversight procedures and will need to consider changing U.S. laws to provide for more aggressive approaches. For example, it may become necessary to turn the USTR's annual review into a Super 301-type process, a mechanism that requires ac-

tion automatically in the areas where there has been repeated failure to achieve compliance.

Our commercial relationship with China deserves the kind of attention evidenced by the hearing before this Commission. Failure to pay serious attention and to take serious action will only lead to more difficult problems in what is increasingly a set of relationships of the first magnitude.

Cochair MULLOY. Thank you.

Chairman D'AMATO. Thank you very much.

Cochair MULLOY. We are delighted also now to have Congressman Ryan and Congressman Ney.

Congressman Ryan, it is a pleasure to meet you. You had me on a radio show with you one time, and I appreciated that, but it is a pleasure to have you here today. And Congressman, I thank you so much for being here.

STATEMENT OF TIM RYAN
A U.S. CONGRESSMAN FROM THE STATE OF OHIO

Congressman RYAN. Thank you very much, you made the radio station a little bit of money that day, so I appreciate your coming on.

I just want to first say thank you to the Commission for all you've done. I use your materials very, very often in trying to educate myself and my community through different media outlets on the economic war that we're in with China. I appreciate your doing that for us.

I would also like to thank you for allowing me to testify today. As you can see, this is really a nonpartisan issue, as we can tell by the makeup of the Commission, and my friend, Congressman Ney, who is here from a district just south of mine in Ohio.

How the United States deals with China on economic and security issues is of extreme importance. Although I represent a Congressional district in Ohio, our trade relationships with China impact all of America. When dealing with China it is immensely important to state the obvious: while the United States might be playing by the rules, China is playing to win.

The rest of the world does not have the same concept of fair play and ethics as we do in America, and we should always be very cognizant of that fact. Recently, your Commission issued a study that ranked Ohio eighth in the number of jobs lost due to America's trade deficit with China. The lost of 61,914 Ohio jobs trails 211,000 jobs lost by California and 106,000 jobs lost by Texas.

When we talk about jobs being lost in communities like the ones I represent in Youngstown, Ohio and Akron, Ohio, just south of Cleveland, it is important for us not to get caught up in the statistics. Those of us in this business seem to see numbers and just look at numbers, but the human toll, as Congressman Levin was saying; the ripple effect of losing these jobs to communities who have the same needs as far as police and fire and taking care of the services that a city provides but losing that tax base of these good, high-wage, high-paying jobs, the effect on school districts.

In my Congressional district alone, in two of the main counties, we can't pass police and fire levies. We can't pass mental health levies, levies for libraries, levies to provide basic services, school levies, bond issues. Regardless of what it is, we can't pass them, because these people are losing jobs that pay $40,000 or $50,000

or $60,000 a year and take up jobs making $9 an hour without health care benefits.

So the toll, as I know you talked a lot about in your report, of us being able to compete and educating our workers and making sure we have healthy, educated workers to compete with the Chinese on a fair playing field down the line, we are not doing that because of the human loss and the loss of the tax base in these basic communities.

So I think it is nice for all of us to say we've got to keep educating our people. We need more engineers, because the Chinese have seven or eight engineers for every one that we have. But if we don't have the resources at the local level to invest in early childhood development, early childhood education, making sure our schools get the job done, we're going to be whistling in the wind for a good long time.

Your study also showed that the rising trade deficit dislocated production that supported 1.5 million U.S. jobs. If this does not cause concern, the following statistics definitely will: the study found that the U.S. trade deficit with China has increased twenty-fold over the last 14 years, rising from $6.2 billion in 1989 to $124 billion in 2003. Study after study shows we are losing ground as we help empower a communist country that does not share our democratic values and certainly doesn't have our best interests in mind.

There can be no safety for the American people without a healthy economy and a vibrant middle class. The United States possesses a giant economy, and its influence should be used to promote fair trade and to not sell ourselves to the multinational corporations that regard making money more important than basic human values.

And I find it funny, too, how we just had an election on values, when we are dealing with a country here that basically didn't get talked about in the last election: forced abortion, sterilization, suppression of religious freedom, all of these issues that we hold so dear as American values, we are not dealing with this head on in the international community.

I want to talk for a minute on the issue of currency. On the topic of China's currency manipulation and peg, which has been set at $1 to 8.28 yuan since 1994, China operates in the international trade world by giving with one hand and taking with the other. As the economist Alan Tonelson put it, quote, think about China during the 1990s. After devaluing the yuan in 1994 and 1996, China helped bring on the Asian financial crisis in 1997.

For months afterwards, the region and the world held their breath wondering if China would offset the nearly weakened currencies of its Asian neighbors by devaluing again. When Beijing demurred, the world cheered and credited a newfound sense of international responsibility in Beijing. Yet, China fooled nearly everyone. While keeping the yuan stable, it boosted industrial and export subsidies and received many of the benefits of devaluation without paying any political price, end quote.

This is classic China trade policy, and we should be very mindful of this, as the United States encourages China to unpeg its currency. I am a firm supporter of demanding China to revalue its

currency and drop its peg, but that is not the be-all, end-all of fixing our trade problems with China. We must also reevaluate how the United States operates in the global economy.

I would also like to make note of the comments that you made at the very beginning of your report saying that we don't have much time to do this. We only have a decade or two, if we are lucky, to be able to do this, because of the strength of the U.S. economy now. And so, I think it's even more imperative for us to have this sense of urgency.

In regards to the WTO, the United States' problem with China's trade practices is a symptom of a much larger problem: the internal structure of the World Trade Organization. From January 1, 1995, to October 1, 2004, there were 318 requests for consultations in the WTO to evaluate disputes between WTO members.

Since China joined the WTO on November 11, 2001, there have been 78 requests for consultation, and China has been named the defendant only once, concerning its value added tax on integrated circuits. During the same time, the U.S. has been named the defendant 27 times or almost 35 percent of the time.

Essentially, the U.S. is the target for other WTO members. We are the target because other countries want to get into our markets. We might be the biggest economy, but we can't promote American interests when we are tied to having the same vote as member countries and, in fact, a much weaker vote than even the EU.

The EU, which is about to end its military arms trade embargo with China, is a WTO member in its own right, as are each of its 25 member states, which totals 26 WTO members. The WTO is made up of only 148 members. Why doesn't the United States have the same leverage in the WTO as the EU? Why doesn't the WTO take into account the size of its members' economies? I am going to propose in legislation that we create the likes of a Security Council within the WTO, where the United States would have veto power in the WTO, and it would represent the strength of our own economy, instead of us having the same power and influence in the WTO organization as a country that is the size of Connecticut or Rhode Island.

We are not trying to bully—I apologize to those from Connecticut and Rhode Island; you'll notice I didn't say Tennessee, Senator. We are not trying to be a bully on the international markets playground, and we want to play fair. And this is not jingoism. But we are getting our clock cleaned by not standing up for ourselves. We need leadership to get us out of our trade deficit with China. We need the President and his administration to be strong in demanding China and the rest of the WTO to play by the rules.

To this end, I have introduced legislation, H. Con. Res. 33, which urges the President to take immediate steps to establish a plan to adopt the recommendations of the United States-China Economic and Security Review Commission in its 2004 report to Congress in order to correct the current imbalance in the bilateral trade and economic relationship between the United States and the People's Republic of China.

In conclusion, I will continue to seek a get-tough approach with China and will introduce a number of bills that put a stop to the

Chinese raid of American jobs and treasure. I will encourage my peers in Congress to follow suit in helping American workers, but we need true leadership from President Bush and this administration. So far, the Bush administration's silence on the China trade gap has been deafening.

Commissioners, thank you for your great work. Your Commission was formed because of concerns regarding China's trade policies and trade agenda, and as your research has shown, those concerns have, unfortunately, turned out to be true.

Thank you very much.

[The statement follows:]

Prepared Statement of Tim Ryan
A U.S. Congressman from the State of Ohio

The hearing will examine China's record of compliance with its WTO commitments and explore options for using U.S. trade laws and WTO mechanisms for addressing continuing trade problems, including China's undervalued currency and weak enforcement of intellectual property protections.

Introduction

Commissioners, I would like to thank you for allowing me to testify today. How the United States deals with China on economic and security issues is of extreme importance. Although I represent a Congressional district in Ohio, our trade relations with China impact all of America.

Ohio

When dealing with China, I think it is immensely important to state the obvious: While the United States might be playing by the rules, China is playing to win. The rest of the world does not have the same sense of fair play and ethics as we do in America, and we should always be very cognizant of that fact.

Recently, your Commission issued a study that ranked Ohio eighth in the number of jobs lost due to America's trade deficit with China. The loss of 61,914 Ohio jobs trails 211,045 jobs lost by California and 106,262 by Texas. Overall, the study shows that the rising trade deficit dislocated production that supported 1.5 million U.S. jobs. If this does not cause concern, the following statistics definitely will. The study found that the U.S. trade deficit with China has increased 20-fold over the last 14 years, rising from $6.2 billion in 1989 to $124 billion in 2003. Study after study shows we are losing ground as we help empower a communist country that does not share our democratic values and certainly doesn't have our best interests in mind. There can be no safety for the American people without a healthy economy and a vibrant middle class. The United States possesses a giant economy and its influence should be used to promote fair trade; and to not sell ourselves to the multi-national corporations that regard making money more than anything else.

Currency

On the topic of China's currency manipulation and peg, which has been set at one dollar to 8.28 yuan since 1994, China operates in the international trade world by giving with one hand and taking with the other. As the economist Alan Tonelson put it, "Think about China during the 1990s. After devaluating the yuan in 1994 and 1996, China helped bring on the Asian financial crisis in 1997. For months afterwards, the region and the world held their breath wondering if China would offset the newly weakened currencies of its Asian neighbors by devaluing again. When Beijing demurred, the world cheered, and credited a newfound sense of international responsibility in Beijing. Yet, China fooled nearly everyone. While keeping the yuan stable, it boosted industrial and export subsidies, and received many of the benefits of devaluation without paying any political price." This is classic China trade policy and we should be very mindful of this as the United States encourages China to re-peg its currency. I am a firm supporter of demanding China to re-value its currency and drop its peg, but that is not the be all, end all of fixing our trade problems with China. We must also re-evaluate how the United States operates in the global economy.

WTO

The United States' problem with China's trade practices is a symptom of a much larger problem—the internal structure of the World Trade Organization. From Jan-

uary 1, 1995 to October 31, 2004, there were 318 "Requests for Consultations" in the WTO to evaluate disputes between WTO members. Since China joined the WTO on November 11, 2001, there have been 78 Requests for Consultation, and China has been named the defendant only once—concerning its value-added tax on integrated circuits [*the Request was made by the U.S. and that Request was resolved by a mutual agreement between the U.S. and China*]. During the same time, the U.S. has been named the defendant 27 times or almost 35% of the time. Essentially, the U.S. is the target for other WTO members. We are the target because other countries want to get into our markets. We might be the biggest economy, but we can't promote American interests when we are tied to having the same vote as other member countries, and in fact, a much weaker vote than the EU.

The EU, which is about to end its military arms trade embargo with China, is a WTO member in its own right as are each of its 25 member states, which totals 26 WTO members. The WTO is made up of only 148 members. Why doesn't the United States have the same leverage in the WTO as the EU? Why doesn't the WTO take into account the size of its members' economies? The United States has the most open market in the world. We are not trying to be a bully on the international market's playground and want to play fair, but we are getting our clock cleaned by not standing up for ourselves.

We need leadership to get us out of our trade deficit with China. We need the President and his administration to be strong in demanding China and the rest of the WTO to play by the rules. To this end, I have introduced a piece of legislation, H.Con.Res. 33, which urges the President to take immediate steps to establish a plan to adopt the recommendations of the United States-China Economic and Security Review Commission in its 2004 Report to the Congress in order to correct the current imbalance in the bilateral trade and economic relationship between the United States and the People's Republic of China.

Conclusion

In conclusion, I will continue to seek a get-tough approach with China, and will introduce a number of bills that put a stop to the Chinese raid of American jobs and treasure. I will encourage my peers in Congress to follow suit in helping American workers, but we need true leadership from President Bush and his administration. So far, the Bush administration's silence on the China trade gap has been deafening.

Commissioners, thank you for your great work. Your Commission was formed because of concerns regarding China's trade policies and trade agenda, and as your research has shown, those concerns have turned out to be true.

Cochair MULLOY. Congressman Ryan, thank you very much for being here with us, and we look forward to continuing to work closely with you.

By the way, that 2004 report was adopted unanimously by this bipartisan Commission. That brings me to Congressman Ney. We are delighted that you are here with us as well, sharing bipartisan concerns from the Congress on these issues.

STATEMENT OF BOB NEY
A U.S. CONGRESSMAN FROM THE STATE OF OHIO

Congressman NEY. Thank you.

Well, thank you, Mr. Chairman, and it is good to be here with my colleague from Ohio, Congressman Ryan. And I think the Commission is important. A lot of people back home say, well, what is really going on and, where is our future? But I think the Commission is important, and it takes the testimony; it gets some items on the record. It helps, I think, with decisions. You all come up with some credibility for us and some things to continue to back.

After the last decade I have been in Congress, we have worked some issues. Mr. Becker and I saw more of each other than we wanted to see probably for a few years on some steel issues, and that one came out pretty good. The Stand Up for Steel Campaign, which was a multistate campaign, came to the streets of D.C. when

President Clinton was in office and simply wanted a level playing field.

We lost on a couple of issues, and I give President Bush credit; he did a 201, very controversial. Europe was upset, and some people were upset in the manufacturing areas of the potential price on steel. Of course, as I said at that time, when the cheap, dumped steel came in the country, and I bought my son his car, I don't remember that the price of the car went down when we had cheap, dumped steel. But all of a sudden, the price was going up another $1,000, which it actually probably should have been maybe $10 more. So I think a lot of things were misconstrued there.

But the 201 and the followup, I wasn't completely happy when the administration didn't go the extra time, but, at the end of the day, the President actually turned out correct on that. We got the tariffs to where we needed them, the 30 percent, but we wouldn't be sitting here today, Wheeling Pittsburgh Steel and Wierton Steel and a lot of other steel companies just literally would have folded and went away.

And that was a 10-year process, and we worked with the company, the Steelworkers, the Independent Steelworkers Union. We worked with citizens from six years old that came with their parents to senior citizens, and it was a great effort. Unfortunately, you can't do that in the streets of D.C. every single time on an issue.

I will give you one other example: Dave Johnson, actually from Congressman Ryan's district up in Columbiana County, Ohio. When he sells his tile overseas, it is a 56 percent tariff on his tile. And his company has struggled. They're coming out of bankruptcy. But he is assessed 56 percent. The Chinese tile is assessed, I think, 6 percent when it comes in here. It is just not fair. It is an unlevel playing field. If Dave Johnson is paying 56 percent, then, the gentleman from China should be paying 56 percent when it comes in here. Now, that is not protectionism; that is common sense.

So the steel effort was great, but again, you just cannot always bring 10,000-some people every single time; I wish you could, to the streets of D.C. So that is why I think you are important; the efforts we put out on a bipartisan basis are important in Congress to do this.

I know my home state has been talked about and the job losses, but I would like to also focus in on something I think is important to mention for the record: in October of 2000, we enacted the CDSOA, the Continued Dumping and Subsidies Offset Act, also known as the Byrd Amendment, Senator Byrd.

That amendment appeals to foreign governments and encourages them to comply with trade rules they negotiated with the United States in the first place, and it lets the U.S. Government fine foreign companies that we judge to be selling goods in America at a below-market price as a result of unfair trade practices such as the illegal dumping that I spoke of and foreign subsidization. The revenues of those fines are then paid to U.S. companies affected by the unfair trade practices, which is common sense.

The World Trade Organization disagreed with the measures of the Byrd Amendment. In August of 2004, a WTO arbitrator determined that members of the organization could impose retaliatory countermeasures. The arbitrator's findings are problematic, how-

ever, because neither the WTO nor our trading partners have been able to demonstrate that they have suffered any adverse trade effects caused by the implementation of the Byrd Amendment. Thus, the U.S. is not required by either U.S. law or WTO jurisprudence to repeal the law or to pay compensation to any of our trading partners.

The Byrd Amendment has impacted the United States economy favorably. It is a good amendment. It has allowed American steel producers to compete against unfair trade practices. For instance, the Congressional Budget Office estimates that there are currently over 130 antidumping orders relating to iron and steel mill products, 30 relating to iron and steel mill pipe products, and 30 relating to other iron and steel products.

In the past, there have been three disbursements under the Byrd monies, distributing over $231 million for fiscal year 2001, $330 million for fiscal year 2002, $190 million for fiscal year 2003, and approximately $234 million for fiscal year 2004. These figures, combined with the fact that the United States faces a trade deficit of over $500 billion with China, clearly suggest that something must be done to ensure the viability of our American steel industry.

The Byrd Amendment assists many steel producers by enabling them to pay down accumulated debt, to obtain working capital and remain viable to keep the jobs going for the people that live in the communities. This includes providing affected steel companies with the means to invest in new manufacturing facilities, equipment, technology and worker retraining to ensure that they may continue to compete despite facing the continued unfair and illegal trade practices of foreign producers.

By doing so, the Byrd Amendment assures that American steel workers do not have to jeopardize their livelihood, and they do not have to lower their standard of living or quality of life. The Byrd Amendment puts America first, frankly.

I'd like to mention that members of the domestic steel pipe tube and fittings industry strongly support the Byrd Amendment, while the industry's largest producers, such as Wheatland Tube Company, which operates Seminole Tubular Products in Cambridge, Ohio, in the district I represent, was established in 1986 as an expansion from their Houston, Texas operations and employs 120 workers, who are provided with good-paying jobs and benefit the local economy. So I just wanted to mention the one manufacturer, but I just wanted to point out that the Byrd Amendment is important.

Let me just sum up by saying that we can compete when it is a fair, level playing field. I haven't gone into the entire other important issues of human rights of Chinese women that are worked 28 days out of a month, given one day off; when they are 28 years old, they are retired because they are worn out. All of the things that are going on, and I know my colleagues have talked about. Those are important, too.

I hope one day that the Chinese people get tired of the pollution cloud above Beijing, and they get tired of making what I would consider slave labor, and they stand up to the government to say we want a different situation. It will improve their lives, and frankly, it will make a more level playing field here.

I want to stress, 25 years ago when I was a state rep, I might have came out to Washington and said protectionism, and we've got to stop all imports. Now, when I was a kid down in Bellaire, Ohio, if I picked up at G.C. Murphy's a foreign toy, I got backhanded potentially by my dad until I put that toy down. You just didn't buy foreign things. I know life has changed in the United States, but I've got to tell you: the attitude has changed, too. It's not a protectionism. You're not hearing protectionism from the companies, and you're not hearing it out of the unions. Again, 25 years ago, we might have taken a line like that, but we understand the global market and the global economy.

But it's just not fair. It is not fair at all, and this is not fair competition. When I was asked to vote permanently for the WTO, for China's entry, which I didn't do, I can remember my friends in the National Cattleman's Association said, after all, we are going to be able to sell some cattle; this will be good for the jobs.

Ask them today, because I do, how many herd. I think it's two herd, 1,500 total to China, because guess what? Our cattle maybe needed to be tested more. It wasn't clean enough. They'll find 100 reasons; they're smart; they really are. They'll find 100 ways to skin that cat plus five more.

So I think that it is going to take a bipartisan cooperative effort. You're keeping the issues alive. The effort has to be there with the administration and Congress to simply say give us a level playing field. It is better for the Chinese people, for their condition, and it's better for us, too.

So I thank you for the important job that you have, and thank you for letting me be here.

[The statement follows:]

Prepared Statement of Bob Ney
A U.S. Congressman from the State of Ohio

Mr. Chairman, Members of the Commission, thank you for allowing me to join you today to discuss this very important issue.

Over the past decade, America's manufacturing base has been severely harmed and countless high-paying jobs have been lost as the result of foreign governments who have chosen to engage in unfair trade practices. Of these foreign nations—China has been one of the most egregious offenders. Year after year, China has consistently refused to follow the rules of international fair trade, and I for one do not believe we can have free trade, without fair trade.

My home state of Ohio has experienced the loss of 170,000 manufacturing jobs since 2001. In the steel industry, more than three dozen U.S. steelmakers, including the former Weirton Steel Corporation (now International Steel Group—Weirton) and Wheeling Pittsburgh Steel Corporation, were forced into bankruptcy after unfair steel imports, many of which came from China, flooded the market in the late 1990s. In recent years, America's domestic steel producers have reduced production capacity, closed numerous inefficient mills, and significantly cut jobs.

As a result of these and other unfair trade practices, in October 2000, Congress enacted the Continued Dumping and Subsidy Offset Act (CDSOA), also known as the Byrd Amendment. The Byrd Amendment appeals to foreign governments by encouraging them to abide by the very trade rules that they negotiated with the United States in the first place; it lets the U.S. Government fine foreign companies that it judges to be selling goods in America at below-market prices as the result of unfair trade practices such as illegal dumping and foreign subsidization. The revenue of these fines is then paid to U.S. companies affected by unfair trade practices.

The World Trade Organization, however, disagreed with measures of the Byrd Amendment, and in August 2004 a WTO arbitrator determined that members of the Organization could impose retaliatory countermeasures. The arbitrator's findings are problematic, however, because neither the WTO nor our trading partners have been able to demonstrate that they have suffered any adverse trade effects caused

by the implementation of the Amendment. Thus, the United States is not required either by U.S. law or WTO jurisprudence to repeal the law, or to pay compensation to any of its trading partners.

The Byrd Amendment has impacted the U.S. economy favorably. It has allowed American steel producers to compete against unfair trade practices. For instance, the Congressional Budget Office estimates that there are currently over 130 anti-dumping orders relating to iron and steel mill products, 30 relating to iron and steel pipe products, and 30 relating to other iron and steel products. In the past, there have been three disbursements of CDSOA monies, distributing over $231 million for FY2001, nearly $330 million for FY2002, $190 million for FY2003, and approximately $234 million for FY2004. These figures, combined with the fact that the United States faces a trade deficit of over $500 billion with China, clearly suggest that something must be done to ensure the viability of our American steel industry.

The Byrd Amendment assists many steel producers by enabling them to pay down accumulated debt, to obtain working capital and remain viable. This includes providing affected steel companies with the means to invest in new manufacturing facilities, equipment, technology, and worker retraining to ensure that they may continue to compete, despite facing the continued unfair and illegal trade practices of foreign producers. By doing so, the Byrd Amendment ensures that American steelworkers do not have to jeopardize their livelihood, and that they do not have to lower their standard of living or quality of life. The Byrd Amendment puts America first.

I would like to mention that members of the domestic steel pipe, tube and fittings industry strongly support the Byrd Amendment. One of the industry's largest producers is Wheatland Tube Company, which operates Seminole Tubular Products Company in Cambridge, Ohio which is in my Congressional District.

It was established in 1986 as an expansion from their Houston, Texas operations and today employs 120 workers who are provided with good paying jobs that benefit the local economy. For a 128 year period involving four generations, this company has held its place as one of the last U.S. manufacturers that is family owned and operated. This company has received offset distributions over the past few years under the CDSOA which have helped them direct resources to their manufacturing operations. While these financial benefits have been helpful, the company today is also struggling with the competition of a surge in imports from China which is contributing to grave economic conditions. In fact, these imports have directly been attributed to recent layoffs of approximately 200 workers at Wheatland's Sharon, Pennsylvania facility.

While these U.S. companies are prepared to compete head-on with foreign competitors, they must also be able to compete fairly. As has been noted by others today, imports of a variety of products from China have been taking even greater percentages of market share for numerous producers and growers. In the standard pipe industry alone, imports skyrocketed from 9,849 tons in 2002, to 92,043 tons in 2003 and 266,661 tons in 2004. The industry fears that these numbers will only grow in 2005 and therefore it will be important that companies like Wheatland and others are able to use the trade laws to remedy these unfair trade practices which threaten the future of the industries.

The Continued Dumping and Subsidy Offset Act enjoys a massive amount of support from a diverse group of U.S. businesses as well as a large majority of the United States Congress. And in order to ensure that American steel can compete and survive these illegal and unfair practices of other countries, Congress should continue ... it must continue ... to be involved in reaching a favorably negotiated solution at the WTO.

Cochair MULLOY. Congressman, thank you very much for being here.

Chairman D'Amato wanted to make a comment.

Chairman D'AMATO. Congressman Ney, I wanted to congratulate you on that very powerful testimony and also on your comments about how we can be competitive in this as long as we have a fair playing field and also your comments on the Byrd Amendment. As you may know, about half of the duties that we are owed as a result of the Byrd Amendment cannot be collected because of the behavior of Chinese exporters and their agents, and there was legislation passed last year in the Senate to correct that. Unfortunately, it didn't go all the way, and we hope that we will get that.

Senator Byrd is coming this morning to talk about his Byrd Amendment; we hope that we can get some support to get that through this year, and that would about double the fines that we can pick up. Most of that behavior is Chinese imports, about 90 percent of the uncollected fines from Chinese exporters.

Thank you very much for your testimony.

Congressman NEY. Thank you, sir.

Cochair MULLOY. We are going to take a short break until a new group of Congressmen and Senators arrive.

[Recess.]

Cochair MULLOY. Senator, thank you for being here.

Senator SCHUMER. Oh, thank you.

Cochair MULLOY. We are delighted to have with us now Senator Schumer from New York, who has been out in the forefront of this issue dealing with the Chinese currency manipulation. Senator, we are honored by your presence.

STATEMENT OF CHARLES E. SCHUMER
A U.S. SENATOR FROM THE STATE OF NEW YORK

Senator SCHUMER. Thank you, and the honor is mine. I want to thank the Commission for the great work that it has done. I will be joined shortly by my colleague and partner in this endeavor, Senator Lindsay Graham of South Carolina.

First, I want to thank you all for the opportunity to address this very distinguished Commission on an issue that is so vital to our economic security. While I am happy to be here with all of you, I'm not happy that a year and a half has passed, and at least on the issue that Senator Graham and I are working on, virtually nothing has happened. In sum, we've gotten nice words from China repeatedly and no action.

I was also, frankly, disappointed that the President did not address this, which is going to be one of the most major issues of the decade, in his State of the Union Address, but I look forward to working with the administration and seeing if we can get them to take a more proactive role.

Now, I want to recognize my two colleagues in this, which are Senator Graham, who I mentioned; also, Congressman Sandy Levin, and I know he spoke earlier, and we're all working together on this. They've been great partners in the fight.

Now, we are here today because we continue to be concerned about China's many misdeeds. The list is long. China manipulates its currency, violates intellectual property laws, limits access to their markets subsidizes Chinese companies, all of which leads them to fail to comply with many WTO rules.

I'm going to talk about currency manipulation, but it is just so frustrating, ladies and gentlemen, every place I go in New York, I hear stories about how China is not playing by the rules. Let's assume that we are all 100 percent free traders, that the Ricardo theory is alive and well. Still, China doesn't play by the rules. And with all of the natural advantages of free trade that they have, for them to try to grab that extra $10 billion or $20 billion in trade account is to me just appalling.

I am going to deviate a little from my text and tell you one little story. Cortland, New York, is an industrial town 30 miles south of

Syracuse. It has had rough times. It is where they used to make Smith Corona typewriters. Anyone bought one of those lately? Buck Bemeers, which made a lot of ball bearings was there.

But the one saving hope of Cortland is a company called Marietta, not Martin Marietta; a different Marietta. It employs about 1,000 people. It's growing. It's adding about 100 people a year. But the head of Marietta called me, and he wanted to share with me his problems. I went and visited the factory.

What Marietta makes is something you have all used. They make the little soaps and shampoos when you go to a hotel and motel that are in your bathroom, and the way they have garnered, they are the leaders in this, and the way they garner it is they sign a contract with the leading hotel chains and say all you have to do basically is pick the size of the soap, the smell of the shampoo; we will make it, and we will make sure that every room in your hotel chain worldwide has the soap and shampoo, et cetera, that you want.

One country doesn't let Marietta's products in: China. So when they sign a contract with Hilton, they will cover all of Hilton's hotels everywhere in the world but China, and China now makes its own little shampoos and soaps. They are busy competing with Marietta not only in China but also in East Asia and now Europe, using the protected base of China, which they can charge whatever they want, because there's no competition, to then compete elsewhere.

I said to the head of Marietta, Mr. Florescu, why don't you go take this to the WTO? And he said, well, in about eight years, I will get a ruling, and we will be out of business.

Now, I hear a story like that over and over and over again. I hear it from large companies; I hear it from small companies. These are not debatable; these are not issues maybe free trade or not free trade, this or that. And so, it adds to the frustration when China so openly violates the maxims of free trade.

I am going to get to currency now—the impact of China's undervalued currency in our home states and the toll it's taking on workers is not improving. Actually, the toll it is taking on our nation is detrimental to our economic vitality. All of us here represent broad sections of the country, and our presence at this hearing illustrates the importance of this issue.

As the Commission knows, China's currency, the yuan, has been tightly pegged to the U.S. dollar since 1994 at a rate of approximately 8.28 yuan to the dollar. During the past 10 years, the Chinese economy has grown dramatically. In 2004, GDP growth was approximately 9.5 percent; it's averaged 8 percent over the last two decades.

But because China continues to peg its currency, in 2004, we saw record trade deficits with China. As of November last year, our record trade deficit with China grew by 25 percent. That is one quarter of our national trade deficit. China's foreign reserves are estimated to be $609 billion, and on Monday, February 7, we will get the full picture when the trade numbers are released. If there's anything you can be certain of, it's the situation has gotten worse since 2003, when China's official reserves rose from $154 billion to $403 billion.

The job losses here in America have been devastating. The United States has lost close to 3 million manufacturing jobs, 90 percent of which were in the last five years. In my State of New York, we have lost 100,000. And last year, we saw a huge deficit in the area of advanced technology products, an area of strategic importance to our country. Losses in this particular field raise the question of whether in the world in which we live, the United States can afford not to have expertise in the techniques and technologies that are used to manufacture the tools and sometimes weapons we use to defend ourselves.

Now, most experts say we are witnessing a dramatic and rapid shift of manufacturing capability from the U.S. to China. But manufacturing is not the only place that's hit. Manufacturing has been hardest hit, but manufacturing jobs are not the only ones at risk. When manufacturing jobs are lost, so are jobs in trucking and warehousing and banking and insurance. There's a chain effect.

So we know there's a real problem. Now, I don't want people to think that I think that the manipulation of the currency is the only reason this has happened. There are many, many other reasons. But this is a serious problem, and it's a problem where, at least on an intellectual basis, there's a consensus: no one thinks the Chinese should manipulate their currency.

In the last year, we have found some unusual partners. Who is suffering from this manipulation now? The Europeans. Because the Chinese currency is pegged, the Europeans pay the price in terms of currency ranges, and since you can't have the yuan float, it puts new pressure on the euro, and as you know, the euro in regards to the dollar is higher and higher each day, and that has hurt the Europeans.

So there seems to be almost a world consensus that what the Chinese are doing is wrong. Compare them to India: India is a country that is also taking jobs and has its own trade problems, but overall, India plays far more fair and closer to the rules than the Chinese. The Indian model would be one that you could look at and say hey, this is how it ought to work. I'm not sure I agree with that, but at least you could make an intellectual argument that that is the case. You can't do that with China.

I'm going to put my entire statement in the record, because it's lengthy, but let me tell you: for one year, Senator Graham and I have been asked by the administration, a year ago when we introduced this bill and spoke to you about it, to slow down and let them try to do this by negotiation. I couldn't agree more. Negotiation is the best way to go.

But we have gotten nowhere. Negotiation hasn't produced a thing in terms of creating fairness, and it is my judgment that the Chinese will only move when they think they are being forced to, when they see the alternative is worse, because on area after area in trade, there is virtually no cooperation, and so, we are going to move this legislation this year.

My hope is when it passes the Senate, and I believe it will at some point during the next six months, that the Chinese say okay, we'll negotiate. We'll set a better rate. And we're not demanding that it be done in one year overnight; we understand there has to be some transition, but the bottom line is that we can no longer

afford to wait. We have enough to deal with, with the changing world under the rules of free trade. We ought to at least make it fair and make it right, and we don't even have to reach the issue of whether free trade is the right way to go and whether the Ricardo rules work anymore and what we ought to do about them.

We have 10 sponsors of our bill, bipartisan, Democrats and Republicans, and this is the year. We are going to move it, and I hope we don't have to, but I don't think we have any choice.

I'm ready for your questions.

[The statement follows:]

Prepared Statement of Charles E. Schumer
A U.S. Senator from the State of New York

I want to thank you for the opportunity to address this distinguished Commission on an issue that is vital to our economic security. While I am happy to be here with you all, I am not happy that a year and a half has passed and we are still battling this issue. I would like to recognize two individuals for their tremendous leadership on the issue of currency manipulation. They are Senator Lindsey Graham and Congressman Sander Levin (who I know spoke on the earlier panel.) Both of these Members have been great partners in this fight for fairness and I look forward to working with them on this issue in the 109th Congress. I am also delighted to be joined here today by my esteemed colleagues in the Senate, Robert Byrd, Mike DeWine, Mary Landrieu and Byron Dorgan, and my colleagues in the House, Congressmen Bob Ney and Sherrod Brown.

We are all here today because we continue to be concerned about China's many misdeeds. The list is long. China manipulates its currency, violates intellectual property laws, limits access to their markets, subsidizes Chinese companies—all of which leads them to fail to comply with many WTO rules. But, today I will not focus on all of these issues. Just one. Currency manipulation.

The impact of China's undervalued currency in our home states and the toll it is taking on our workers and businesses are not improving. Actually, the toll it is taking on our nation is simply detrimental to our economic vitality. All of us here today represent a broad cross section of the country and our presence at this hearing illustrates the importance of this issue and this hearing to the United States and the future of our economic security.

As this Commission knows, China's currency, the yuan or renminbi, has been tightly pegged to the U.S. dollar since 1994 at a rate of approximately 8.28 yuan to the dollar. During the past ten years, China's economy has grown dramatically. In 2004, China's GDP growth was approximately 9.5%, averaging over 8% annually for the past two decades.

Because China continues to peg its currency, in 2004 we saw record trade deficits with China. As of November of last year our trade deficit with China grew by almost 25 percent. This number represents one quarter of our national trade deficit. Today, China's foreign reserves are estimated to be over $609 billion. On Monday, February 7th, we get the full picture when the trade deficit numbers are released. If there is anything I can be certain of it is that the situation has gotten dramatically worse since 2003 when China's official reserves rose from $154.7 billion to $403.3 billion.

China has enjoyed unparalleled economic success, but only by flaunting the rules of international trade. While China continues to enjoy its questionable success, American workers are fighting for their livelihoods.

Our job losses have been devastating. The United States has lost close to 3 million manufacturing jobs—90 percent of all the jobs lost in the last five years. In my state of New York we have lost approximately 100,000 manufacturing jobs and it continues to grow every day. The most discerning part is that the manufacturing sector is less than 14 percent of the American workforce.

Three million jobs lost clearly shows that millions of America's hardest working people find themselves unjustly in the ranks of the unemployed in part because of unfair Chinese trade practices. When these jobs and skills leave this country they are not coming back.

Last year, we saw a huge deficit in the area of advanced technology products—an area of strategic importance to our country. Losses in this particular field raises the question of whether, in the world we live in, the United States can afford to not have expertise in the techniques and tech-

nologies that are used to manufacture the tools and sometimes weapons we must use to defend ourselves. I would say, "we can't afford to."

Many experts believe that we are witnessing a rapid shift of manufacturing capability from the United States to China. Mostly because both Chinese companies and some U.S. companies are drawn not only by the low cost of quality labor, but also by the added benefit of a 15 to 40 percent purchasing power advantage. China's emergence as a manufacturing powerhouse at the expense of the United States raises significant economic security concerns and the question of whether a country that loses its ability to produce tangible products will long remain an economic power.

While manufacturing has been hardest hit, manufacturing jobs are not the only ones at risk. When manufacturing jobs are lost, so are jobs in trucking, warehousing, banking and insurance. There is a chain effect that reduces the overall productivity of the U.S. as a location of economic activity. Some studies indicate that each manufacturing job generates over four other jobs, the highest multiplier of any industrial sector.

We are also witnessing the loss of jobs much higher up the value chain. These were the very jobs that people displaced by manufacturing were supposed to move into. In fact the new economy was supposed to be based in information technology and services—jobs like engineers, designers, radiologists, stock analysts, accountants, and researchers, in addition to clerical, customer service and telemarketing workers.

But now those jobs are also leaving the U.S. at a rapid rate. What jobs will be left for American workers when all these jobs move overseas?

My colleagues and I hear the real life impact of these losses countless times in our home states. A local business works hard to succeed in the world market. They know it is tough under the new rules of globalization. But they are ready, willing and able to compete.

But when they face a competing good or service coming here from China, which gets a 40% price break, it makes it impossible to make a profit or stay in business.

I have watched plant after plant close in upstate New York over the past few years because China's unfair advantage allows them to sell their products lower than the cost of the materials used to produce them. Month after month we have watched our largest export industry—the manufacturing sector—take it on the chin.

Don't get me wrong—I am fully aware that there are other factors responsible for the pain in our manufacturing industries. But this problem is a serious one and one we can address. It is important we do so—as President Bush himself has acknowledged—the state of our manufacturing sector is clearly one of the driving factors in our nation's current and prolonged economic difficulties.

The Administration has made clear that our country's manufacturing capability is a matter of national security. Yet they have taken no definitive action to address this problem. This brings me to another area of grave concern.

The Administration has engaged in quiet diplomacy for years now and it continues to fail. Over the past several months President Bush, Secretary Snow, Secretary Evans and Ambassador Zoellick have all attempted to convince China's leaders to revalue their currency. And, every time the Chinese government has made it clear they are working on their own schedule. And what does the Administration do? Continue to talk.

China continues to thumb their nose at us because the Administration lets them. The Administration continues to use diplomatic measures that clearly do not work.

The Treasury Department in their bi-annual reports to Congress continues to refuse to acknowledge that the Chinese are even manipulating their currency.

When we call China's misdeeds to the attention of the Administration they choose to ignore us. In the fall of last year the U.S. Trade Representative rejected the Section 301 petitions filed by the Fair Currency Alliance and the Congressional Currency Coalition led by Congressman Levin and me. Many groups such as ours have utilized the tools in place to protect against the injury caused by China's undervalued exchange rate, but repeatedly have been unable to find support in an Administration that claims to understand the importance of an industry that is vital to our nation's economic success.

Teddy Roosevelt once advised that the best negotiating strategy was to, "speak softly and carry a big stick." Taking that advice we had hoped quiet encouragement could get China's leadership to see the light. It has not worked.

In late September of last year the Treasury issued a joint statement with China in which it "reaffirmed" China's promises to "push ahead firmly and steadily" to end its currency manipulation practices. Two days later, the Deputy Governor of the People's Bank of China made clear that China had no intention of addressing this issue in a meaningful timeframe, stating: "We have already said, time and again, that we are moving towards more market-based, supply-and-demand based, exchange rates. How long it takes, I don't know. … Because China has an 8,000-year history, a decade is truly a short period. I have been asked numerous times, 'What is the timeframe?' I tell them, 'No timeframe.'"

More recently, on January 12, 2005 China's Commerce Minister Bo Xilai told Former Secretary of Commerce Donald Evans: "Judging from the view of friends and judging from the achievements of your work, I should say that 70 percent of what you have done has been pretty good."

While it is certain that this statement was not intended as flattery, a brief look at Chinese history reveals that it was probably more insulting than it even appeared. An expert in Chinese history explained to me that after Mao Zedong died in 1976, Deng Xiaoping took over as supreme leader of China. Deng, who had been purged by Mao three times before taking power after his death, famously declared that Mao's role in history was "70 percent positive and 30 percent negative." This would later come to be known as the seven-three formula. Many China experts believe that Deng had really believed that Mao's contribution had been the opposite, 30 percent good and 70 percent bad. As such, although there is no way to know for sure, Bo Xilai's claiming Sec. Evans was 70 percent "pretty good" was, in fact, a way of saying he has done more harm then good.

So, because China has given us no other choice and our Administration has given us no other choice, it's time now to bring out the big stick.

Today, Senator Graham and I are introducing a straightforward bill that we feel will level the playing field. We are joined by 10 of our colleagues—this is a bi-partisan effort. Senators Reid, Durbin, Kohl, Dole, Bunning, Stabenow, Dodd, Levin, Clinton and Bayh have joined us today to introduce a bill that allows for a 180 day negotiation period between the U.S. and China, if the negotiations are not successful, a temporary across the board penalty will be applied to all Chinese products entering the United States—a penalty that corresponds to their estimated currency advantage.

Since economists estimate China undervalues its currency between 15 percent and 40 percent, our bill institutes a stiff 27.5% tariff, the mid-point of those figures. If China ends it unfair play, this tariff will never have to be levied. I have always said that this is not my first choice of action. The Chinese government can easily avoid all of this action by taking the responsible steps to revalue its currency to reflect its fair market value.

Our bill is compatible with the rules governing international trade set by the World Trade Organization. The Chinese government's trade practices are deeply harming a vital U.S. industrial sector. They are damaging the manufacturing industry almost beyond repair.

China's trade status has long been debated. It has at times been a very contentious debate in this very body. Over the years Members have been deeply concerned about China's human rights policies, its commitment to democracy and basic freedoms, its military intentions, and its trade practices.

But, China had long sought the status of full membership in the world trading community and formally entered the WTO on December 11, 2001, nearly four years ago. And many of us supported them by voting in favor of China's permanent most favored nation trade status.

But we did it with an understanding that—as U.S. trade negotiators had argued—the Chinese government was fully committed to eliminate many of its trade distorting practices within a short period of time. As we know, one of the major areas of focus and concern was China's currency practices. Yet on the one-year anniversary of China's entry into the WTO, the United States Trade Representative issued a report that raised serious concerns over China's compliance with its WTO commitments. Today we are still talking about those same concerns.

We think there is no more broad based and serious violation of the spirit and rules of international trade than a purposefully undervalued currency. When those conditions are violated, the system must respond or else the actions of one nation will upset the whole global balance.

China's undervalued currency is not simply a United States issue or problem. China's manipulation has become a real threat to our global economic system. With the yuan pegged to the dollar, and as the dollar

weakens against the euro—China's currency also falls against the euro. This evolution, if not corrected immediately, threatens to cause weakness in the European economy, thus, threatening the entire global economy. Our international partners are deeply impacted as well, and the strength of our international trading system is called into question when one of the largest trading nations in the world does not abide by the rules and spirit of international trade agreements.

So it is in the interests of free trade—in defense of free trade—that we are urging action. We cannot turn our backs and allow one major nation to engage in mercantilist policies.

China's continued flaunting of the rules and spirit of international trade undermines the validity and authority of our international agreements. And the failure of the U.S. to hold China accountable demonstrates an absence of traditional U.S. leadership on world trade issues.

As their economic data vividly illustrates, China has benefited greatly from membership in the world economic community. Their economic growth has been enormous. We feel strongly that it is only fair that they abide by the terms and spirit of the community's rules and responsibilities.

Our bill serves to support the very foundation of free trade. As we know, free trade is a delicate balance. It rests on certain conditions—multiple nations both weak and strong abiding by a common set of rules.

For all these reasons, my colleagues in Congress and I feel we must take legislative action to hold China accountable to the commitments it has made to the United States and the international community.

For the good of American workers, and for the sake of our international trading partners and free trade systems, it is time to hold the Chinese government accountable for its unfair and illegal currency practices.

Thank you for allowing me to speak today at this very important hearing.

Cochair MULLOY. Senator Schumer, I thank you again.

Senator SCHUMER. Can I ask consent that my entire statement be included in the record——

Cochair MULLOY. Oh, absolutely.

Senator SCHUMER. Thank you.

Cochair MULLOY. Senator Schumer, just a couple of things I wanted you to know: we've invited the Treasury Department to come to a couple different hearings here to talk about how they can maintain that China is not a currency manipulator in these reports that they send to the Congress that Congress required in law in the 1988 trade bill.

Yet, they say they're going over to negotiate with the Chinese about currency manipulation but fail to fulfill their statutory duty. It's an amazing situation——

Senator SCHUMER. Yes, it is.

Cochair MULLOY.—and they refuse to come here, because we want to ask them questions how they figure that out.

Senator SCHUMER. I'll tell you one thing, Commissioner: I remember once about nine, 10 months ago, Secretary Snow was going to China to, quote, negotiate, and the Chinese said before he landed, don't even talk about this; we're not changing. That's some negotiation.

Cochair MULLOY. The other point I wanted to mention, in the 1988 trade bill, I think you had the primary dealers amendment.

Senator SCHUMER. That's the model.

Cochair MULLOY. That's the model, and maybe you just want to take that and spin off that for a minute.

Senator SCHUMER. Let me explain that: you know, we always face these situations. It's never been as broad as currency manipulation, which, of course, affects every product, manufacturing, service, whatever. But when Japan was growing, they did the same

thing. Growing countries tend to do this. And, our bill, for instance, does not apply to tiny little countries that peg their currency to the dollar; they need that kind of stability. But when you become a big, big power, when you have such a huge trade surplus, balance of trade surplus, then, it matters.

Well, Japan was very strong in 1986, but they weren't that strong in financial services, and they wanted to become big players in financial services, obviously of great importance to my home city of New York. And they wouldn't let American companies in. If you were a New York or an American bank, you couldn't open an ATM machine in Japan. If you were a New York securities firm, Merrill Lynch was not allowed to buy a seat on the Tokyo Stock Exchange. They said there was no room; that it was all taken up by Japanese companies. And I became frustrated: well, what did the Japanese really want? They wanted to become primary dealers, which meant that they could sell the currency, they could underwrite bonds, U.S. Treasury bonds, which is big prestige and brings you a whole lot of benefits.

So I put in a bill when I was a Congressman that said the Japanese, no country could become a primary dealer unless their markets were open to us. It was the same outcry that I heard about this bill, everything the same: A, it will create a trade war. Well, it's not going to create a trade war, because trade is in the interest of both countries, and the economies of both countries would go down if that happened.

B, the Japanese then had all our currency. They'll dump our currency. Well, we knew that wouldn't happen, because that would be cutting their nose to spite their face. They have $1 trillion or $100 billion in U.S. Treasuries. They're not going to try to drop the price of their whole investment, because they can't sell it all at once, that kind of amount, on the market. So they'd sell a little bit of it, and then, the price goes down, and the rest of their investment is worse; all of these things.

But we persisted in our bill. I passed it in the House of Representatives. It took a lot of work, lot of resistance, just as there is, there's resistance in the Senate. This is the wrong approach. No one disagrees with the result of our legislation, but it's the wrong approach. And it's not the best approach. I would much prefer to see this done by negotiation.

But anyway, we passed this in the House, and all of a sudden, the Japanese opened up their markets, and it created thousands of jobs in New York and elsewhere in the United States, and it was better for both countries, because there was free competition in both places. It was an area where we had an advantage, we still do, thank God, banking, securities, insurance, and it worked.

And so, I'm not deterred by the editorial boards or the others, the nay sayers who say, who paint these pictures of gloom and doom, because I've been through it once before, and I'm confident we're going to get this done.

Cochair MULLOY. Senator, just one comment: we are having testimony later today from a lawyer with the Collier Shannon law firm who has done a brief showing how the Chinese currency manipulation violates both its IMF and WTO obligations and setting forth

a pathway maybe even to bring a WTO case. We'll make sure that your staff gets a copy of his statement.

Senator SCHUMER. I'd love to see it. I'd love to see it.

Cochair MULLOY. Can you stay for a few questions, Senator?

Senator SCHUMER. A few questions, yes; I have to go to the Judiciary Committee but——

Cochair MULLOY. Commissioner Wessel.

Commissioner WESSEL. Thank you, Senator, for all your work over a very long period of time, not only in the House but for what you continue to do, and if I remember correctly, you have just gained a seat, you have earned it as well, on the Trade Subcommittee, I believe, of the Finance Committee.

Senator SCHUMER. I am; I'm on Finance. It was my goal in life to get on the Finance Committee.

Commissioner WESSEL. Well, you have achieved your goal.

Senator SCHUMER. Here I am, Lord.

Commissioner WESSEL. It's great news especially because of your leadership on this issue.

We heard from I think it was Congressman Ney just a couple of minutes ago about a manufacturer in his district that faces a 56 percent tariff on the products they make going into China; only 6 percent here. You mentioned Marietta. We have seen a number of companies all across this country raising concerns.

At the same time, we are engaged in the Doha Round, which is about to confer additional benefits on the members of the WTO in terms of lower tariffs. Some have started to question whether we should start phasing benefits in, that, for example, a country like China, you're able to engage in the negotiations at the WTO, but we put the new trade benefits on the shelf until there is some certainty that you have actually complied and enforced your previous commitments; again, all the various things you've talked about, distribution rights, et cetera.

What are your views of that, of letting them participate but basically saying until you comply, you don't get the rest of the benefits? Let's not give it to you right away.

Senator SCHUMER. I don't think there's probably a set rule. Some cases, it would work; hold everything back, in others, it would work, use carrots and sticks.

I've got to tell you: to me, if we have the will, we will get this done. It's a question of will. And I've talked to Secretary Snow. He's a fine man. I knew him when he was the head of the CSX Railroad, when they had all those changes, when they took over Conrail. We had a lot of issues in upstate New York, and he was very supportive.

But there is no will, and so, I don't think I have to tell you. I think until the Chinese see the handwriting on the wall, and they're going to be forced to change, they're not going to change. And we can beat around the bush and come up with, you know, twist the dials a little on the approaches. I don't put much faith in it. Otherwise, they might have shown us a little bit of change themselves, which they have not.

Cochair MULLOY. Chairman D'Amato has a question, Senator.

Senator SCHUMER. I'll take one from the Chairman, and then, I want to let my colleagues speak.

Chairman D'AMATO. Very quickly, Senator, thank you very much for your very powerful testimony, and we think that we're a product completely of the legislature, and you are our main client, our only client, and we think legislative will has credibility with the Chinese.

Last year, we made a recommendation that the U.S. look at bringing a currency case in the WTO.

Senator SCHUMER. Yes.

Chairman D'AMATO. Since that time, we have visited again with the WTO just in the last month. We believe, and we're going to have some testimony today on it, but I personally believe that the time is right for us to bring a currency case in the WTO, and there basically is a foundation for it; we should pursue it, and I think that would give another route to this, along with your route, which route gets to the goal line first. That's our——

Senator SCHUMER. Exactly. I think pursuing a case is a good idea. The research that we did before we even introduced the bill, because if this violated the rules of the WTO, it would go for naught. It is our view that our legislation is in consonance with the WTO and would be upheld by the WTO. The only problem is, as you know, these things take a long time.

Nonetheless, I think having two tracks is a great idea, and I would be supportive of what you're doing.

Chairman D'AMATO. Thank you, Senator. These things take a long time, but the one case we did bring against the Chinese, they settled out of court within a month. So it may be that that will be the incentive to get this thing rolling.

Senator SCHUMER. Let us pray.

Chairman D'AMATO. Thank you very much for coming today.

Senator SCHUMER. Thank you, thank you, Chairman, and thank you, Commissioners, and again, I want to compliment both my colleagues here, Lindsay Graham, my partner in the Senate on this, who I talked about this before, and Congressman Strickland, who has really been a leader on this issue not only in the House but in the country.

Cochair MULLOY. Thank you, Senator, for being here with us.

Senator Graham, would you mind if we asked Congressman Strickland to join you.

Senator GRAHAM. Please.

Cochair MULLOY. I know you want to speak on the same matter that Senator Schumer spoke on. Senator?

STATEMENT OF LINDSEY GRAHAM
A U.S. SENATOR FROM THE STATE OF SOUTH CAROLINA

Senator GRAHAM. Thank you.

Well, we are back again talking about the same stuff, and talk doesn't work, does it? I haven't seen any movement by the Chinese based on talk, and if you want to sue them, sign me up. I don't know if it's a contingency case or not, but—we'll let Fred do it. The funny thing is it's not funny. Every part of the economy is beginning to be sympathetic to this particular issue of the currency valuation. I'm trying to make contact with the European Union. They have spoken about how this adversely affects their economic abilities, and at Davos, John was there; I didn't get to go; I don't know

how that happened, but the Chinese pretty much told us that there are no plans soon to do anything.

I know there's somewhat of a ripple effect: if they do anything overly dramatic, whether you revaluate or you float the currency, I'm not so sure what the right solution is, but the status quo is the wrong solution for the American economy and for all the competitors of China.

This body has appointed you to do a job. You have done that job, and we seem to listen to no one. We don't seem to listen very closely to our business interests who are telling us this is hurting our ability to compete in the international marketplace, because the Chinese currency is manipulated in a fashion to give our competitor an advantage that we cannot secure ourselves.

So the legislation that Senator Schumer and I are authoring in the Senate, this is the second go-around. I was promised last year that we would have hearings, and this would be a statement that the Chinese would hopefully take seriously. Secretary Evans, our recent Department of Commerce Secretary, has done a good job of going to China. The President has spoken openly about the currency problem.

But I am confident with this communist dictatorship that they are looking for deeds, not words. So I am wholly endorsing a two-prong strategy or a five-prong strategy. I think there is an element that we need to look at in the Congress where we enlist the European Union, other nations that are competing in the world marketplace with China and have a world voice: take legal action and legislative action but have the world community, the international community who believes in basic fairness in business transactions to loudly proclaim this policy must come to an end and allow the Chinese to readjust the value of their currency in a way that is fair to the Chinese consumer, will not disrupt the Chinese economy overly and allow our companies to compete.

It's not just the currency issue. I come from a textile state, so I am often easily written off as a guy trying to protect a dying industry. Well, let me tell you that the industries I am worried about are not just textile industries. If you make a widget in America, and China decides to make the same widget, you are in trouble, not because the Chinese are smarter or they work harder, but because they have a way of manipulating the marketplace that is inconsistent with free and fair trade.

It is not my goal to build a wall around my country. It is my goal to knock down walls built by people who cheat. Transshipment of goods is a chronic, consistent problem, and I'm always told we just need more customs agents. Well, what we need to do is have a more forceful pushback by using international regimes like the WTO on all fronts.

I am told that the Chinese constantly and continuously pirate American-produced videos starring Fred Thompson, denying his children a fair return on his money, on his work effort. I am constantly told by the entertainment industry that the music and the video, the movie industry, is under assault by Chinese piracy. I am constantly told by people who do business in China that our intellectual property is at risk; we want to do business in China, but we don't want to go to China and have our intellectual property

copied and stolen and the Chinese open up a business right across the street making the same product in an unfair way.

You have told us repeatedly this is a problem. Now, my statement is not to you but to the body: when will we take this seriously? How many more jobs will we lose to unfair competition before we stand up for fairness in the workplace? And my hope is that this dual track of WTO action, legislative action and the third prong being international community outcry will bring some reason to the problem.

I am here to let my colleagues know that this year will not go by without us addressing this in the Senate. I have only been here two years, but I have learned one thing: if you really want to do something, it's hard to shut you out. Whatever bills come down the pike eventually are going to have this put on it. I think it is now time for the United States Senate, and I appreciate our House colleagues, taking the recommendations of this Committee seriously, because they were seriously given.

You represent a wide array of talent in our nation, so I would encourage you to be vocal, because it helps people like me and Senator Schumer. And the fact that Chuck Schumer and Lindsay Graham are doing anything together is an amazing political moment. Chuck and I have come to an agreement on this: whether you live in New York, or South Carolina, whether you're from the right side of the aisle that we are all being affected unfairly. So I really appreciate what the Commission has done, and you have my promise and my pledge to try to take your product and do some good with that product for the American consumer and the American business community.

Thank you very much for having me.

[The statement follows:]

Prepared Statement of Lindsey Graham
A U.S. Senator from the State of South Carolina

Thank you for the opportunity to appear before you again. I appreciate the work this Commission and its Members are doing to highlight the issues facing us.

We *know* that China continues to flaunt international standards and agreements when it comes to trade. We *know* they continue to peg their currency to the dollar in clear violation of their WTO commitments.

China's currency manipulation hurts U.S. manufacturers, it hurts American workers, and quite frankly it hurts Chinese consumers.

The Chinese currency policy also puts incredible pressure on the European Union as it stifles growth. As the former EU Commissioner for external Relations, Chris Patten, pointed out: "There are concerns on the level of the Chinese exchange rate."

As many of you know, I have been working with Senator Schumer and others to encourage the Chinese to move forward on a market-based valuation of their currency to give American manufacturers a level playing field.

This continued policy of pegging the yuan to the dollar results in a 29% tariff on all American exports into China and a 29% subsidy of their goods coming here and results in a steady supply of hard currency for the government in Beijing.

I think it's long past time for this to change. If China wants to be part of the community of nations, this is one of the best places they can start.

I would also encourage the regime in Beijing to begin abiding by the agreements they have already signed.

And what can we do?

The United States, on all levels of government, must do a better job of enforcing the agreements we have and start holding accountable our supposed partners to these agreements. That means STOP transshipping and protect intellectual property. Don't pay lip service to these issues, *DO SOMETHING* about them.

On the transshipment front, we *know* the Chinese continue to flaunt their international obligations. We know that even with the repeal of quotas on all textile and

apparel at the beginning of this year, the Chinese prepared to transship billions of dollars of goods through Southeast Asian, Central American, and African countries should those quotas be reinstated. China must stop its daily attempts to circumvent the very agreements they signed. They must STOP TRANSSHIPMENTS.

On the intellectual property side, we *know* that the Chinese government has attempted to enforce some rules, but only after their own intellectual property began to be copied, stolen, and reproduced. By the time a movie is released here in the U.S., you can buy a bootleg copy of it for the equivalent of one dollar on the streets of China.

My only real hope in the intellectual area is that the pinch on China's domestic industry will lead to a crackdown on violators of patent and trademark laws and agreements.

In conclusion we need to act decisively on several fronts:

1. Enforce our existing trade agreements, especially before we consider others;
2. Join forces with other free market economies, to fight the China threat;
3. Balance our own budget, this will reduce China's ability to react to our new get tough policies;
4. Protect intellectual property rights;
5. And press strongly for a revaluation of the yuan.

I appreciate what the Administration has done on this issue, but if we continue to press the Chinese on these issues and they don't respond, we can only blame *them* for so long.

Eventually, and I believe that time has come, we must blame ourselves for doing nothing to stop the erosion of our manufacturing base.

If you won't stand up to the bully, you can only blame the bully so long.

We need to act aggressively, decisively, and immediately.

Cochair MULLOY. Senator Graham, thank you very much for being with us. I just want to make two comments before we turn to the Congressman: we are going to have a panel later today on the utilization of the textile safeguard and how that has worked, and then, tomorrow, we're having a panel on intellectual property rights and the lack of protection going on in China. These will be subject to some additional recommendations in those areas for your consideration.

Finally, I just want to mention the IMF. If we file a WTO case, the WTO will look to the IMF for advice on this exchange rate issue. It's very important for our government to be working the IMF process. And I think you and others will pass that message on to Secretary Snow, because I don't think they have been as active as they should be.

Senator GRAHAM. Well, we will gladly do that, and I'll end with one last comment. I have a statement I would like to submit for the record. When you talk about the textile industry, I don't think any industry in America should be considered a dying industry, because it can't compete against unfair competition. If it dies for lack of innovation, lack of capital, lack of attention to detail, lack of work ethic, so be it. That's capitalism. But if it's dying because it can't compete against a country that manipulates everything about the marketplace, that's unfair.

One last comment about the textile industry: the highest rate of employment for African-American women in the South is in the textile industry. I'm going to be 50 in July. There are a lot of people my age who have textile jobs that pay them benefits in terms of retirement and health care, and where are they going to go? Are they going to get cross-trained into another industry that also is subject to China's manipulation and cheating?

This is a huge problem for a lot of Americans regardless of political affiliation. Thank you for your work.

Cochair MULLOY. Thank you Senator.

Congressman Strickland, thank you for being here with us.

STATEMENT OF TED STRICKLAND
A U.S. CONGRESSMAN FROM THE STATE OF OHIO

Congressman STRICKLAND. Thank you, Mr. Chairman.

Thank you, Mr. Chairman, and I would just love to associate myself with every word that the good Senator has just spoken. I have a statement that's longer than I will read, and if I could submit it for the record, I would appreciate that.

Cochair MULLOY. It will be included in the record in full, Congressman.

Congressman STRICKLAND. Thank you very much.

I represent the Sixth Congressional District of Ohio. My district stretches for about 330 miles along the eastern and southern border of Ohio. It is a district where there have been steel mills and a lot of other heavy manufacturing in the past, and those jobs, sadly, many of them are now gone.

I would just like to briefly mention three things in regard to China: the first is the trade deficit. The trade deficit with China in 2004 is projected to be as high as $160.5 billion, nearly a 30 percent increase from the 2003 trade deficit. In January of '05, a report to this Commission, the Economic Policy Institute states, and I quote, the rise in the United States' trade deficit with China between 1989 and 2003 caused the displacement of production that supported 1.5 million American jobs.

Some of those jobs are in the textile industry; many of those jobs are in the steel industry. I also represent a lot of pottery and china companies that certainly are suffering right now. So it is just so critically important that we acknowledge what's happening to our job base.

China's unfair trade practices, more has been spoken here than probably needs to be spoken about this to illustrate the point, but in my district there are steel mills in bankruptcy, shuttered factories, empty industrial parks, laid off manufacturers, former employees of the service providers that once supported the manufacturing sector, and now, laid off workers from call centers and technology companies.

And while my constituents in Ohio are retraining, searching for jobs, collecting unemployment, what is the administration doing to push China, what is this Congress doing to push China to meet its WTO commitments? I feel troubled by the lack of what I think is effective response on the part of our government. I get tired of continually responding as the WTO rules against the United States, often resulting, in my judgment, in the repeal of our own sovereign laws or causing us to back down on tariffs.

It makes me especially angry to know that while we are being held accountable to other nations through this process that I consider flawed, China is getting away with this currency manipulation because we seem to stand idly by, refusing to use the processes available to us in a way that could correct this serious problem.

I would just like to say something about what I would consider the need to enforce the trade laws: in addition to the manipulation of its currency, it seems that we as a government are prepared to

let the steel monitoring program expire, and there are those within the administration who even advocate for the elimination of the Continued Dumping and Subsidy Act, which is known as the Byrd Amendment.

The steel import-monitoring program, which was part of the President's steel safeguard program in 2002, under current Department of Commerce regulations, is going to expire next month. This program is a critical tool that enables government and industry to identify surges in imports from our trading partners. I am hopeful that the President will acknowledge the value in making the steel monitoring program permanent and expanding it to cover all steel mill products. I am aware of no objections to this program, and I sincerely believe that the continuation and expansion of the steel-monitoring program really shouldn't take a second thought on the part of the government.

In closing, I would like to briefly underscore the importance of keeping the Continued Dumping and Subsidy Offset Act, also known as the Byrd bill. Again, the administration has the opportunity to stand up and to protect injured U.S. industries and their workers by defending this vital amendment. There are those within the administration and probably within the Congress that have proposed eliminating the program under pressure from our trading partners.

This important legislation is a lifeline to American companies fighting to survive in an increasingly competitive and sometimes hostile world marketplace. This is a perfect example, in my judgment, of how we are refusing to defend ourselves by using trade laws that are available to us.

Thank you for allowing me to be here. Thank you for accepting my total statement for your record, and thank you for your interest in this issue and what I hope will be significant help forthcoming as we face these critical issues.

[The statement follows:]

Prepared Statement of Ted Strickland
A U.S. Congressman from the State of Ohio

Thank you for the opportunity to be here this morning to share with you my serious concerns about the United States' trade relationship with China.

In 2003, Chinese exports to the Unites States represented over a third of all Chinese exports. There is no doubt that the U.S. has leverage to make certain China complies with World Trade Organization (WTO) commitments. However, the current Administration refuses to use the trade tools designed to ensure compliance. Instead, our progress with China is being measured by the exploding amount of cheap goods and services being imported to the U.S. Using this test toward progress is unconvincing, unwise, and unacceptable. The Bush Administration's willingness to turn a blind eye toward China's unfair trade practices at this critical time forecasts the American people as the inevitable loser.

I would like to discuss three topics today: (1) our trade imbalance with China, (2) China's unfair trade practices, and (3) better enforcement of trade laws.

Trade Deficit

The U.S. trade deficit with China is now larger than our trade deficit is with Japan, Canada, Mexico or any other trading partner. The trade deficit with China in 2004 is projected to be as high as $160.5 billion. (Congressional Research Service, *China-U.S. Trade Issues*, January 26, 2005). This is nearly a 30% increase from the 2003 trade deficit with China. In a January 2005 report to this Commission, the Economic Policy Institute (EPI) states, "The rise in the United States' trade deficit with China between 1989 and 2003 caused the displacement of production that supported 1.5 million U.S. jobs."

The EPI report continues, "the number of job opportunities lost each year grew rapidly during the 1990s, and accelerated after China entered the World Trade Organization (WTO) in 2001." I cannot overstate the need for the United States to address these job losses and trade deficit trends immediately while we still have leverage with China to make meaningful progress, both economically and politically.

Maintaining a manufacturing base in this country is imperative—our national security depends on it. In fact, this Commission's 2004 report states, "... manufacturing is critical for the nation's economic and national security. ..." Ignoring China's failure to meet market access commitments closes the door on export opportunities for many of our industries—agriculture, intellectual property, pottery, steel, and more.

Even three years after accession to the WTO, China continues unfair trade practices and does so with little consequence. If our government checks China's bad behavior with inaction arguing such inaction is best for our national interests, China may lock our export door permanently leaving the United States holding a very large IOU for Chinese goods and services. How can we allow China's unfair trade practices to continue when we know it harms it our manufacturing base and threatens our national security?

I know I am not alone in this view as the 2004 report this Commission issued to Congress states, "If we falter in the use of our economic and political influence ***now*** to effect positive change in China, we will have squandered an historic opportunity." (2004 Report to Congress of the U.S.-China Economic and Security Review Commission, June 2004).

China's Unfair Practices/Currency Manipulation

In discussing China's trade advantages, I would like to invite the Commission to consider illustrating its next report on the effects of the trade imbalance with China by visiting the Sixth Congressional District of Ohio. There, you will see steel mills in bankruptcy, shuttered factories, empty industrial parks, laid-off manufacturers, former employees of the service providers that once supported the manufacturing sector, and now increasingly workers laid off from call centers and technology companies.

Ohio workers are desperate to make it, and they are willing to do whatever it takes to support themselves and their families, but there is only so much they can do to beat the relentless slide brought on by meager wages, human rights violations, intellectual property robbery, and disregard for the WTO agreement.

And while Ohioans are re-training and searching for jobs, what is the Administration doing to push China to meet its WTO commitments so that we realize true trade equality and political reform with China?

My frustration with the Administration is evident, just as it is evident that China refuses to take steps to re-value its currency. And why shouldn't they refuse, ***when no one is urging them to cease this behavior, which allows every Chinese industry—from socks to steel—to flood the U.S. and European markets with goods that are artificially cheap?***

By intentionally manipulating its currency values, China makes *every one of its exports* artificially cheap when it reaches the shelf in the U.S. On the other side of the coin, currency manipulation makes *every one of our exports* artificially expensive when it reaches the shelf in China. What's more, this manipulation is clearly illegal under China's IMP and WTO commitments.

As a Member of Congress, I continually respond to WTO rulings against the United States, which often involve repealing our own sovereign laws or backing down on tariffs. But it makes me especially angry to know that while we are being held accountable to other nations through this WTO process, China gets away with currency manipulation because our Administration stands idly by, refusing to use the process in a way that could begin to correct the gross imbalance of trade between these two countries.

Convincing China to re-value its currency certainly may not be the silver bullet that will once and for all create fair trade between these two nations, but it would be a very significant step toward eliminating the excessive trade deficit that punishes American workers and threatens the manufacturing base that has been the foundation of our economy for generations and is essential to our national security.

Better Enforcement of U.S. Trade Laws

In addition to the Administration's acceptance of China's manipulation of its currency, it seems prepared to let the steel monitoring program expire and even advocates for the eliminate of the Continued Dumping and Subsidy Offset Act, known as the Byrd Amendment.

Under current Department of Commerce regulations, the Steel Import Monitoring Program, which was part of the President's steel safeguard program, will expire next month. This program is a critical tool that enables government and industry to identify surges in imports from our trading partners. I am aware of no objections to this program and sincerely believe continuation and expansion of the steel monitoring program should not take a second thought.

I must briefly underscore the importance of keeping the Continued Dumping and Subsidy Offset Act, also known as the Byrd Amendment, (CDSOA) on the books. Again, the Administration has the opportunity to stand up and protect vital U.S. industries and their workers by defending the Byrd Amendment. Instead, this Administration has proposed eliminating the program under pressure from our trading partners. This important legislation is a lifeline to American companies fighting to survive in an increasingly unfair and hostile world market. This is a perfect example of the Administration refusing to defend our trade laws and it is unacceptable.

In addition, Public Law 106–286, Normal Trade Relations for the People's Republic of China, Section 421, authorizes the President to provide trade relief for U.S. manufacturers from market disruptions attributed to imports from China. Under the law, increased duties or other import restrictions could be levied to protect U.S. producers from economic harm. *However, under the law, it is at the discretion of the President to determine whether or not such safeguards on behalf of domestic producers are in the national economic interest or could threaten our national security.*

There have been at least five completed Section 421 investigations. In three of those cases the International Trade Commission found that increased imports threatened to cause market disruptions here at home. Unfortunately, in those three cases, the President decided *not* to grant trade relief. He defended that position by claiming such relief would not be in the national economic interest of the United States. With that response, I can only assume, the Administration is neglecting to look past today and into our nation's future.

I firmly believe we are at a critical time for our nation with respect to China. We can no longer stand by applauding cheap Chinese imports with no recognition of the potentially devastating consequences this trade relationship may have on our economy at home and the ability to defend our country. Too much is at stake. In the short run, cheap goods and services are desirable. In the long run, we risk our leverage with China and our way of life in America.

Cochair MULLOY. Congressman, thank you very much. Do you have time for a question or two?

Congressman STRICKLAND. Oh, I certainly do, sir.

Cochair MULLOY. In the Senate, we have the Schumer-Graham bill. Is there a strong sentiment for similar legislation in the House?

Congressman STRICKLAND. Well, I think there would be. I'm a member of the steel caucus, and we met week before last with eight industry leaders, CEOs. We talked extensively about many of the problems that are being discussed here this morning, especially with regard to China. I do believe that there is a growing recognition that we do face a very serious problem, a problem that should be addressed as soon as possible, and so, I do believe, in response to your question, that there is strong and growing sentiment in the House that we take action.

Cochair MULLOY. Senator Byrd is on his way, but does any other panelist have a question for Congressman Strickland?

Commissioner BARTHOLOMEW. Mr. Chairman, not a question but a comment. We, of course, were up in Ohio in September for a daylong hearing and heard about the impacts on Ohio industries. One of the comments that was made that day has really stayed with me. It was one of our small business witnesses who said that Ohio's biggest export is its young people, because there is no future for them there economically. I think that we hold that in mind as

we have listened to so many people, what is the economic future for the young people, both in Ohio and across the country, and when are we going to do something about it?

So, Congressman Strickland, thank you.

Congressman STRICKLAND. Thank you. If I can just respond. Senator DeWine gave a speech in Ohio a few weeks ago and one of the things he emphasized was the fact that so many young people, I think age 18 to 34, were leaving Ohio because of lack of job opportunities. It is a very, very serious problem.

The good Senator mentioned the textile workers. Along the Ohio River, which is in the heart of Appalachia country, we have china and pottery factories, the Homer Lauchlin China Factory produces Fiestaware, which a lot of people know about. These companies have existed for over 100 years. There are not a lot of jobs to replace those jobs.

I've met with the managers of those companies. They are incredibly concerned that the products flooding into this country from China, much of it mimicking their products, taking and trying to camouflage what they're doing so that it looks like it's a Homer Lauchlin product. It's a very serious situation. If these jobs leave, there are no comparable jobs to replace them.

That is why I think speed is of essence here. This problem has existed for a long time. It is growing in its importance. But the longer we wait, the more jobs that are going to be lost, and once some of these jobs are lost that we are discussing here, it's going to be incredibly difficult—we will never be able to bring them back.

Cochair MULLOY. Congressman, thank you very much.

We are honored now to have the presence of Senator Landrieu and Senator Byrd. We will wait a few minutes and then start. Congressman Strickland, we can't thank you enough for being with us, and we'll look forward to working with you and your staff.

[Pause.]

Cochair MULLOY. I'm going to turn the chairmanship back over to Chairman of our Commission, Richard D'Amato.

Chairman D'AMATO. Thank you very much, Cochairman Mulloy. The Commission is delighted to welcome Senator Byrd and Senator Landrieu with us today. We are honored to give a special welcome to you, Senator Byrd, who more than anyone else is the father of this Commission and has given us unstinting and unwavering support since the outset of our work.

Senator Byrd has also been an ardent champion for the many, many businesses and industries in the United States who have been unfairly damaged from imports dumped through subsidies and other ways in our economy, below market prices, in particular, more and more from China. He took action, supported by both bodies of the Congress, to reimburse those American producers for the damage they have endured in nearly every state of the union in a law called the Continued Dumping and Subsidies Offset Act of 2000.

That action has drawn a sharply negative response from the WTO in a very controversial decision based on a wildly broad interpretation and exaggerated self-authority on the part of the WTO.

We look forward to your comments on this issue as well as others involving thing WTO and so-called globalization.

Senator Byrd, this Commission continues to work, pursuant to your inspiration to bring justice and fairness to hard-working Americans and American businesses. Thank you for taking the time to visit with us this morning.

STATEMENT OF ROBERT C. BYRD
A U.S. SENATOR FROM THE STATE OF WEST VIRGINIA

Senator BYRD. Thank you, Mr. Chairman, and I consider myself fortunate to have with me here this lovely lady from Louisiana, Mrs. Landrieu. I know her father. I knew him when he was Mayor and visited with him at that time.

I thank all of you, and I thank you, Mr. Chairman, for your dedication to this effort and for the inspiration that you bring to it, an inspiration that is infectious. And I thank all the Members, all of the other Members. I thank Vice Chairman Robinson and the Co-chairs of this esteemed U.S.-China Economic and Security Review Commission, for inviting me to speak today on the topic of the Continued Dumping and Subsidy Offset Act of 2000.

I greatly appreciate your providing me with this opportunity to discuss the merits of this important U.S. trade law and for permitting me to appear here today with so many of my distinguished friends from both the House and Senate. In this regard, I would first like to express my congratulations to the newest Member of the U.S.-China Economic and Security Review Commission, former U.S. Senator Fred Thompson, who was just appointed by Senator Frist to serve a two-year term on this august body.

I trust that he will find time to complete his work on the Commission in between filming takes on his popular television program, Law and Order. Law and Order, what a man—where he plays, let me tell those who may not know, where he plays District Attorney Arthur Branch.

While preparing for this hearing, I was thinking about who is actually a better actor: Dick D'Amato or Fred Thompson.

I decided that all things being equal, Senator Thompson is certainly a more convincing actor.

Well, congratulations to you both. You are great friends; you are great Americans. I shall never forget my service with Fred Thompson in that great forum, where every state is equal, where every Senator is equal, some more equal than others, and which is the foremost upper body in the world today. No other Senate, except perhaps the Roman Senate in its heyday, comes nearer to being and having the history of the United States Senate. Well, I will save further talk on that serious subject for another day.

I would like to begin, Mr. Chairman, by explaining the purpose of the Continued Dumping and Subsidy Offset Act, also known as CDSOA, and why it is so important to our nation. This law was enacted five years ago to give U.S. companies injured by unfair foreign trade, including unfair trade with China, the ability to invest in their factories and workers with funds collected by the Customs Service on unfairly traded imports.

Under other U.S. trade laws, Customs imposes antidumping and countervailing duties on dumped and unfairly subsidized for-

eign products in an attempt to force foreign exporters to charge a fair price. But in spite of these efforts, many foreign traders, including Chinese producers, refuse to trade fairly. Instead, they continue dumping year after year after year. And the prices of these dumped Chinese and other foreign imports continue to unfairly undercut the prices of American-made products sold here in our own country.

Faced with the loss of U.S. market share, American producers struggle to stay afloat, unable to invest in new plants and equipment and unable to meet their payrolls and provide necessary health and pension benefits for their workers. And this is particularly true for small businesses and our nation's farmers, ranchers and aquacultural producers.

Continued dumping damages our companies and robs our workers of their livelihoods. CDSOA was enacted to prevent these losses by restoring conditions of fair trade so that jobs and investment that should be made in the United States are not sent overseas or outsourced as a result of unfair competition.

Each year, our Customs Service collects duties imposed on unfairly traded imports from nations like China, which continue to ignore our trade laws. These collected duties are held in special accounts at Customs until the fall of the year, when companies that have been unfairly injured by foreign trade can apply for and receive these funds as reimbursement for their having invested in themselves and in their workers.

American manufacturers of axes and shovels—I believe we had the greatest shovel manufacturer in the world in Parkersburg, certainly, at one time. My wife and I once took a trip around the beautiful isle of Ireland, and we saw on our trip a castle, a beautiful castle with a lake out in front of it and some swans and geese out there, and we spent the night there, and everything inside was in red: the upholstery, the tablecloths, the carpets; everything was in red. This was owned by a constituent of mine in Parkersburg. He didn't know I was going there, so I didn't expect him to have anything in particular special for me.

But that used to be the greatest shovel company in the world. I don't know whether it is or not. We have lost so many of our smokestack industries to unfair trade. American manufacturers of axes and shovels, like the family-owned firm of Warwood Tool Company of Wheeling, West Virginia, and producers of lumber, wheat, shrimp, catfish, bearings, mushrooms, crawfish, pasta, steel, raspberries, furniture and a long list of other industrial and agricultural producers stand to be reimbursed. Why shouldn't they be? They stand to be reimbursed under the law for having borne the cost of bringing successful trade practices against illegally traded imports.

Now, the WTO is trying to force the United States to repeal this law and rewrite our trade laws to allow wave after wave of dumped and unfairly subsidized goods from China and elsewhere to flood the U.S. market. We cannot allow it, and I hope we will be determined not to allow it. The United States is a sovereign nation. It cannot be forced to comply with yet another wrongheaded WTO decision.

The WTO was overzealous in striking down this law. It overreached. This WTO ruling was technically beyond the scope of the WTO's legal mandate. The WTO had no authority to issue a ruling against our law. Instead, the WTO incorrectly read into international agreements a prohibition against CDSOA that was never approved by any WTO negotiator, certainly none empowered to negotiate for the United States.

The WTO cannot force the United States to repeal its law. No overzealous, pointy-headed WTO pseudo intellectual has a vote—none—in the United States Senate, and no WTO panel can force the United States to abandon our law.

That was a very difficult piece of legislation to enact. It started out one night, probably about 11:00 p.m. or 12:00 a.m., I believe, Mr. Thompson, in an Appropriations conference with the House of Representatives. You may have been there, Mr. Chairman; I don't recall. And there were strong arguments on behalf of it. And some of my Republican friends on the House side were supportive of it, and we were able to enact it. And it has withstood attack after attack after attack because it is the real stuff.

Now, this legislation continues to have the support of an overwhelming majority of the U.S. Senate, and it enjoys strong backing in the U.S. House of Representatives. American companies in nearly every state of the union are currently entitled to distributions under its provisions, and they deserve to continue to receive these funds so long as foreign traders keep dumping.

Now, if the foreign traders don't like the law, there is a simple answer for them, a simple solution, a simple way to go: just stop dumping. If our trading partners want to eliminate distributions under the law, I have two simple words for them, and I'll repeat them: stop dumping.

In the fiscal year 2004 and 2005 Consolidated Appropriations Acts, both houses of Congress directed the Bush administration to undertake negotiations in the WTO to resolve this dispute. The administration has put this matter on the table in those negotiations, but our negotiators are not giving these negotiations the priority that they deserve. Unbelievably, the administration is not moving aggressively to defend innocent American companies and their innocent workers, even though their economic future depends on these negotiations.

The administration needs to stop stalling and start negotiating. It needs to make it clear that WTO members have the right to distribute duties collected on unfairly traded products as they deem appropriate. Now, I have talked with Mr. Zoellick and others. I believe I have mentioned this to the President upon a trip to West Virginia earlier in the administration, and the administration.

Nothing in the WTO agreements precluded the enactment of this legislation, and no faceless WTO bureaucrat can force us to abandon it. American industries and their workers support the law, and they will not condone its repeal. At a time when the United States is losing millions of manufacturing jobs, now is not the time to let foreign traders sabotage another U.S. trade law. This is a law that is working to keep American jobs here at home. Workers with jobs have the best chance to pay taxes, obtain health and pension benefits, and contribute to a stronger economy.

When this law was first considered, some claimed that it would lead to the filing of a greater number of U.S. trade cases against other nations. That never happened, and even the WTO recognized that the law has not resulted in more cases; in fact, the number of cases filed under the law has actually declined. Unfortunately, this might be because some companies have simply given up and closed their doors.

More and more, it appears one of the reasons that companies are closing their doors is because Customs has been unable to collect millions of dollars of duties from Chinese importers in particular, and we have only learned of this because these companies could not obtain distributions under the law. Without the law, it is possible that we would never have known that $130 million in customs duties were never collected in fiscal year 2003, and another $260 million were not collected in fiscal year 2004.

Of that $390 million in uncollected duties, $255 million pertains to the dumped imports of a single product: crawfish, crawfish tail meat from China. I presume Senator Landrieu will address that issue today, because it is the crawfish producers in her state that are being hurt badly by this.

But duties have also not been collected on Chinese imports of honey, garlic, mushrooms, and other items, decimating entire sectors of the U.S. economy. In view of the ballooning U.S. trade deficit with China, I and other Senators have repeatedly asked Customs to focus on solving this problem of noncollection, but we have received no meaningful response or plan of action.

Therefore, Senators Cochran and I last year introduced a bill to address this problem, which passed the Senate by unanimous consent. Our bill requires the posting of cash deposits instead of bonds in new shipper antidumping review so Customs gets its money up front and is not left holding the bag when Chinese importers later claim that they cannot honor the bonds that they have posted.

They refuse to pay millions of dollars in duties that they owe the United States Government, so let's recognize that. At the end of the day, when Customs is left holding the bag, the American worker is left holding a pink slip.

This inability of our government to hold the Chinese accountable shows that what we need to do is improve the enforcement of our trade laws, not modify or repeal them when they have already indicated that they work so well. I will therefore continue to beat the drum in support of CDSOA. I will defend it, I will defend it against all enemies foreign and domestic, and I will urge my colleagues in Congress to join me in asking the administration to expedite negotiations to make certain that this law continues to be a valuable weapon in our nation's arsenal against unfair trade from China and other nations around the globe.

Mr. Chairman, it has been a great pleasure to be here with you again, to see you again, and to have this opportunity to speak before your illustrious group. I again thank all of the Members; I particularly salute again my friend, Fred Thompson, and I wish God's blessings on each of you.

Thank you very much, and thank you, Senator Landrieu.

[The statement follows:]

Prepared Statement of Robert C. Byrd
A U.S. Senator from the State of West Virginia

The Continued Dumping and Subsidy Offset Act of 2000

I would like to begin by explaining the purpose of the Continued Dumping and Subsidy Offset Act, also known as "CDSOA," and why it is so important to our nation.

This law was enacted five years ago to give U.S. companies injured by unfair foreign trade—including unfair trade with China—the ability to invest in their factories and workers with funds collected by the Customs Service on unfairly traded imports.

Under other U.S. trade laws, Customs imposes antidumping and countervailing duties on dumped and unfairly subsidized foreign products in an attempt to force foreign exporters to charge a fair price. But in spite of these efforts, many foreign traders, including Chinese producers, refuse to trade fairly. Instead, they continue dumping—year, after year, after year. And the prices of these dumped Chinese and other foreign imports continue to unfairly undercut the prices of American-made products sold here in the United States. Faced with loss of U.S. market share, American producers struggle to stay afloat, unable to invest in new plants and equipment, and unable to meet their payrolls or provide necessary health and pension benefits for their workers. This is particularly true for small businesses and our nation's farmers, ranchers, and aquacultural producers. Continued dumping damages our companies and robs our workers of their livelihoods.

CDSOA was enacted to prevent these losses by restoring conditions of fair trade, so that jobs and investment that should be made in the United States are not sent overseas or "outsourced" as a result of unfair competition.

Each year, our Customs Service collects duties imposed on unfairly traded imports from nations like China, which continue to ignore our trade laws. Under CDSOA, these collected duties are held in special accounts at Customs until the fall of the year, when companies that have been unfairly injured by foreign trade can apply for, and receive, these funds as reimbursement for their having invested in themselves and their workers.

American manufacturers of axes and shovels, like the family-owned firm of Warwood Tool Company in Wheeling, West Virginia, and producers of lumber, wheat, shrimp, catfish, bearings, mushrooms, crawfish, pasta, steel, raspberries, furniture, and a long list of other industrial and agricultural producers, stand to be reimbursed under the law for having borne the costs of bringing successful trade cases against illegally traded imports.

Now the WTO is trying to force the United States to repeal CDSOA and rewrite our trade laws to allow wave after wave of dumped and unfairly subsidized goods from China and elsewhere flood the U.S. market.

We cannot and will not allow it! The United States is a sovereign nation. It cannot be forced to comply with yet another wrong-headed WTO decision. The WTO was overzealous in striking down CDSOA; it overreached. This WTO ruling was technically beyond the scope of the WTO's legal mandate. The WTO had no authority to issue a ruling against our law. Instead, the WTO incorrectly read into international agreements a prohibition against CDSOA that was never approved by any WTO negotiator—certainly none empowered to negotiate for the United States!

The WTO cannot force the United States to repeal its law. No WTO official has a vote in the United States Senate, and no WTO panel can force us to abandon our law! CDSOA continues to have the support of an overwhelming majority of the U.S. Senate and enjoys strong backing in the U.S. House of Representatives. American companies in nearly every state of the Union are currently entitled to distributions under its provisions, and they deserve to continue to receive these funds so long as foreign traders keep dumping. If our trading partners want to eliminate distributions under the law, I have two simple words of advice: stop dumping!!

In the Fiscal Year 2004 and 2005 Consolidated Appropriations Acts, both Houses of Congress directed the Bush Administration to undertake negotiations in the WTO to resolve this dispute. The Administration has put CDSOA on the table in those negotiations, but our negotiators are not giving these negotiations the priority they deserve. Unbelievably, the Administration is not moving aggressively to defend innocent American companies and their workers, even though their economic future depends on these negotiations. The Administration needs to stop stalling and start negotiating. It needs to make it clear that WTO members have the right to distribute duties collected on unfairly traded products as they deem appropriate.

Nothing in the WTO Agreements precluded the enactment of CDSOA. And no faceless WTO bureaucrat can force us to abandon it. American industries and their workers support the law and will not condone its repeal.

At a time when the United States is losing millions of manufacturing jobs, now is NOT the time to let foreign traders sabotage another U.S. trade law. This is a law that is working to keep American jobs here at home. Workers with jobs have the best chance to pay taxes, obtain health and pension benefits, and contribute to a stronger economy.

When CDSOA was first considered, some claimed it would lead to the filing of a greater number of U.S. trade cases against other nations. But that never happened, and even the WTO recognized that the law has not resulted in more cases. In fact, the number of cases filed under the law has actually declined. Unfortunately, this might be because some companies have simply given up and shut down.

More and more it appears one of the reasons companies are closing their doors is because Customs has been unable to collect millions of dollars in duties from Chinese importers in particular. And we've only learned of this because these companies could not obtain distributions under CDSOA. Without CDSOA, it is possible we would never have known that $130 million in Customs duties were never collected in Fiscal Year 2003, and another $260 million were not collected in Fiscal Year 2004. Of that $390 million in uncollected duties, $255 million pertains to the dumped imports of a single product—crawfish tail meat from China. I presume Senator Landrieu will address that issue, today, because it is the crawfish producers in her state who are being hurt by this. But duties have also not been collected on Chinese imports of honey, garlic, mushrooms, and others—decimating entire sectors of the U.S. economy.

In view of the ballooning U.S. trade deficit with China, I and other Senators have repeatedly asked Customs to focus on solving this problem of non-collection, but we have received no meaningful response or plan of action.

Thus, Senators Cochran and I last year introduced a bill to address this problem, which passed the Senate by unanimous consent. Our bill requires the posting of cash deposits instead of bonds in "new shipper" antidumping reviews, so Customs gets its money "up front," and is not left holding the bag when Chinese importers later claim they cannot honor the bonds they have posted. They refuse to pay millions of dollars in duties they owe the U.S. Government. Let's recognize that, at the end of the day, when Customs is left holding the bag, the American worker is left holding a pink slip.

This inability of our government to hold the Chinese accountable shows that what we need to do is improve the enforcement of our trade laws; not modify or repeal them.

I will therefore continue to beat my drum in support of CDSOA. I will defend it against all enemies, and I will urge my colleagues in Congress to join me in asking the Administration to expedite negotiations on CDSOA, to make certain that this law continues to be a valuable weapon in our nation's arsenal against unfair trade from China and other nations around the globe.

Senator LANDRIEU. Thank you, Senator Byrd.

Chairman D'AMATO. Thank you very much, Senator Byrd, for your leadership and for that very strong testimony and your leadership on these issues.

Just on one point that you made that $260 million in dollars not collected in duties in 2004. We note that almost 90 percent of that, $244 million, was Chinese business. So Chinese companies are cheating and chiseling on our customs side, and it's in epidemic proportions. So we congratulate you on that legislation. Unfortunately, it wasn't passed finally last year, but I wish you god speed in getting it passed this year.

Senator BYRD. Thank you.

Chairman D'AMATO. Also, the Commission welcomes Senator Dorgan. If you would like to come up to the table, you're certainly welcome to do that, Senator Dorgan.

Senator Landrieu.

STATEMENT OF MARY LANDRIEU
A U.S. SENATOR FROM THE STATE OF LOUISIANA

Senator LANDRIEU. I thank the Chairman, and I am glad that we are joined by Senator Dorgan, who really has been one of the most effective spokespeople on the floor of the Senate, and with Senator Byrd's leadership, there is a growing number of us concerned about this issue because of the dramatic effects it's having in all of our states and the economy and just the general principle of fairness.

As we try to promote open trade, we want fair trade, and so, these details are very important to get right. And Senator Byrd, before you leave, and I know that you can't stay because of your time, but I do want to share with Senator Byrd here two success stories of businesses in Louisiana that were saved by Senator Byrd's efforts and with our help before he leaves, and then, I'll come back to the rest of my testimony.

As you know, Mr. Chairman, and as Senator Byrd certainly knows, in Louisiana, few things signify the passage of winter, however mild, and the coming of spring more than a family crawfish boil. These backward-crawling crustaceans may not appeal to some, but we eat them in large numbers, heads and tails. They are a spring ritual, and all of us look forward to that ritual. Without a doubt, catching, cooking and enjoying crawfish are truly part of Louisiana's culture.

But equally as important, Mr. Chairman and Members, it is a large segment of our economy. Families make a living from this industry. Children go to college from this industry. Families are able to take one or two vacations, perhaps the first in many years because of this industry. Because of Senator Byrd's efforts and our somewhat successful efforts to collect some of these antidumping duties, the LaBlau family that had been in this business for 27 years, who sold crawfish meat in Breaux Bridge, Louisiana, for 27 years—it's lifetime for a child, of course—production hit a low of around 16,000 pounds when the Chinese began dumping crawfish into Louisiana.

Their 27-year-old successful family-run business was just about to go under. Tail meat prices sank so low that Mike and his father were not able to expand; they laid off workers. But since they received funds through the Byrd Amendment, they have been able to buy three new delivery vehicles, increase the square footage of their production facility, increase their cooler storage area, upgrade their disposal equipment and buy a new icemaker. Their employees are now up to 45; the production season in 2004 went up to 105,000 pounds.

One more story for Senator Byrd, so he can start his day off on a positive note. The Guidries of Patahoula Crawfish, Inc. have been selling crawfish since 1977, and his father before that, starting in 1958. Their industry, their company was on the verge of collapse because of this dumping. But because our suit was successful, and we began to get some relief, their production is now up. The Guidries have new trucks, two new freezers, a large vacuum packing machine that's making them more efficient, a 6,000 pound icemaker, and they purchased over 750,000 pounds of live crawfish and processed it into 130,000 pounds of Louisiana tail meat while increasing the number of employees.

Mr. Chairman, this is about jobs; this is about fairness; this is about principles, and I just wanted to share those stories with Senator Byrd before he has to leave, and I thank him so much for his efforts.

Senator BYRD. Thank you very much, and thank you for your leadership in this effort. We'll have to continue fighting. Thank you again.

Senator LANDRIEU. Thank you. Thank you, Senator Byrd.

And let me just continue with some brief remarks as the Senator moves out of the room, and Senator Dorgan's testimony begins. In addition to those two stories that I wanted to share, I did want to call to your attention, Mr. Chairman, you just stated it, that we have been collecting these tariffs, or we have been levying these tariffs but not collecting them and the ability to transfer some of these funds back to those who are injured by dumping.

Again, we are asking no subsidies for industries that are fairly competing under the rules that we have established, but when those rules are violated, we should be able to use some of those tariffs that are levied or commissions, the charges that are levied, and help our industries, many of whom are small businesses.

So I just wanted to come and lend my support to thank the Crawfish Alliance that I helped to encourage and push forward as well as our delegation, all of us to make that particular issue come to light and come to the forefront. But there are ways that we can make this situation work. This Commission needs to be aggressive. Our other parts of the system, both the work of the Congress, the work of the administration needs to be aggressive, and if we can be, then, this can be a true win-win situation: we want China to prosper; we want America to prosper. We want there to be fair and open trade.

But there is a right way to do that, Mr. Chairman, and a wrong way, and we can see the benefits when it's done in the correct way for these industries in Louisiana to continue after decades and decades and generations and generations.

So thank you so much. I will submit the rest of my testimony as a longer statement for the record, but I'll be happy to answer any questions or provide any additional details to any of the Commission Members.

[The statement follows:]

Prepared Statement of Mary Landrieu
A U.S. Senator from the State of Louisiana

Mr. Chairman, thank you for inviting me to testify today before the U.S.-China Commission. Your Commission's work is vital to ensuring that our free trade with China elevates the prosperity and security of both nations through a fair and open exchange.

I would also like to thank Senator Byrd for his constant leadership and vision on this issue. If it were not for his persistent efforts, we would not be discussing the Continued Dumping and Subsidies Offset Act or "Byrd Amendment." As you all well know, this program helps countless American industries survive in a highly competitive global marketplace. In Louisiana alone, dozens of companies that may have collapsed under the weight of unfairly traded goods are surviving and even thriving. These companies are keeping jobs in Louisiana and holding together traditional industries that often mean more than a paycheck, they are a way of life. We owe a debt of gratitude to you, Senator Byrd, and to the hard work of other Members like Senator DeWine, who have fought for this program and these industries. Louisiana agriculture, seafood and lumber industries have all been bolstered by this critical

program. I pledge my support to work with you to ensure that the Byrd Amendment continues to sustain our domestic industries in a growing world of free and fair trade.

In Louisiana, few things signify the passage of winter, however mild, and the coming of spring, than a family crawfish boil. These backwards crawling crustaceans may not appeal to some eaters, but to nearly all Louisianians they are a sumptuous feast of food and fun. It is a spring ritual. Boiled in a pot with vegetables, spices, and a few secret ingredients, these crawfish are brought to the table for all family and friends to enjoy. And to many Louisiana families who catch and sell these crawfish, it is business passed down from generation to generation. Without a doubt, catching, cooking and eating crawfish are truly parts of our Louisiana culture.

But not too long ago, the ability of the Louisiana crawfish industry to earn a fair price for their crop was devastated by foreign imports, largely from China. These crawfish were raised in ponds far away, using cheaper labor and relaxed standards. Their sale in Louisiana and across the U.S., completely undercut the domestic market. However, through the efforts of the Louisiana Crawfish Processors Alliance and the Louisiana Department of Agriculture, antidumping duties were imposed on Chinese crawfish to help stabilize prices. The crawfish industries success before the Department of Commerce and International Trade Commission did help raise prices somewhat, but if it were not for the promise of the Byrd Amendment (the Continued Dumping and Subsidy Offset Act), these businesses would have boarded up and shut down. But the very goal of this program, to distribute the duties collected at our borders to those injured by unfairly traded imports, gives hope to industries like ours in Louisiana.

Unfortunately, the program isn't working so well for some and I want to share with you what is happening to our crawfish processors in Louisiana.

As imports of crawfish tail meat from China have remained steady and have even increased since the trade suit was won, the U.S. Bureau of Customs has failed to collect the funds owed to the Louisiana industry under this Federal law. Based on the number of imports and under the antidumping order issued by the Department of Commerce, the Louisiana Crawfish Processors were owed $64.5 million in Fiscal Year 2002 and only $7.5 million was collected. In FY2003, $94.7 million was owed and only $9.7 million was collected. In FY2004, $150 million was owed and only $8.2 million was collected. This terrible track record was brought to my attention and I immediately called upon Customs to let me know why their success rates for crawfish were hovering around or below 10%. At the urging of Secretary Scott Angelle, the Secretary of Natural Resources in Louisiana, I have continued to press Customs for answers. According to Customs, they are addressing what they refer to as a unique case, but the results of instituted changes may not be seen for a few years. This news is discouraging to me and could be devastating to Louisiana's Crawfish industries, and others across the country. The very program that is designed to lift up those industries cast down by unfairly traded goods could serve to hurt them even more.

My message to the Commission is simple: the Byrd Amendment is sound policy that serves to counter acts of unfair trade. If these commodities were fairly traded, trade suits and this program may not be necessary at all. But numerous industries, injured by unfair trade, are viable and prosperous players in the world market today because of this program. I support it for the reasons I have outlined here today and for what it has done for our crawfish industry. Also, I call on this Commission to ensure that the Byrd Amendment is enforced by the United States Government so that its mission of preserving American jobs and bolstering our industries can succeed. The Customs Department plays a critical role in protecting our borders, but that does not give them a free pass from tariff enforcement and duty collection. I urge the Commission to look into this issue of collection failure, which largely stems from items traded with China, and to report to the Congress on its findings. These uncollected duties owed through the Byrd Amendment are too valuable to American industries to take no action.

I want to close (OR submit for the record) with a few stories of folks in my home state:

Mike LeBlanc and his father CJ LeBlanc with CJ's Seafood has sold crawfish tail meat in Breaux Bridge, Louisiana for 27 years. Production hit a low of around 16,000 pounds after the Chinese started dumping tail meat. Even with the antidumping order in place, tail meat prices sank so low that Mike and his father were not able to expand or upgrade any equipment, including coolers, ice machines and delivery equipment.

Since CJ's has received Byrd Amendment funds they have been able to buy three new delivery vehicles, increase the square footage in their production facility, increase their cooler storage area, upgrade their disposal equipment and buy a new

icemaker. They have also increased their production employees to about 45. Production for the 2004 season was approximately 105,000 pounds.

Mr. Terry Guidry of Catahoula Crawfish Inc. sold crawfish in the Lafayette/Baton Rouge and New Orleans area since 1977 (and his father before that, since 1958). After the Chinese started dumping tail meat in the mid-1990s, the business was devastated. At one point in 2000, Mr. Guidry's production dropped to only 20,000 lbs. of tail meat. Even with the antidumping order in place, the Chinese continued to dump at prices so low that it was impossible for Mr. Guidry to upgrade any of his aging equipment.

Thanks to the Byrd Amendment, Mr. Guidry now has two new delivery trucks, two new freezer compressors, a larger vacuum packaging machine and a new 6,000 lb. icemaker. In 2004, Mr. Guidry purchased over 750,000 lbs. of live crawfish to process into 130,000 lbs. of Louisiana tail meat while increasing the number of his employees.

Again, thank you Mr. Chairman for allowing me to testify here today. I would also like to thank Senator Byrd again for his leadership and work on this issue. I look forward to working with you and with the Commission to support and improve the Byrd Amendment.

Chairman D'AMATO. Thank you, Senator Landrieu, and thank you for that testimony and for those stories that really bring it down to earth about what this legislation can actually accomplish. You can be sure that this Commission is going to be aggressive in its recommendations.

I think Commissioner Bartholomew may have a question or two.

Commissioner BARTHOLOMEW. Actually, just a comment. Senator Landrieu, thank you for your leadership on this issue, but I also wanted to take a moment to thank you for your leadership on issues relating to tsunami relief. The comments you made on your visit shortly after that disaster were very poignant and very moving, and a lot of people in the world appreciate the work that you have done on that.

Senator LANDRIEU. Thank you so much. I felt so compelled, living in a coastal state myself. I was joking with Senator Pryor, who has been a wonderful helper, even though he is not from a coastal state. But I said he has a definite incentive and he's encouraged, because if we're not successful in Louisiana, he and Senator Lincoln will be a coastal state. So he has some incentive to join this effort.

The tsunami devastated so many of these beaches with one wave, but all around our coastal areas, not just in the United States but around the world are being eaten away by thousands of smaller waves. Our efforts to reinvest in our coast and the industries, of which this is one industry that is represented in large measure, the crawfish industry, as well as rice in Louisiana, which is grown in places where it's wet, keeping salt water out of rice paddies and helping the crawfish industry; it is all very much tied together.

So I thank you for those comments. We'll continue working on that.

Chairman D'AMATO. Thank you, and your full statement will be included in the record. Thank you very much.

Commissioner Mulloy.

Cochair MULLOY. Yes, I want to now thank Senator Dorgan for being with this Commission. The Senator has been a great supporter of the work we are trying to do, and we are delighted that he is here now to share his view on the WTO, China's compliance, and the larger trade vision that's going on in this country.

Senator Dorgan.

STATEMENT OF BYRON DORGAN
A U.S. SENATOR FROM THE STATE OF NORTH DAKOTA

Senator DORGAN. Commissioner Mulloy, thank you very much. Some long while ago, Senator Byrd and I conspired in legislation to create the effort that has led to all of that, and we did that then because we were concerned about our trade policies. Things have gotten much, much, much, worse, and I'm really pleased that you're taking the time to sit and listen to all of this testimony and digest it and come up with some recommendations.

Let me just make a couple of comments. The trade deficit with China last year will turn out to be somewhere close to $170 billion. It was $140-plus billion through October. It is unbelievable, and it is, in my judgment, a real emergency. We have to get our hands around this trade policy and deal with it, and especially, we have to do that with respect to the bilateral relationship with China.

Trade policy ought to be, in most cases, thoughtful economic policy. Instead, it is mushy-headed foreign policy in most cases. Let me say that is especially the case with China. I can describe that to you through the lens of wheat trade, but I won't spend a lot of time doing that.

Let me just describe what's happening with respect to China. I grew up not affording a Schwinn bicycle but certainly admiring them from a distance, because the Schwinn bicycle was the top of the line. Schwinn bicycles still exist, but it's simply the name. We don't make any Schwinn bicycles on them anymore. The Chinese make bicycles, and the Schwinn name goes on them, so it's a Schwinn bike but made in China.

Huffy, they have gone to China. They took that little American flag decal off the front between the handlebar and the fender and replaced it with the globe and gone to China. Little red wagon, Radio Flyer, gone to China; 110-year-old American company, made in China.

I can talk about wheat; I will not deal with that at great length, but our wheat trade with China is a miserable failure, in our judgment. They promised to buy much more in the bilateral agreements than they did. Their agricultural minister went to the southern part of China. In the South Asia Post, it was reported that, well, the 8.5 million metric tonnes tariff rate quota, that is just talk; that doesn't mean we'll actually do that. That was right after the bilateral.

The issue just goes on and on and on with China. This is a big, wonderful country with a rich history, but it must be smiling broadly at the relationship they have carved out with our country, where they can run giant, giant, giant trade surpluses that become a cash cow for their economy, and this country doesn't have the backbone, the will or the nerve to stand up to it and say wait a second: trade between us, bilateral or multilateral, has to be hard-nosed economic policy. We believe in fairness; we believe in reciprocal treatment, so own up to that if you want to have this trade relationship with us. If not, send your trinkets and your trousers and your shirts and shoes to Zambia and see how quick they sell.

This country needs some nerve. Let me just describe something I read in—I believe it was the Times recently. It's a story, and I'm sure this is going to go on, and nobody's going to lift a finger to

stop it, but it's a story about automobiles. And by the way, very few people know this, but in the bilateral agreement we made with China, here's what we agreed to. And I've been trying to figure out who would have made this agreement, which negotiator would have exhibited this incompetence.

We agreed that after a phase-in, the Chinese can levy a 25 percent tariff on any U.S. automobile sold in China, and we, by contrast, would levy a 2.5 percent tariff on any Chinese automobile sold in the U.S. We agreed, with a country with whom we had a giant trade deficit, that they could impose a ten times higher tariff on bilateral automobile trade. Now, I would just like to find the name of the person that did that so that we could forever bar that person from public service once again.

But it's hard to determine who actually agreed to that proposition. But as a result of that proposition, let me describe what is happening. Time Magazine, January 10, has an article that says here come the really cheap cars. It reported that a Chinese firm has allegedly stolen production line blueprints for the new General Motors compact car called Chevrolet Spark. In fact, General Motors has now gone to the legal system, because they say their production line blueprints were stolen.

And so, what is happening is the Chinese are now producing a car through a company called the Chery Company, and the copycat car with General Motors' blueprints alleged by General Motors in court is called the QQ. It looks like the identical twin to the Chevrolet Spark. And the Chinese company is now offering it for sale in China for a $3,600 sticker price, a third less than the GM car, and the Chinese company has just now announced plans to sell five different models, including an SUV in the United States.

And their plan is to import up to a quarter of a million Chinese cars a year, starting in 2007. And they will do that under circumstances in which this country agreed that the Chinese should be able to levy a tariff that is 10 times higher on U.S. cars we aspire to sell in China versus the tariff that we would charge on Chinese cars that come into this country.

It is unbelievably incompetent for that to exist. And I hope if nothing else happens with this Commission, I hope that as you digest all of this that a giant signal will come out of this Committee that what is happening with our bilateral trade with China is unsustainable and is hurting this country.

Having told you twice I won't talk about wheat, let me be sure to talk about it, because as I'm thinking about this, to demonstrate this is just mushy foreign policy, the week before a member of USTR left that organization, he gave a speech, and this is all on the record. And he said that with respect to wheat trade, the recommendation of the group inside the administration that meets to make recommendations like this was that we should take action against the Chinese on wheat.

But when that went up the line, it was decided that no action should be taken, despite the fact it was recommended. Why? Because it would be seen as an in-your-face thing to do with respect to China. So what does that say to our wheat producer? Or what does all that say to a person that worked on an assembly line making Huffy bicycles or little red wagons?

What does it say when our country decides that there is no admission price to the American market, that the so-called doctrine of comparative advantage is now not necessarily a comparative economic advantage, which we understood to mean that we would see the trade of textiles for wine between England and Portugal; that is what we all studied; that it is no longer an economic comparative advantage but it is, in fact, a political one in the politics of a government saying to workers, organize and you're fired, becomes an advantage in lower wages and repressed workers that then is an advantage, but it's not a comparative advantage that represents the marketplace.

And yet, our country is saying that's all; let all of that happen; that is all right. And it does not matter that our manufacturing migrates to 30 cent an hour labor, where people work 12 hours a day, seven days a week, because that is the market system.

If this country doesn't get its head straight about these issues, we will have no manufacturing sector left, and no country will long remain a world economic power without a vibrant manufacturing sector. This country ought to aspire to move China up rather than pull America down with respect to wages and work issues and the environment. Instead, we have this theory, this economic theory that is now a demonstrated failure, with trade deficits that go up, up, up, up, to dangerous levels, and it is the only area of public policy in which abject failure is trumpeted as a huge success.

And my hope is perhaps that at least with respect to this issue, bilateral trade with China, that you will issue a report that finally summons the requirement of our government and the American people to confront this issue and to say that there are admission prices to the American economy; there is a requirement of fair, reciprocal trade, yes, between the U.S. and China. I didn't talk about Japan, Korea, the European Union and others, and I'd love to do that, but time doesn't require it.

Let me finally say this: I have constantly talked about these trade issues, not because I want to put walls around our country. I think expanded trade is good. But expanded trade must be fair trade. Fair trade, in my judgment, is not something that can be masqueraded any longer as foreign policy. That was fine 25 years after the Second World War when we didn't have tough competitors, but that has changed.

And I constantly talk about trade on the Senate floor and seem to have very little impact, but I am reminded of the quote by Sigmund Freud's grandson, Clement, who lived in England, and he said the following: he said, when you hit someone over the book and get a hollow sound, it doesn't necessarily mean the book was empty.

Mr. Chairman, thank you very much.

Cochair MULLOY. Senator, again, thank you for coming.

I want to just comment on the point made about the tariffs, because I think I understand what goes on here. I was inside the trade bureaucracy when those things were going on.

The people who pay attention to that are the automobile manufacturers. And if they're planning on not making cars and shipping them to China but making cars in China and shipping them back here, that makes perfect sense, and I think that explains why that

happens. These guys are multinationals; look at the fact that they can manufacture over there: no labor standards, no pensions, no health care costs, and ship it right back here.

There is something wrong with the way this system is presently working, in my view, Senator.

Senator DORGAN. I had not thought about that. That may well be the case, but if they did that, they dramatically miscalculated, because the Chinese are not particularly interested in a lack of control over their automobile sector. They want to build a vibrant automobile sector, and they want to export. And this is the richest market in the world. There is no substitute for the American maker.

I think what we experience here is General Motors is discovering what the Chinese will do is simply take their blueprints, build the car in China, and compete in the United States against the GM product.

Cochair MULLOY. One last point: I saw in the paper, and I don't have the article with me, but the Europeans are so concerned about the U.S. increasing trade deficit and the falling value of the dollar versus the euro that they have called for the United States Government, the German deputy central banker, said the U.S. Government has got to produce a plan on how to reduce its trade deficit, and I don't——

Senator DORGAN. Right.

Cochair MULLOY. —see that high priority in our own government.

Senator DORGAN. I did not mention that I am introducing legislation in the Senate that creates what is called a trade debt limit. We have a limit on fiscal policy deficits, and when we reach the limit, we have to have a debate and a vote to increase the debt limit. We've done that repeatedly: we have to increase the debt limit.

With respect to trade debt, Katie bar the door. Whatever it is, it is; there is no debate; no discussion, there is no need to decide affirmatively that it should be increased. I am going to introduce legislation to deal with that. I want the Congress to have to confront the trade debt, because it is dangerous to the country and ought to be considered at this point a crisis.

One other point I would make: with respect to China especially, I believe this country should begin to renegotiate the bilateral agreement with China. It is clearly not mutually beneficial; clearly does not work for this country's interests. And part of it is lack of enforcement; part of it is, I think, the determination by the Chinese to use the cracks and crevices in that agreement, and part of it is it was incompetently negotiated.

But for all of those reasons, I believe we ought to renegotiate a bilateral agreement with China that is fair and that begins to have mutually beneficial relationships between the two countries with respect to trade.

Cochair MULLOY. Thank you, Senator Dorgan.

Senator DORGAN. Well, thank you. This was very therapeutic for me.

Chairman D'AMATO. Thank you, Senator.

Senator DORGAN. I have no idea whether it was good for you, but——

Cochair MULLOY. It was very good.

Senator DORGAN. But thank you for the work you're doing, and Senator Thompson, it's good to see you. Thank you very much.

Cochair MULLOY. Senator, just one last comment: the reason it is so helpful to have you and other Members pay attention to what we're doing, because we can do this work, but if we don't get some attention and traction in the Congress, of course, it's nice academic stuff, and we don't intend it to be academic.

Senator DORGAN. Thank you for your commitment of time and interest in this issue. Thank you.

Cochair MULLOY. Thank you.

Chairman D'AMATO. Thank you, Senator.

Cochair MULLOY. I think we are going to take a five-minute break before we start the first governmental panel.

[Recess.]

PANEL I: ADMINISTRATION VIEWS

Cochair MULLOY. Thank you for bearing with us. We are now going to have the first panel of this hearing. We heard from Members of the Congress and the Senate. We have now two very distinguished public officials to present the administration's views on these matters dealing with China and its WTO compliance.

Our first witness is Deputy Assistant Secretary of Commerce for Asia Market Access and Compliance, Henry Levine. We first met Mr. Levine when he was Consul General in Shanghai, when we were there in the year 2001. He was very generous with his time and his advice, and we appreciate him being back here again today.

Our second witness is Mr. Shaun Donnelly, who is the Deputy Assistant Secretary of State for Economic Bureau Trade Policy Promotion. I saw where Secretary Rice has indicated that the State Department wants to be a much more visible and bigger player in terms of these trade and economic issues and including compliance with trade agreements, so we were delighted to read that, and we welcome both of you, Mr. Donnelly and Mr. Levine.

Mr. Levine, shall we start with you?

STATEMENT OF HENRY A. LEVINE
DEPUTY ASSISTANT SECRETARY OF COMMERCE FOR ASIA MARKET ACCESS AND COMPLIANCE

Mr. LEVINE. Well, Mr. Chairman, Members of the Commission, thank you very much for giving me the opportunity to speak here today on these important issues. Commissioner Mulloy, thank you for your kind words about the visit in Shanghai, something I enjoyed, by the way, and got quite a lot out of in accompanying all of you on your visit. I have a more complete statement that I will submit for the record. I will, of course, give a brief summary here.

China has, of course, just recently passed the third anniversary of its WTO accession, and for that reason, I think this hearing, in fact, is quite timely and very worthwhile. I guess to sum up, to put it briefly, I would say that over the past three years of China's

membership in the WTO, I believe that China's leadership has exhibited a good faith effort to bring China into compliance with its WTO commitments. It has been a monumental effort on their part, changing tariffs, rewriting laws, and I think they deserve due credit for the tremendous effort that they have made.

That having been said, the fact remains that we continue to have significant areas of concern with regard to China's performance. Of those, I guess I would characterize our paramount unfinished business as the issue of protection of intellectual property rights in China.

While the Chinese government continues to work hard to overhaul its legal system, change its procedures, improve internal coordination and so forth, the fact of the matter is that today, U.S. companies who are exporting to China, doing business in China or in many cases companies that have had no contact with China suffer a serious risk of infringement of their intellectual property rights by enterprises in China. This issue is damaging to U.S.-China economic relations, and it is an area where we are demanding change, so that our workers and our companies can enjoy the benefits due them from China's WTO accession.

At the risk of oversimplifying the issue, you know, I think ultimately, this comes down to China's inability so far to enforce the laws that it has on protection of intellectual property rights, and our mantra is enforce, enforce, enforce. Until the violators of intellectual property rights in China feel the sting of enforcement, I think they're not likely to change their behavior.

In addition to the IPR issue, we continue to work a number of other issues of concern in China. These range from questions of use of technical standards and other technical barriers to trade, the pending regulations on government procurement of software, issues of transparency, pending regulations on direct sales, questions over implementation of distribution rights, express delivery services and so forth. In addition, our colleagues at the Treasury Department, of course, have led the administration effort to encourage China to adopt a market-based flexible exchange rate.

We are working all of the issues hard, and we have made progress on many issues. We will continue to be focused very aggressively. I will say, though, that at any point where we feel that we have gone as far as we can go through other means, the administration will not hesitate to employ the full range of dispute settlement and other tools that are available through China's WTO agreement and, at the same time, we will continue to strictly enforce our trade laws here at home.

Now, I'd shift and just say a few words about what we at Commerce in particular are doing to address the issues. First, let me say that over the past 18 months or so, on an interagency basis, working closely with our other colleagues at the other agencies, we have tried to pursue a very focused agenda and approach. The centerpiece has been the Joint Commission on Commerce and Trade.

In December of 2003, President Bush and Chinese Premier Wen agreed to elevate of the JCCT. We then embarked on a very intensive process with the Chinese to identify goals for the JCCT meeting, and those efforts paid off. At the JCCT meeting in April of 2004, we resolved several significant issues and laid the foundation

for progress on others. I won't detail all of those here. I think many of them, of course, are widely known and included in my written testimony.

In addition, I should say, to addressing issues of immediate concern, we at the Commerce Department are engaged in fairly extensive capacity-building efforts with China, for example, training programs on the criminal enforcement of intellectual property rights with Chinese prosecutors; these types of efforts aimed at strengthening China's ability to implement its commitments.

Second, I would say that internally, we have taken a number of steps to reorganize ourselves and make sure we are most effectively focusing our Commerce Department resources on the high-priority China issues. We have established an IPR policy and compliance investigations office. Our Import Administration has established a China office of compliance to focus expertise on anti-dumping cases and related issues.

Reflecting the importance of the IPR issue, we have assigned the first ever intellectual property rights officer at our U.S. Embassy in Beijing. He is a Chinese-speaking expert on China IP, one of the great authorities and a terrific resource both for U.S. companies and the U.S. Government.

I would also briefly mention the efforts that we are making to promote U.S. exports to China. While strictly speaking, this is not a WTO compliance issue, nonetheless, our efforts to support the efforts, particularly of small and medium U.S. companies, I think, are an important piece of the effort to make sure that our workers and our companies are getting the benefits that they deserve as a result of China's WTO implementation.

Of course, the fact is that China today is our fastest-growing export market. We, though, want more, and we are dedicated to working harder and increasing those numbers, but we have taken a variety of concrete steps. We have created the China Business Information Center Website that provides a one-stop shop for U.S. Government information and assistance for companies that want to export to China.

We are establishing American trade centers in China to enhance our ability to develop trade leads and support U.S. companies there. Our commercial service has roughly 100 people on the ground in China at our embassy and our consulates, supporting the efforts of U.S. companies, and then, across the board, we are strengthening and focusing our efforts.

Finally, I would sum up simply by saying that China's economic growth and its growing importance in the world economy has developed at an unbelievable rate, a rate that few of us would have predicted even a few years ago. For our part, we will continue to insist that China's growing economic importance be based on a strict adherence to the promises that China made in conjunction with its WTO accession, and we at the Department of Commerce are committed to working strenuously and effectively to that end.

Thank you.

[The statement follows:]

Prepared Statement of Henry A. Levine
Deputy Assistant Secretary of Commerce for
Asia Market Access and Compliance

I. Introduction

Mr. Chairman, Members of the Commission, thank you for the opportunity to testify today on behalf of the Commerce Department regarding China's compliance with its World Trade Organization (WTO) commitments and our role in promoting market access and compliance with international agreements.

We recently passed the three-year anniversary of China's WTO accession. December 11, 2004 ushered in some of the remaining obligations in the phase-in of liberalization in the areas of tariffs, trading and distribution rights, and investment. So, I believe today's hearing is very well timed. Let me start with some comments on where things stand three years into China's WTO Accession.

II. China's Compliance with its WTO Commitments

Throughout the three-year period from December 11, 2001 to December 11, 2004, China's leadership has exhibited a good faith effort to bring China into compliance with its WTO commitments. This has involved thousands of tariff reductions, revocation of outmoded regulations and the subsequent issuance of hundreds of new regulations and legal revisions. It has been a monumental task in terms of scope and complexity. China deserves due recognition for this tremendous effort.

That having been said, China's compliance record has not been consistently positive over the past three years and problems remain today. Generally speaking, in 2002—China's first year of WTO commitments implementation—China appeared to be off to a good start. By 2003, there was a clear slowdown in the pace of implementation and significant WTO-related problems that were surfacing as new regulations and laws were being put into place. Many of these concerns have now been settled and cleared. China's efforts in complying with its WTO commitments gained momentum during 2004, and U.S. companies have expressed much greater satisfaction with China's WTO performance in the past year. The American Chambers of Commerce for China and Shanghai (AMCHAM), which represent more than 1,800 American companies, stated the following in their 2004 joint, annual White Paper:

> "[While the 2003 White Paper] conveyed an overall sense of dissatisfaction with the slow pace of implementing some of China's WTO commitments, our message this year is much more positive. With the exception of intellectual property rights, we believe China is substantially in compliance with its WTO deadlines and specific obligations."

Although China's performance in 2004 showed marked improvement over its performance in 2003, there is still much to be done. In this regard, protection of U.S. intellectual property rights (IPR) remains paramount "unfinished business" in our bilateral discussions with the Chinese government.

While China continues to work diligently to overhaul its legal regime to ensure protection in accordance with the WTO's Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS Agreement), I cannot report to you today that American companies can export or do business in China without serious concern for the sanctity of their intellectual property. This is damaging to U.S.-China trade relations and is an area where we are demanding change so that our companies can enjoy the benefits due them from China's WTO accession.

One problem that remains is the inability of the Chinese government to systematically and vigorously enforce the laws and regulations in place to protect intellectual property. In 2004, China intensified the crackdown on IPR infringements and moved to lower the threshold for criminal convictions for IPR violations. While these were positive developments flowing from the April 2004 Joint Commission on Commerce and Trade (JCCT) meeting, the long-term results of these actions remain to be determined. As promised by Vice Premier Wu Yi at the 2004 JCCT, a Judicial Interpretation was released in December, lowering the thresholds that must be met to allow criminal convictions of IPR violations. The Judicial Interpretation is a step forward, though it does contain some problematic elements. We continue to press China to do more; to do whatever it takes to produce tangible results in the protection of intellectual property. This is a serious problem and I believe Secretary Evans said it well last month in Beijing with regards to how we are judging China on IPR: "Process isn't progress. Results are progress." Primarily, this means enforcement, enforcement, enforcement.

One of Secretary Evans' last orders of business in his capacity as Secretary of Commerce was a return to China to confer a final time with China's leadership on IPR and other issues of concern to the U.S. In his meetings he conveyed the depth of our concerns on these issues. In his Senate confirmation hearings last month,

Secretary-designate Carlos Gutierrez highlighted IPR protection in China as a priority issue when he takes office. This Administration places the highest priority on the protection of IPR in China, and the Department of Commerce, along with USTR and other agencies, will continue to push China to step up its lax protection of intellectual property until we see results.

In addition to IPR, we continue to have concerns about China's practices in specific industry sectors and broad-based commercial policies. Some of these are related to WTO commitments and others are not. These include issues of standards and other technical barriers to trade, regulations on the government procurement of software, transparency, Customs valuation on certain products, direct selling regulations, implementation of distribution rights and express delivery services. In addition, the Treasury Department has led the Administration effort to encourage China to adopt a market-based, flexible exchange rate. We monitor all actions, policies and implementing regulations affecting manufacturing and services, and we pursue each and every matter brought to our attention. While not reaching agreement on all issues, we have successfully resolved many disputes and continue to work with China on a case-by-case basis to resolve our remaining differences. When this process is not successful, the Administration will not hesitate to employ the full range of dispute settlement and other tools available to us through China's WTO accession agreement. At the same time, the Administration will continue to strictly enforce its trade laws to ensure that U.S. interests are not harmed by unfair trade practices.

III. Department of Commerce Role in Achieving Market Access and Compliance in China

I'd now like to lay out for you some of the approaches that we at the Commerce Department, working with other agencies, are taking to ensure market access and compliance in China.

Over the course of the last eighteen months, the Administration's strategy with China has included monthly visits by Cabinet or other senior officials to China to engage with China's leaders. Senior Commerce Department officials have been a key part of this strategy. Further, our efforts have involved development of goals for progress, achieving Chinese government agreement to pursue those goals, and structuring senior-level meetings to establish milestones to push this process forward. In particular, President Bush and Premier Wen Jiabao reached agreement in December 2003 to elevate the level of the U.S.-China Joint Commission on Commerce and Trade (JCCT) and to pursue a set of concrete outcomes for the subsequent JCCT session. Between December 2003 and April 2004, the two agencies chairing the JCCT on the U.S. side, Commerce and USTR, supported by the entire interagency community, held an intensive set of meetings and teleconferences with our Chinese counterparts to push forward our mutually agreed upon agenda of issues.

These efforts paid off. At the JCCT meeting in April 2004, we resolved several significant issues and laid the foundation for progress on others. Issues resolved included implementation of China's commitments on trading rights and major progress on distribution services, potentially worth billions of dollars of increased market access to U.S. companies; and the WAPI encryption issue. We also achieved significant commitments on IPR. Further, we achieved Chinese concurrence to open a dialogue on the key structural issues (such as subsidies) that can distort U.S.-China trade and create an unlevel playing field for U.S. companies. While not technically a WTO implementation issue, I would note our breakthrough understanding at the JCCT on improved cooperationan arrangement for end-use visits on high-technology items. This understanding has already born fruit as we have eliminated the backlog of end-use visits and begun to build the confidence necessary to facilitate U.S.-China high-technology trade. In addition, I believe the successful JCCT paved the way for the subsequent resolution of the integrated circuit VAT issue, which was resolved bilaterally without the need for lengthy litigation at the WTO.

In addition to our intensive focus on solving immediate issues of concern, the Department of Commerce has undertaken extensive "capacity building" efforts as part of a strategic effort to ensure China's compliance with WTO commitments and avoid future obstacles to U.S. exports to China. These include training for Chinese officials in areas such as criminal enforcement of IPR and exchanges on drafting of key economic laws and regulations. These efforts have produced results that help us identify and address key problems in China's WTO implementation.

Second, to reinforce the Administration's strategy, the Department of Commerce has undertaken a number of new steps that will continue to pay dividends in the future. These include establishment of the IPR Policy and Compliance Investigations Office, increased staffing and recruitment of top language-qualified China experts to manage our China compliance efforts, the creation of a China Office in our

Import Administration to focus and deepen our expertise on unfair trade cases from China, and for the first time using technology to enable compliance officers in China and the United States to work collaboratively on compliance cases in the Market Access and Compliance Bureau on a real-time basis. We have also maintained an office at our Embassy in Beijing staffed by two Compliance and two Import Administration Officers to ensure a focused effort on those issues. Reflecting the importance of the issue of IPR protection in China, last year the U.S. Patent and Trademark Office (USPTO) established in Beijing the first Intellectual Property Rights attaché position at a U.S. Embassy abroad. This position is staffed with a Chinese-speaking attorney from USPTO who is an expert on China IP issues. He is an invaluable resource for U.S. companies and the U.S. Government on these issues.

We have also taken steps to enhance the effectiveness of our staff working on China compliance issues by, for example, providing a continuous cycle of training opportunities to enhance their skills. We have made strenuous efforts to increase our staffing on China compliance issues to reflect its importance to the United States, and we have added additional experienced managers to this staff to enhance their effectiveness.

I would also note the enhanced efforts the Commerce Department is making to promote U.S. exports to China. While not strictly speaking a WTO compliance issue, these efforts are an important factor in ensuring that U.S. companies and workers enjoy the benefits that they should from China's WTO commitments. China today is our fastest growing export market. In fact, from 1999 to 2004, U.S. exports to China increased nearly ten times faster than U.S. exports to the rest of the world. As a result, China has risen from our 11th largest export market five years ago to our fifth largest export market today. However, we believe there are even greater opportunities ahead. Our Commercial Service has roughly one hundred employees on the ground in China to assist U.S. companies. Further, we have created the China Business Information Website in the U.S. that provides a one-stop shop for U.S. Government information and assistance on doing business in China. Finally, we are establishing American Trade Centers in China to enhance our ability to develop trade leads and other information in major commercial centers outside of those where we have an Embassy or Consulate. We have also been conducting an active program of "Doing Business in China" seminars across the U.S., providing information to small and medium U.S. companies on the opportunities and challenges of the China market, including tips on how to best protect their intellectual property rights.

IV. Conclusions

China's global trade volume has more than doubled since 2001. Last year it surpassed the U.S. to become Japan's largest trading partner. It is a top destination for foreign direct investment and (with the U.S.) the other main engine of global economic growth. It is the source of our largest trade deficit and it is our fastest growing export market. China's emergence as a major economic and trading country poses enormous opportunities and challenges for U.S. companies and workers. We will continue to insist that China's growing economic importance must be based on a strict adherence to the promises China made in conjunction with its WTO accession. We at the Department of Commerce are committed to working strenuously and effectively to that end.

Mr. Chairman, thank you again for inviting me to testify today.

Cochair MULLOY. Thank you, Mr. Levine.

Mr. Donnelly?

STATEMENT OF SHAUN E. DONNELLY
DEPUTY ASSISTANT SECRETARY OF STATE
ECONOMIC BUREAU TRADE POLICY PROMOTION

Mr. DONNELLY. Thank you, Mr. Chairman, and Members of the Commission. I want to thank you for the opportunity to testify today on behalf of the State Department to discuss our assessment of China's compliance with its World Trade Organization commitments. I'm filling in for my boss, Assistant Secretary Wayne, who is traveling to the Middle East today on an important terrorist finance issue.

I'd like to begin with the State Department's overall assessment of China's WTO compliance and then mention some areas of par-

ticular concern. I'd also like to highlight the State Department's special role with regard to working with China on its WTO commitments. I look forward, of course, to answering your questions and hearing your comments, and I understand my longer formal remarks will be in the record.

Cochair MULLOY. That is correct, Mr. Donnelly.

Mr. DONNELLY. Thank you, Mr. Chairman.

In December, China marked the third year of its accession to the WTO. This milestone is really a midpoint in China's efforts to comply with the massive tasks of restructuring its economy undertaken in joining the WTO.

In acceding to the WTO, China promised substantial tariff liberalization, new rights for foreign investment, and critical new rights to trade and distribute both goods and services. This year, foreign investment in trading and distribution rights figure very prominently among China's new WTO obligations.

In general, since acceding in 2001, China's leadership has made substantial effort to bring China into compliance with its WTO commitments. These efforts include extensive tariff reductions, regulatory reform and harmonization, some significant legal changes, and China deserves due recognition for those efforts.

But we must be clear, however, that China's overall compliance record has been uneven over the last three years. 2003, in particular, was a year in which we, and others became concerned with the slowdown in the pace of WTO implementation. We saw problems with agriculture in terms of nontransparent applications of sanitary and phytosanitary, biotechnology rules, unfair applications of tariff rate quotas (TRQs). We saw problems in services, excessive capitalization requirements for insurance, and we saw WTO inconsistent use of a value added tax policy in key sectors.

State and its sister agencies have been engaged fully to address these issues. Fortunately, with determined, coordinated efforts by the U.S. Government, and close coordination with the U.S. private sector, we have been able to substantially improve the situation, resolving a number of outstanding issues in 2004, often using the highly effective mechanism of the upgraded Joint Commission on Commerce and Trade (JCCT) that Mr. Levine mentioned. When negotiations did not work, we did not hesitate to use legal recourse available to us, such as our successful use of the WTO Dispute Resolution Mechanism in the semiconductor VAT case.

We are more satisfied with China's WTO performance in 2004, despite some continuing serious problems, most particularly, intellectual property rights or IPR, as Hank has said. Many of the concerns from 2003 have been settled, and U.S. exports to China have continued to increase dramatically in 2004, as they have every year since China joined the WTO, reaching $34 billion last year; China is now our fifth-largest export market, up from 11th place in 2001. U.S. Exports to China are up 80 percent since it joined the WTO.

Inadequate protection of intellectual property (IP) rights remains perhaps our single most serious bilateral economic concern with China. China has made some strides in bringing its legal system into compliance with its WTO obligations. It has created a multiagency IP task force headed by Vice Premier Wu Yi, and its top

court has recently promulgated a new judicial interpretation, allowing greater use of criminal statutes against IP violators.

Raids against infringing markets and production facilities have netted tens of millions of infringing copies; however, we have not seen a reduction in piracy and counterfeiting rates. The reality on the ground remains that IP problems in China are pervasive and very serious. Simply put, we must see substantial improvements in 2005. The State Department will work with the senior IPR officials in other agencies and our Embassy in Beijing, to ensure that China makes progress on this vital front. Secretary Rice promised the Senate she would pay close attention to the IPR problems in China during her testimony.

Apart from the IP situation, we are concerned about China's WTO compliance on trading and distribution as well as specific industry sectors and transparency overall. China agreed to liberalize distribution rights, effective December 11 last year, but has yet to issue guidelines to clarify how to implement these liberalizations.

This is a very serious problem. The right to freely distribute goods within the whole Chinese market as well as the right to provide logistics and high value added service to Chinese industrial and retail customers is at the heart of the next phase of China's integration into the global economy.

We also see problems with poorly drafted direct selling regulations that are relevant to companies like Avon and Mary Kay, and express delivery service rules that discriminate against our highly competitive companies such as FedEx and UPS.

We are also troubled with issues that are not only WTO accession problems, such as the growing issue of standards and technical barriers to trade. We have seen a disturbing trend of China using high technology standard setting in order to benefit its domestic industry. This undermines the principle of letting industry develop international standard setting bodies that create harmony and a level playing field for everybody.

Similarly, we are carefully watching the issue of government procurement of software, for that is one of the few licit markets for legitimate software in China. We also remain troubled by the lack of transparency in Chinese government regulation drafting processes, particularly those conducted by bodies outside of the Ministry of Foreign Commerce or MOFCOM.

The administration will continue to strictly enforce our trade rules to ensure that U.S. interests are not harmed by unfair trading practices in China or elsewhere. Administration officials at all levels interact with their Chinese counterparts regularly on this broad range of issues. From the deputy assistant secretary level up through the cabinet level, we dedicate significant amounts of time to economic issues and problems with China, both here and in Beijing. Secretaries Mineta, Abrahams and Evans recently traveled to China, and each dedicated significant amounts of time to trade issues.

The constant effort is paying off. Significant issues are frequently resolved bilaterally. The so-called WAPI wireless computing standard issue is one example. Interaction over many months finally produced a resolution acceptable to both parties that was announced during the April JCCT.

Multilaterally, this administration devotes equal attention and effort using the WTO Transitional Review Mechanism or TRM vigorously to review Chinese compliance in connection with our other WTO members. The Department of State has a unique role in this process and in the development and implementation of the administration's overall strategy. State not only facilitates ongoing engagement with the Chinese and all of the USG's front line economic agencies, but we are a player among all other agencies in Washington when it is time to make decisions.

State Department officials based at our Embassy in Beijing work with their colleagues in the other agencies analyzing how Chinese thinking is evolving, liaising with the private sector and explaining U.S. positions to Chinese officials. My colleagues and I personally participate in JCCT working groups and meet regularly with Chinese officials. My boss, Assistant Secretary Wayne, recently sponsored a conference in Hong Kong for our embassy officers posted throughout East Asia and the Pacific and South Asia to talk about intellectual property rights and working closely with the U.S. private sector. China was a special focus.

Under Secretary Alan Larson at the State Department chairs the administration's dialogue with the Chinese State Council's influential National Development and Reform Commission or NDRC, a dialogue that complements the JCCT and other dialogues; this one focuses on medium-to-longer term structural issues. We've talked about things like agriculture, industrial restructuring, and investment issues. Our Under Secretary, along with our Secretary and Deputy Secretary, of course, regularly participate in the White House meetings on the administration's China strategy.

In addition to the considerable staff dedicated to WTO compliance at our Embassy in Beijing, we have got a number of officers at the State Department in Washington in the Economic Bureau, the East Asia Bureau, including the so-called China desk that are heavily involved in all of these issues. In Beijing, Ambassador Randt has personally provided extraordinary leadership to the embassy's team on WTO accession and the whole range of trade and investment problems.

And our Embassy team is not just the Foreign Commercial Service and the Economic Section comprised of State Department foreign service officers. We involve the Defense Attaché, the Science Attaché, the Public Affairs Section, the Political Section, the Homeland Security and Department of Justice personnel, because it really takes a team effort if we are going to make progress on these trade issues with China.

In conclusion, the U.S.-China economic and commercial relations portfolios are central to our overall bilateral relationship, as the Secretary Rice has said, and to vital U.S. interests. Nowhere are the stakes for our economy, for U.S. firms and U.S. workers higher. The State Department will continue to play a significant role in ensuring that these problems are dealt with effectively and that our engagement with China continues to pay dividends for our companies, our workers, and economies.

Thank you very much.

[The statement follows:]

Prepared Statement of Shaun E. Donnelly
Deputy Assistant Secretary of State
Economic Bureau Trade Policy Promotion

Introduction

Mr. Chairman, Members of the Commission, thank you for the opportunity to testify today on behalf of the State Department to discuss our assessment of China's compliance with its World Trade Organization (WTO) commitments.

On December 11, 2004, China marked the 3rd year of its accession to the WTO. This milestone marked China's continued commitment to ongoing tariff liberalization, as well as new, important steps in the areas of trading and distribution rights and investment. I'd like to begin with the State Department's overall assessment of China's WTO compliance, and then mention some specific areas of concern. I would also like to highlight the State Department's special role with regard to working with China on its WTO commitments. I look forward to responding to your questions related to our approach to China's WTO implementation.

Overall Assessment of China's Compliance with its WTO Commitments

Overall, since December 2001, there is much to be pleased with, and, in general, China's leadership has made an effort to bring China into formal compliance with its WTO commitments. China's efforts include extensive tariff reductions, regulatory reform and harmonization, and significant legal changes. China deserves due recognition for this concerted effort.

This general assessment notwithstanding, it must be acknowledged that China's compliance record has been uneven over the past three years. 2003, in particular, was a year in which we and American businesses in China became concerned with both the slowdown in the pace of implementation and the significant WTO-related problems as new regulations and laws were promulgated and implemented. From problematic IPR enforcement and industrial policies such as the discriminatory use of value-added taxes to problems with agriculture (non-transparent and scientifically questionable application of SPS measures) and services (excessive capital requirements in many sectors), we at State, as well as all the agencies tasked with monitoring China's WTO compliance, were engaged fully to address these issues. Fortunately, with determined, coordinated efforts, we and our interagency colleagues were able to substantially improve the situation. We were able to resolve a number of outstanding issues in 2004, using the highly effective mechanism of the elevated Joint Commission on Commerce and Trade (JCCT). When discussions and negotiations did not work, we did not hesitate to use legal recourse available to us, such as our successful use of the WTO dispute resolution mechanism in the semiconductor VAT case.

U.S. stakeholders were significantly more satisfied with China's WTO performance in 2004 than in previous years. Nevertheless, serious problems remain, and new problems regularly emerge. Many of the concerns from 2003 have now been settled and cleared. U.S. exports to China continued to increase dramatically in 2004, as they have done every year since China joined the WTO, reaching $34bn. China is now our 5th largest export market, up from 11th place in 2001, and exports are up 80% since China's WTO entry.

Key Areas of Concern

Although China's performance in 2004 showed marked improvement over its performance in 2003, there remains a substantial agenda of trade issues. Most notably, inadequate protection of intellectual property rights (IPR) remains our most serious bilateral economic concern.

The good news is that China has made strides in bringing its legal system into compliance with the WTO's Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS Agreement). Specifically, it has created a multi-agency IP task force headed by Vice Premier Wu Yi, and its top court has recently promulgated a new "judicial interpretation" allowing greater use of criminal statutes (vice administrative) against IP violators. Raids against infringing markets and production facilities have netted tens of millions of infringing copies. However, the bad news is that neither we, nor the Japanese and Europeans, have not seen a corresponding reduction in piracy and counterfeiting rates, and the reality on the ground remains that IP problems in China are pervasive, both at the small-scale and commercial-scale ends of the spectrum, in copyright, trademark and patent infringement. Simply put, we must see substantial improvement in 2005,and the State Department will work with the new IP Negotiator as well as the IP Policy Coordinator, both created by Congress in 2005 budget legislation, to ensure that China

makes progress on this vital front. Secretary Rice promised the Senate that she would pay close attention to the IP problem in China.

Apart from the IP situation, we remain concerned about China's WTO compliance in specific industry sectors as well as in the critical arena of transparency. For example, we see problems with customs valuation on certain products as well as with proposed direct selling regulations and proposed legal changes governing the provision of express delivery services. China agreed to liberalize distribution rights on December 11, 2004; but has yet to issue guidance to clarify for firms and officials how to implement these liberalizations. This is of serious concern—the right to freely distribute goods within the whole Chinese market as well as the right to provide logistics and other high-value added services to Chinese industrial and retail chain customers is at the heart of the next phase of China's integration into the global market.

We are also troubled with issues that are not easily defined as WTO-accession problems, but that are serious all the same, such as the growing issues of standards as technical barriers to trade. We have seen a disturbing trend of China using high-technology standards-setting in order to benefit its domestic industry, a tactic that undermines the general practice of industry reliance on international standards-setting bodies that create harmony and a sturdy playing field for everyone. We will continue to work with China to underscore the benefits to industries and consumers to use global standards-setting mechanisms. Similarly, we are carefully watching the issue of government procurement of software, an issue that has come to the fore in recent months. We are working with the Chinese government and U.S. industry to ensure access to government purchasers, one of the few licit markets for legitimate software in China. We also actively encourage China to join the WTO Government Procurement Agreement as soon as possible, fulfilling China's WTO promise to begin the process to join the group.

We also remain troubled by the lack of transparency in Chinese regulation drafting processes, particularly those conducted by non-MOFCOM bodies. The Administration will continue to strictly enforce its trade laws to ensure that U.S. interests are not harmed by unfair trade practices.

U.S. Government Approach, and the State Department Approach for Achieving Broader and Better Compliance from China

Since mid-2003, the Administration's strategy to engage China on economic matters has been to interact with Chinese officials both multilaterally and bilaterally at senior and working levels. We interact regularly on a broad range of issues, underscoring the essential nature of making tangible progress for the American people.

Administration officials, from the Deputy Assistant Secretary level up to the Cabinet level, dedicate significant amounts of time to our efforts. Officials, such as Mr. Levine and his counterparts in USTR, USDA and other agencies log significant miles traveling to Beijing and hosting their counterparts here. Deputies Shiner and Aldonas do much the same, often in advance for meetings with their Principals. Secretary Evans recently traveled to China. The effort is time-consuming, but pays off. Significant issues are frequently resolved bilaterally, due to the intense, high-level groundwork being laid nearly continuously. The "WAPI" wireless computing standard issue, which generated focused interest by some of our most competitive high-tech firms, is an excellent case in point: intensive interaction over many months finally produced a resolution acceptable to both parties, a resolution that would in all likelihood have been impossible without that level of engagement. Multilaterally, this Administration devotes equal attention and effort, using the WTO Transitional Review Mechanism vigorously to make key points with the Chinese, often joining our efforts with other countries with similar concerns.

The Department of State has a unique role in this process and the Administration's overall strategy. State not only facilitates ongoing engagement with the Chinese and all of the USG's front line economic agencies, but is an equal player among agencies in Washington when it is time to make decisions. Our officials based at the Embassy in Beijing and our four Consulates General work with their colleagues in the other USG agencies every day, analyzing how Chinese thinking is evolving vis-à-vis these ongoing issues and explaining U.S. positions to tough Chinese officials. I personally participate in JCCT Working Groups and meet with visiting Chinese officials. Our Assistant Secretary recently sponsored a conference in Hong Kong for all of our mission personnel posted in East and South Asia and the Pacific who deal with IP issues. Our Under Secretary Larson chairs the State Department's dialogue with the State Council's influential National Development and Reform Commission, a dialogue focusing on long range macroeconomic restructuring issues such as the development of agribusiness, adoption of clean energy solutions, SOE restructuring, and how to integrate advanced M&A techniques into economic reform

strategies. Our U/S along with our Secretary and Deputy Secretary regularly participate in WH meetings in which China economic strategy is decided. In addition to the considerable staff dedicated to WTO compliance at our Embassy in Beijing, State also has a number of officers in Washington focusing on these issues, both in our East Asia and Pacific Bureau and our Economic Bureau. Most are experienced mid- and senior-level officers with extensive policy experience in Washington and overseas.

Conclusions

U.S.-China economic and commercial relations portfolio are central to our overall relationship, and to U.S. interests. Nowhere are the stakes for our economy and American workers higher. I remain confident that China's leadership is dedicated to fulfilling its WTO obligations, despite inevitable problems that occur. And where problems occur, specifically on lax IPR enforcement, this Administration will push China to live up to its WTO commitments. The State Department will continue to play a significant role in this process to ensure that our engagement with China continues to pay dividends for our companies, workers and economy.

Cochair MULLOY. Mr. Donnelly, thank you.

Before we turn to other Commissioners for questions, I just want to make a comment that I have made before. We regret that the Treasury Department is not part of this panel. We very much wanted to hear from the Treasury Department, because as you heard, the Members of Congress have a great concern about the exchange rate issue, which is in Treasury's portfolio, not your portfolio. We regret they are not here.

Chairman D'Amato.

Panel I: Discussion, Questions and Answers

Chairman D'AMATO. Thank you very much, Commissioner Mulloy.

Mr. Levine, I have a question: we had testimony at our last hearing in Seattle. There's a fellow who's the president of a company called the Faria Company, Mr. David Blackburn. They make highly sophisticated gauges for boats; all the Humvees in Iraq have these gauges, for example. And he discovered a couple of years ago that a company had been created in China to counterfeit his gauges, and they were marketing them worldwide. They looked exactly like his gauges. They didn't work very well, but they looked exactly like them.

What I worry about is how many of our Humvees in Iraq have these lousy Chinese gauges? The question I have here is that a company like this, which is a 95 or 100 year-old company, a highly sophisticated, well-established company, starts to go on the ropes, because, first of all, their brand is impugned, their reputation is impugned because the quality of the counterfeiting is no good, and the people are concerned about getting the right gauges.

So the company is hurt; its credibility is hurt, but secondly, its market is damaged. Now, we asked him, what did you do? What does someone do when this happens, president of a very old, reputable company, what do you do? What are you going to do? Sue them in Beijing? Well, that's not going to work. Where do you sue them? Connecticut? They're not coming.

So he went to the Commerce Department, and we asked him what was the result of your meetings with the Commerce Department, and it was fairly unsatisfactory. So, what I'd like to do is two things: first of all, I'd like to get him connected up with you so that he can tell his story to the appropriate officials, and we'd like to find out how can he be helped. How can the Department on the

ground, with an American credible businessman who is being hurt by this unfair IPR theft? That's the first thing.

But where does the guy go in the Commerce Department? What floor does he go to and who does he see to try and get this fixed?

Mr. LEVINE. Well, first of all, please, feel free to direct anyone to me. I'd be happy to serve as the point of contact. We actually have quite a number of people, including a number of attorneys, people with legal experience both in Washington, and then, as I mentioned, one of the top experts on Chinese IP stationed in our Embassy in Beijing.

So we have a lot of resources, and I understand the government is a big place, and sometimes, it is difficult for people to find the front door. With regard to specific China issues, again, I'd encourage you to have people get directly in touch with me. I would be happy to make sure that issues are followed up on.

I would say that the situation that you describe in this case with regard to the counterfeiting of the gauges is unfortunately precisely the kind of issue that we have seen so much of and it encapsulates a very large part of the problem that we are having, and as I say, these are issues we're working very hard.

In November, I went out to Beijing with a large agency team, including representatives from FBI, my counterpart from the USTR, Charles Freeman, the Patent and Trademark Office, and others, and we sat down with the Chinese. Part of the discussion was how do we deal with these very specific issues and cases? When they come up, we have established with the Ministry of Commerce a new mechanism now where we can take individual cases and direct them to the Ministry of Commerce and look to them to help coordinate interagency in the Chinese process.

And so, again, I would be happy to talk to this particular company and see what we can do. It's a big problem, and we are determined to aggressively pursue it.

Chairman D'AMATO. Thank you. We would be interested in getting more information about how this process that you have created works with the Chinese in order to sort of track it and see how successful we are on that. That would be of very great interest to us. Thank you very much.

Cochair MULLOY. Each Commissioner has a five-minute period of asking questions, so Commissioner Wessel.

Commissioner WESSEL. Thank you both for being here, and I want to add my voice to Commissioner Mulloy's and others for thanking you for being here.

We all share a similar frustration about the challenge of China. We want to be able to engage actively. We want to be able to have a strong bilateral relationship. And your being here and sharing openly and honestly some of the concerns you have as well as some of the successes you have achieved is very important to us.

It is somewhat frustrating that some of your colleagues in the administration are not participating. We have questions about currency manipulation. As you well know, it is a high point on our agenda. Senator Schumer and Senator Graham and others raised it earlier. We are having a little trouble understanding why, if this is such a high priority issue, that the Secretary has been over to

China—many secretaries have discussed this; on the other hand, our Treasury Department says that manipulation doesn't exist.

It sounds at times like the sound of one hand clapping on this issue.

But I also want to go to another issue that both of you have raised, and Mr. Levine, I believe you have said that at the end of the day, the Chinese need to feel the sting of enforcement. I believe that is a quote. And Mr. Donnelly, you spoke about needing to see progress——

Mr. DONNELLY. Right.

Commissioner WESSEL. —which we all need to see. When we had our field hearing in Ohio last year, we heard from a large number of small businesses about their frustration with the enforcement regime.

Two of the 421 cases, came out of Ohio, and so, we heard from manufacturers there that played by the rules, abided by the law in terms of pursuing their rights under 421. The ITC agreed with their cases. And then, when their issue went before the policy makers in the White House, their relief was denied. Again, similar with currency manipulation, where everyone complains, but at the end of the day, the policy makers don't take it to the next level, and we've seen little action.

What kind of confidence can you give businesspeople and workers that time is coming to a close when we are going to be talking about these issues, and the Chinese are going to see a more serious response from our government?

Mr. LEVINE. Well, I can start, and then, if Shaun wants to add, that's fine, too.

I guess first just to clarify my quote, I think what I said was that those violating intellectual property rights in China need to feel the sting of enforcement.

Commissioner WESSEL. I understand, but that can also be taken to a larger level that if they don't feel the sting of enforcement more broadly, they may not respond, but I understand.

Mr. LEVINE. Well, I just wanted to clarify my quote and my intent.

Commissioner WESSEL. I understand, yes.

Mr. LEVINE. But I guess to respond substantively to your question, I would respectfully differ a little bit with the implication of the question, which is that we have not to date been dealing seriously with the Chinese on issues. The fact of the matter is, of course, that there are many approaches, many tools, many ways, to address issues, sanctions or even, for that matter, litigation in the WTO obviously are always possibilities.

But we have found that in many areas, we have been able to make substantial progress without necessarily using those tools. As I say, those tools are available and would be used as appropriate, and for that matter we did bring the first case in Geneva, in the WTO, ever brought against China in the WTO on the integrated circuit VAT issue.

So I guess what I'm saying is, I wouldn't accept the notion that one could judge our seriousness by the number of times that sanctions have been imposed or by the number of times that cases have been brought to the WTO, for example. So we are serious. Again,

where there are individual company cases and concerns and we will address those as aggressively as we can. When we find that we have gone as far as we can go through other means, we will continue to exercise our rights under the WTO or otherwise pursue other avenues.

Mr. DONNELLY. If I could just add, Mr. Wessel, we certainly hear stories and cases and so on where there is a belief that the administration has perhaps not taken the right decision or not been as firm as some might have liked, and those can always be debated. What I have not seen in working in the U.S. Government administration through several administrations is this sense that that decisions, certain actions should be taken or made, and then, they are overturned on a political basis as it gets to a higher level.

I know my bosses at the State Department, whether Secretary Powell and certainly Secretary Rice and Ambassador Zoellick, assuming he's confirmed, have made it very clear that they see, you know, moving American economic interests, including with China, getting tough with China, making sure they live up to their commitments are a serious concern and something that they feel that we need to be taking seriously.

Now, people can debate whether one should be pushing here or there or publicly or privately or something like that, but I think there is a commitment; there has been a commitment, and it is shared at the working expert level up through the policy people and at the Cabinet level. And do we always make every decision right? Maybe not, but I think we have got the same objectives.

If I could just add two specific things on intellectual property rights on the earlier question, and I wanted to get on record: there is, on this particular issue of piracy and IPR, the United States Trade Rep is leading a very serious out of cycle review, as it's called, a special review of China to consider, and they are actively seeking input from the U.S. private sector on cases, on problems they've had.

And so, I would encourage any U.S. firms that have had problems to get details. And we can look at what's happening and what particular remedies there might be, and everything is on the table in this review, and we've also, the President launched a new initiative called STOPS, Strategy Targeting Organized Piracy, last September, and it's a multifaceted thing.

But one of the aspects is to try to get our Japanese and European friends and others in the world to join with us in fighting piracy, whether it's entertainment and software or hard industrial goods and so on, so that if we can get our customs working with their customs so that not only do we keep these things out of our market but out of other markets. It's an initiative, and Hank has played a leading role in that.

So we need to do more; we need to do better, but there is a serious commitment to it.

Commissioner WESSEL. I see my time is up. Let me just ask one question, Mr. Levine, if we could do this afterwards, but Congress asked us in consultation with the Department of Commerce to report on a number of items; it came out of the House Appropriations Committee. If we could talk to you about the status of that report;

it was due several months ago. We'd like to work with you in expediting that for the Members who requested it.

Cochair MULLOY. Thank you, Commissioner Wessel.

Commissioner Becker.

Commissioner BECKER. Thank you, Mr. Chairman.

I was going to hit on some of the same subjects as Mr. Wessel. I think I'll leave that alone at this point, though. Let me ask you about trade agreements: it seems that every trade agreement that's negotiated, whatever surplus, trade surplus that may be in existence at that point rapidly disappears, and we start accumulating deficits, large deficits. That's not just on one; but on all of them.

When you look at China, that trade deficit with China has reached epidemic proportions. We are approaching $161 billion for fiscal year '04. It's expanding at the rate per year of 20 to 29 percent. It will double or triple within 3 to 5 years, if the trend stays the same. I've never seen a trend go down; it continues to follow that. You talked about having a strategy, strategy sessions on how to deal with problems. First of all, do you consider that a problem?

Second, what and how are you going to deal with this? If you stay with this trend, what will we be facing here in the United States five years from now or 10 years from now?

Mr. LEVINE. I'm happy to take a shot at that.

First, with regard to the question of whether the deficit is a problem, I think certainly, at a minimum, as we all know, and as reflected in this hearing, it is at a minimum a significant political issue and much on the minds of many.

I think that economists seem to differ on the economic impact of a bilateral trade deficit such as that that we have with China and, in fact, of course, with regard to the China deficit in particular, it is the case that much of this deficit or much of China's exports are the result of production, manufacturing production that has shifted from other countries or other parts of Asia into China.

I am told that, in fact, the higher share of U.S. imports from China has been more than offset by a declining share of imports from other Asian countries. In other words, many of the products we're importing from China some years ago would have been produced in another Asian country.

Commissioner BECKER. The Chairman of the Federal Reserve says that we can't continue doing what we are doing now. There used to be an old Missouri saying; I don't know if anybody's here from Missouri, but if you always do what you always did, you'll always get what you always got. We're on that trend, and that's what's happening. Regardless of who's shipping it into the country, from China, the trade deficit is there, and it keeps mounting.

What I want to know is what's going to happen if nobody does anything.

Mr. LEVINE. Well, to come around to the solution side of it, which I think really goes to your other point, and you mentioned the question of a strategy, and from our perspective, we are focused on both of the elements that make up the deficit; in other words, we have and will continue to strictly implement our trade laws so that the products coming into the U.S. are not the result of unfair trade practices.

On the export side, we are very focused on ensuring China's WTO implementation, on removing remaining barriers that U.S. companies, U.S. exports face in the China market and furthermore, we at Commerce, our trade promotion colleagues are very focused on helping assist U.S. companies to export more.

So we are actively working both sides of the equation in a very focused way.

Mr. DONNELLY. Mr. Becker, I certainly agree with what Hank said. We are concerned when there is a deficit, and when it is a growing deficit, it gets our attention, and I think the solutions are the ones that Hank laid out. Increasing our exports is obviously one way to do it, and that's a high priority for the State Department, the Commerce Department, to help our firms do that; make sure other people follow the trade rules; whether it's WTO rules, that we use the Dispute Settlement provisions; or if it's a bilateral agreement, and we have other provisions, and we keep working to remove barriers.

But I can assure you that in our building, we take notice of deficits, and they do get our attention, and we are trying to be a part of a strategy that can address them.

Commissioner BECKER. Let me just phrase one other question on that, not to beat a dead horse. What are we looking at five years from now if this continues? What are we looking at 10 years from now? Is there any danger of a collapse of our economy if this continues just like it is now? It's at the level of 29 percent a year, where it would triple every five years?

Mr. LEVINE. Clearly, at a minimum, in political terms——

Commissioner BECKER. Right.

Mr. LEVINE. Clearly unsustainable to see this type of growth in the bilateral deficit with China; there's no doubt about that. You know, again, I wouldn't want to hazard a prediction as to what the number would be in five years or 10 years or 20 years, but clearly, it's unsustainable. There is no doubt about that.

Cochair MULLOY. Commissioner Dreyer.

Cochair DREYER. I don't know if you heard the first panel with the Members of Congress or not, but listening to your testimony and comparing it with theirs reminds me of the difference of opinion on the definition of work. Is it hours put in, which you obviously have been doing, or successful accomplishment of goals, which hasn't been happening.

As I listen to what you all were saying, Mr. Levine, you were saying we're taking steps to help China enforce its IPR obligations. Mr. Donnelly, you've been saying Dr. Rice says she will pay close attention to IPR and that China has agreed to do such and such, but that it has yet to issue guidelines.

Again, listening to your testimony, you say "we're concerned with," "we're disturbed by," "we're carefully watching," "we remain troubled by," "we interact regularly with." I don't see anything coming out of this in terms of successful resolution. Is it our intention to dialogue forever without seeing any results, or do you think at some point, we will do something. You've said you think this deficit is unsustainable. At what point do we finally say we've talked enough and actually do something?

In this regard, you've said we're working with China to help China to enforce its IPR obligations. Somehow, this gives me the impression that you think the Chinese are sincere about this. I would say, given the fact that the system is riddled with corruption, and that too many people are making money off of it, and having seen this myself, that nothing is really happening. You ban something, and so, the factory goes out of business. But it opens up three days later a block down the street.

Do you think any of this really is making a difference, or are we deceiving ourselves by saying, "look, we're helping the Chinese; we're going to get some results one of these days?" I get very depressed about it.

Mr. DONNELLY. I came in, and I believe Hank came in when Senator Byrd was speaking, so I heard that part, and Senators Landrieu and Dorgan, so I didn't hear, to answer your question. Look: in my view, and I believe it is the view of our Department, there is a lot of work to do; we're not making as much progress as we want to make. We're working hard.

How far along we are in that spectrum, everybody, I guess, would decide on their own. But I guess I would just make the point that I don't think it's a dichotomy between talking on one side, and progress on the other side. This is what the talking, the dialogue, the pressuring, whether it's Ambassador Randt out there in China or the embassy staff or visiting delegations or dialogue with our people in Geneva, with the Chinese people in Geneva about a case or something like this.

This is one of the tools through which we make progress. We probably didn't get as much progress as fast as we would like, but I think we are making progress. Now, I am not going to deny that we make progress in one area, and a new problem opens up. Yes, and we just have to keep putting more resources on it and try on the export side. I think China is, as I said, our fastest growing export market. I think since China joined the WTO, U.S. exports to China have increased by about 80 percent.

So that says to me working with the private sector and others, we have been able to make some progress. Have we solved all of the problems? No. Are we having to make decisions about where we can do it and where we have leverage and all of that? Yes. Is it where we want it to be? No, in my view.

But I think the idea of working hard and dialogue and digging in, whether it's at the ambassadorial level or at the cabinet level or at the junior officer level out in our embassy in Beijing or the consulate in Shanghai is one of the ways we make progress. It's not the only way, but it's really an important part of it working with the American companies that are out there.

Cochair DREYER. What progress would you say you've made? I don't mean saying they've passed regulations, because I've been working with the Chinese for 40 years now: They will say that they will do a lot of things, and they will change a lot of things on the books, but you don't notice any actual change.

So what real successes can you say you've had?

Mr. DONNELLY. Well, I will cite the fact that American exports are up by 80 percent in four years.

Cochair DREYER. But the trade deficit is worse, so is that progress?

Mr. DONNELLY. The trade deficit is worse.

Cochair DREYER. I would say no, that is not progress.

Mr. DONNELLY. No? Okay.

Mr. LEVINE. Let me, if I could; I would want to respond very directly to the characterization of what we're doing as work without results and I have to differ with that.

Maybe we don't do a good enough job in communicating all of the details of everything that we do, but the fact of the matter is that all of us, on an interagency basis, are producing results. Talk to the IT industry about the results we got on the WAPI encryption issue. Talk to the fertilizer industry about the resolution that we had on a technical standard for cadmium in foreign fertilizer. Talk to the medical devices folks about an issue that we helped them solve in Shanghai a couple of years ago on pricing. Talk to a small company that we helped about eight months ago that was on the verge of going out of business based on a customs valuation problem they were having in China that we got resolved for them.

And I could go on. Talk to the auto industry about the efforts that we made in helping to achieve modifications in China's auto industrial policy. So, from my perspective, as Shaun said, we certainly haven't solved all of the problems, but we are making progress on many of them and have had concrete results.

Cochair DREYER. Thank you.

Cochair MULLOY. Commissioner Wortzel.

Commissioner WORTZEL. I appreciate the testimony from both of you, and I appreciate the work you do for the country.

If we have had this 80 percent increase in exports to China, I'd be interested, if you could, just characterize what sectors they have occurred in. Are they in specific sectors? Second, we have seen a lot of figures that would tie imports from China to losses in American manufacturing jobs.

It would probably be useful, at least for those of us that think trade isn't a bad idea, if we could get data that might tie imports to the United States or, rather exports from the United States to China specifically to numbers, manufacturing jobs that are supported by that or jobs in general; doesn't have to be manufacturing, and then, the number of indirect jobs that those direct jobs support. So that's not something I would expect you to answer here. I hope you will be able to answer the question on what sectors it's growing in, but if you would point us in a direction that would let us get those figures, it would be very useful.

Hank, I focus on a very narrow portion of your testimony here, the written, that I find very interesting, and I'm going to ask you a series of questions, none of which do I expect you to have to answer at the table, but I think if the Chairman might, my questions may drive a letter to your Department that will ask for a more detailed report on a series of issues.

I am fascinated by the progress you have made in dual use, end item user visits. For folks who don't understand that, that means a company in China has applied for a license to get some item manufactured in the United States that has military utility and that could improve China's military technology.

My own experience at the Embassy with you in China is that about 90 percent of the times I went to visit a place that applied for a license, it didn't exist. It was a false front that was set up so that some Chinese military producer could get a technology that China couldn't produce. So what you're doing is very important.

Could you give us the number or percentage of false addresses you've found in your end use visits? And do you visit and confirm every end user, or do you sample on these licenses? When you go on an end use license visit, do you make the visit before the item is licensed for export to make sure it's going to the right place, or is the cat already out of the box, the horse out of the barn, and do you visit after the fact?

As you're doing this, how many front companies have you found? Now, as I said, in my time, it was 90 percent. Today, is this getting better? How many front companies are there that are fronting for military producers, or are these real licenses today? How many people at the Embassy in Beijing do you have involved in this effort? Can you go to other offices like the Defense Attaché's office to go out and help you with these things? And finally, are there people in the consulates also producing these end items?

So that's a lot of questions. I think it probably could be the subject of a hearing or a report. I hope the Commission will ask for that, but I appreciate your time on it.

Mr. LEVINE. Very briefly, let me say that we will be delighted to get you those answers. The details are the purview of our colleagues in the export control side of Commerce. I will just very quickly say that the arrangement that we achieved with China cleared out a very large backlog of requests that we had pending to get in and do these end use checks.

Again, in response to Commissioner Dreyer's comment, I think a concrete step forward which has allowed us to facilitate these visits and clear out a backlog. As to the rest of it, we will get you all the details.

Mr. DONNELLY. Could I just respond to Commissioner Wortzel's question about fastest growing sectors? We will get you that detail. It may, in fact, come from the Commerce Department, but my sense, the biggest sectors we're exporting are electrical machinery, industrial machinery, aircraft—Boeing just signed another agreement with the Chinese last week at the Commerce Department—also, oil seeds, a big thing, and cotton, a couple of agricultural areas, raw materials, copper, and so on like that, are the sectors, most of the things we're exporting to China, but we'll get you a detailed list with the changing patterns.

Cochair MULLOY. Commissioner Bartholomew.

Commissioner BARTHOLOMEW. Thank you very much, Mr. Chairman, and thank you to our witnesses their taking the time to come up and testify before us and for their service to the United States and the people of the United States. It is appreciated.

I would like to associate myself with Commissioner Wortzel's questions. I think they are important ones. I would take issue just with one comment he made, which is the implication that there are people who do not support trade. I don't actually believe that is the case, and I do not think he does either. The question is what are the conditions under which trade is taking place?

You can probably detect a fair amount of frustration up here. In some ways, my question is going to be more rhetorical than anything else, because I share the frustration. I found that Commissioner Dreyer was asking questions essentially framing them the same way that I and a number of us are thinking about them.

The reality is it seems that the United States has, for at least the last 15 years, bought into the framework that the Chinese government has created, not only on trade but also on proliferation and on human rights, that somehow, negotiations are in and of themselves progress and that talk is its own reward.

I recognize, of course, as do we all, that negotiators and those of us sitting up here have jobs. We have income. We have health benefits. And so, the talk, frankly, can go on forever in terms of the people who are participating. I do not mean to cast aspersions on any of your efforts or any of the efforts of the other people who have done this.

But given the fact that things don't seem to be improving in so many areas, given the fact that the trade deficit is soaring, that new barriers for American products go up seemingly every time the Chinese agree to bring some of them down, you look at the history on intellectual property rights alone. We have had what? Four memoranda of understanding in the last 12 years.

I just wonder and would appreciate your thoughts on why should American workers who have lost their jobs, jobs that aren't coming back, why should they believe that the U.S. Government either is going to be able to do anything about this economic situation with China?

Thanks.

Mr. LEVINE. Good; well, I'd say first, again, I'm picking up on the thread of the previous exchange with Commissioner Dreyer. I would say that I think a review of the record of the past four years would show significant progress on any number of issues, concrete resolution of problems that are faced by U.S. companies, barriers to exports, and for that matter, I think this four-year period probably compares favorably with any four-year period in our relationship, our economic relationship with China.

A few moments ago, I went through some of the concrete results, and again, Commissioner Wortzel mentioned the end use visits; again, another area where we have made progress. So again the underlying assumption that the United States is being taken to the cleaners by China, we are being talked to death and not getting any results is one, frankly, that I think is in error, and I think we're making important progress.

Certainly, the deficit continues to rise. It rises very rapidly. As we said earlier, it is not sustainable over the long run. However, it is also important to keep in mind the complexity of the factors that go into creating that deficit. As I say, a large part of it simply being the relocation of production facilities from other parts of Asia onto the China mainland, and we have therefore seen a decrease in our deficits with other parts of Asia as the deficit with China has increased.

So judging, in other words, making the deficit or the size of the deficit the benchmark of how well we are doing in terms of our trade relations with China making that the sole benchmark I don't

believe is the best approach. Bottom line, I guess, is to say that as Shaun mentioned, our exports to China are way up.

As I mentioned, I think we have tackled problems. You're frustrated, certainly we're never satisfied with the amount of progress that we have made, and all I can say is that we will continue to try to do even better in the future and continue to open the market more for U.S. companies.

Mr. DONNELLY. Well, I'll just say diplomats and State Department people are often accused of just liking to talk for talk's sake. That is not our approach on this. We, like you, like the business community, want to see results, and as Hank says, on the export side, on getting the Chinese to apply the rules, we're seeing some success; not enough; we need to keep working at it.

But we certainly don't see talk as its own reward or dialogue or promises. It's results we're looking for, just like you.

Commissioner BARTHOLOMEW. Mr. Chairman, just one closing comment on my end. This Commission spent a day in South Carolina last year and a day in Ohio, and it is a stark reminder of what is happening in communities on the ground. I think it behooves all of us to spend time traveling outside of Washington, D.C. and into these communities to remind us what's at stake.

Thank you.

Cochair MULLOY. Vice Chairman Robinson.

Vice Chairman ROBINSON. Thank you, Cochairman Mulloy.

I have a couple of questions. You just made an interesting statement about the fact that the deficit seemed to be falling in other Pacific Rim countries, whereby it's growing in China, in part because China is used as a highly competitive export platform and the like. We have statistics here, however, that indicate that the Pacific Rim deficit is up from 2003 to 2004 22.6 percent; Japan 13; China, admittedly, the largest at 29.9, but that overall, the deficit figure for the region is rising. That's just something that we might like to have clarified, if you don't mind. A second question: It's my understanding, and I think that of my fellow commissioners, that under our trade laws, the U.S. has a right to keep what have been identified as counterfeit goods out of our markets. Is that correct? And how well policed is that kind of denial mechanism?

And to Mr. Donnelly, a slightly different question: When you look at overall U.S.-China relations, and this goes back to a point that you were making earlier, is it your position that you have seen no evidence that we are pulling punches, so to speak, in the trade portfolio, whether it's bringing issues to WTO dispute settlement or the robust nature of enforcement measures to help advance what are regarded by senior levels of the administration as more strategically sensitive dimensions of the bilateral relationship, such as denuclearizing North Korea?

We have heard a lot about these alleged tradeoffs. I just wanted to clarify your position as to whether you see evidence that these kinds of trade-related punches are, in fact, being pulled for what are perceived as greater gains in U.S.-China relations.

Mr. DONNELLY. Let me address that, Mr. Vice Chairman, because I think it's a very important point.

You have stated accurately what I have seen or not seen. There is no question we have a broad agenda with the Chinese: North

Korea proliferation is obviously a very important issue. But I have never seen a case where there is a trade decision to be made, and someone at the State Department or at the White House or the National Security Council says, no, we can't do that.

People at various levels can say let's not do this this week; let's do it next week; let's do it publicly, privately, but in the fundamental case of whether we somehow trump an aggressive, strong enforcement trade policy to advance other issues, I have not seen that, and I would welcome any evidence in that regard.

On the counterfeiting question, Hank may know more about this than I do, but we do have—we are allowed, there are provisions under WTO but also under U.S. law to keep counterfeit goods out, and we can perhaps get more detail for you on that. I will be candid with you and say that the people who enforce that are the Customs Service in the Department of Homeland Security; they have a lot of other things they are looking for at the border these days, and the amount of resources they're able to devote to it are finite and so on and so on.

But we have a legal basis to do it; we have a commitment to do it; the Homeland Security people are trying to do it to the best of our ability.

Mr. LEVINE. If I could just quickly, first of all, I echo what Shaun said. From the perspective of the Commerce Department, were there some kind of concern about overall relations with China or their help in other areas; we would be on the receiving end of that, and the fact of the matter is absolutely not. Every trade issue that I have been involved in during my tenure at the Commerce Department have been addressed on the merits as a trade issue, and I am not aware that we have been subject in any way to pressure with regard to unrelated issues, number one.

Number two, yes, we will need to get back to you on the details. Indeed, it is largely a function of interaction, as I understand it, between U.S. companies and the Customs Service.

Vice Chairman ROBINSON. Right.

Mr. LEVINE. Companies can register their trademarks and patents with the Customs Service, and that allows Customs, then, to identify goods that are coming in that would be in violation, for example, of those trademarks and patents. There is a mechanism, but we will undertake to get you more details.

Cochair MULLOY. Yes, that would be enormously helpful if you would provide us the details on that.

I'm going to ask my question now as Chairman, and it fits right in with what you just asked: Section 421, which is the China-specific safeguard, when Congress put that into the law, Congress said if the ITC makes an affirmative determination, there would be a presumption in providing the relief. The ITC looks at the matter, and they make a recommendation to the President.

Now this has been invoked by the ITC a number of times, found that American companies have been damaged, sought relief under Section 421, and the administration, the President, has denied relief at least three times. The statutory standard is that President should find relief unless providing relief would have an adverse impact on the United States economy clearly greater than the benefits of such action or that in extraordinary cases, that such action

would cause serious harm to the national security of the United States, end quote.

So, in other words, ITC makes the recommendation; this is the statutory standard. The President should grant relief unless he finds there's some kind of extraordinary economic harm or national security of the United States. Mr. Stewart, who is going to testify later, comes in and tells us that on those Section 421 determinations, when they come from the ITC, there is an interagency committee that meets and then makes recommendations to the President.

He tells us that the Chinese government has lobbied strongly to discourage the President from utilizing 421. And he gives specific examples of lobbying efforts by the Chinese government to really make that provision of law not applicable, because if people apply, spend money to get that relief, they don't get it, they get the message they're not going to get relief, and nobody else, then, goes through the channel of asking for it.

Now, you probably both in State and Commerce, are on that interagency committee that advises the President whether to give relief or not. One, I ask you, have either of you specifically been involved with any of these Section 421 recommendations, and two, has there been political lobbying going on that influenced your judgments on whether to use that or not? Thank you.

And maybe I'll go to Mr. Levine first and then Mr. Donnelly.

Mr. LEVINE. Yes, I would say on that that first, the Commerce Department is actively involved in the interagency process on the 421s which, as you know, I think, is led by USTR.

Cochair MULLOY. Correct.

Mr. LEVINE. I have personally not been present literally in the room and directly involved. I will say, however, that again, I am not aware, and have absolutely no reason to believe that there were any inappropriate influences in any way, shape or form that influenced the outcomes.

And I'd further, want to expand and say, the Chinese government expresses its unhappiness on lots of things that we do. In fact, as we all know, one of the benefits of our system and one of the things that we keep criticizing the Chinese about is we are a tremendously transparent system, and that allows everyone to know what we're doing, and it allows all kinds of groups and foreign governments and everyone else to try to weigh in with their positions.

The Chinese government was not happy when we implemented textile safeguard some time back. The Chinese government was not happy when we took a case to the WTO. The Chinese government was not happy when we have sanctioned Chinese companies for proliferation related activities, and they have made their views known. So I guess the fact that the Chinese government makes its views known to the U.S. Government on issues of concern, I don't find exceptional in any way.

To my knowledge, all of the decisions on the 421s are taken on the merits of the case.

Cochair MULLOY. Under that statutory standard, so to utilize it, it must be in some national security interest of the United States, or providing relief would have an adverse impact on the United

States economy clearly greater than the benefits; that's the standard.

Mr. LEVINE. That is my understanding.

Cochair MULLOY. And you say that these decisions are being made on that basis?

Mr. LEVINE. That is my understanding.

Cochair MULLOY. Mr. Donnelly?

Mr. DONNELLY. Mr. Chairman, I would say the same thing. In my recollection, in the four years I have been in this job, I have been at a handful, it might be one, it might be three interagency meetings at my level where the 421 cases were discussed. People who work for me, some cases get resolved, or an interagency consensus is reached at a lower level, but I have been involved in a couple of other cases not personally in the room.

In none of those cases have I been approached in a meeting or so on by a Chinese official or a representative on behalf of Chinese officials. On some of those cases, there have been representatives of U.S. firms around the case, the original filer of a case or someone who uses—who takes the product and uses it further or a competitor or something like this, but nothing from the Chinese side and certainly nothing, no influence I've ever felt.

And it's been my sense that the debate in the sessions I've been in—the interagency has all been about what is the overall net economic effect on the U.S. economy, and it's on that basis that USTR leads the discussion and comes up with a recommendation that goes to the President.

Cochair MULLOY. Are you required to report to the Congress on the utilization of that provision? Do you know?

Mr. DONNELLY. I do not know.

Mr. LEVINE. I don't know. We'd have to check on that, and USTR is kind of the main lead on the issue.

Cochair MULLOY. If you could and——

Mr. LEVINE. We'll get you the details.

Cochair MULLOY. Sure.

Senator Thompson.

Commissioner THOMPSON. Mr. Chairman, if you have another question, I'd like to cede my time to you.

Cochair MULLOY. Well, thank you, Senator. I do have another question for Mr. Levine and Mr. Donnelly.

As you know, China has been lobbying to be declared a market economy, and they have gotten that from Brazil, Argentina, New Zealand and others. The EU has declined to give China market economy status.

We have a statutory framework, which governs whether we can recognize another country as a market economy or not. My understanding is that the Chinese are lobbying the American Government to give them market economy status, and one reason, of course, I think it makes our dumping laws less effective than they might be otherwise under when they're a nonmarket economy.

The question is, you have set up a working group with the Chinese under the JCCT. Is it the administration's intent to follow the statutory standard, or would politics get into this decision making and lobbying on behalf of firms that might want China to have that status or are you going to stick to the statutory standard? Among

the rules there is that China not be manipulating its currency. So I just want to clearly get that on the record what's going on here.

Mr. LEVINE. Thank you. Yes.

We did, indeed. One of the outcomes of our April 2004 JCCT was the establishment of a working group which we refer to as the Structural Issues Working Group, and the intent of our activities under that working group is to make crystal clear to China the requirements of the statute which you have just described, and we don't want there to be any lack of clarity or misunderstanding on the Chinese part about what the requirements of the statute are.

Indeed, it is the administration's intent to apply the requirements of the statute on the question of market economy status for China. So yes, absolutely, the intent is to apply the requirements of the statute.

Mr. DONNELLY. This is a process that's led by the Commerce Department, but that is certainly the understanding of the State Department as well. There is not going to be a special deal or a political deal. There are requirements under the statute and led by the Commerce Department, that will proceed on that basis.

Cochair MULLOY. Fine, thank you. We have two Commissioners who wanted to ask very brief followup questions.

Commissioner Becker and then Chairman D'Amato.

Commissioner BECKER. Yes, very quick, because it's on the same subject, the nonmarket economy.

When PNTR was negotiated, American industry—I'm talking about your core industries, your big industries, all of them, the workers were promised by USTR that there was a 15-year span before they could become a market economy. And I feel, from the conversations we've had and with other groups, that if this is not followed, if this is rolled back in some way, that industry in the United States and workers in the United States would consider this a betrayal from the understanding they had when PNTR was passed.

I just wanted to make that comment.

Cochair MULLOY. Thank you, Commissioner Becker.

Chairman D'Amato.

Chairman D'AMATO. Thank you, Chairman Mulloy.

I have a question: Senator Byrd, in his legislation, in fiscal year 2004 and 2005, both years, the Consolidated Appropriations Act, both houses of Congress directed the Bush administration to undertake negotiations in the WTO to resolve this dispute with regard to the Byrd Amendment and decisions in the WTO.

We understand the administration has put that on the table, but we are not clear that the negotiations are ongoing. Can you give us some assurance that they're ongoing, or can you get back to us on that, or what is the status of the statutorily directed negotiations in the WTO?

Mr. LEVINE. I would say that I would have to get back to you on that and get you the update.

Chairman D'AMATO. Thank you.

Cochair MULLOY. I want to thank both of you for being here with us, and I want to thank your Departments. We have been well received by Ambassador Randt when we were in China, and he has been very helpful to this Commission. And my former colleagues in

the Commerce Department have been enormously helpful as well, and tell them we do appreciate it so much.

Thank you.

Mr. DONNELLY. Thank you, Mr. Chairman.

PANEL II: EVALUATING AVAILABLE TRADE REMEDIES

Cochair MULLOY. In our next panel, we are going to examine available trade remedies under U.S. law, and we have with us two outstanding witnesses, Mr. Terence P. Stewart, who is the managing partner of Stewart and Stewart law firm, and Mr. Alan Wolff, who is a partner with the law firm of Dewey Ballantine.

So we won't take a break. We'll move right ahead and ask you, Mr. Stewart, you have done a study for the Commission regarding China's WTO compliance. It would be helpful, if we started with you and then moved on to Mr. Wolff. And then, after you finish your statements, which are limited to eight minutes or so, then, we'll have questioning by the Commissioners.

STATEMENT OF TERENCE P. STEWART, ESQ.
MANAGING PARTNER, STEWART AND STEWART

Mr. STEWART. Thank you very much. It's a pleasure to be here this afternoon.

Mr. Wolff and I have decided to kind of split up the topics, where he is going to take the antidumping regime generally and CDSOA specifically and talk about those, and I will give a general overview of the trade remedies and some of the problems in using the trade remedies as it pertains to China generally.

You may have seen in the current issue of Business Week the front cover story is entitled Fakes. It deals with the counterfeiting issue, and I believe that they estimate, the World Customs Organization estimates that globally, the problem of fakes or counterfeiting is roughly a half trillion-dollar issue, and roughly two-thirds of that counterfeiting flows from China at the present time.

The remedies you all were asking the prior panel about, Section 337 lets you deal with import problems of products that violate a variety of laws, including our intellectual property laws. Customs has the ability to seize product that is in violation of copyright provisions. So those two deal with the U.S. side.

The problem, of course, is whether you can catch the fact that there are products coming in; the fact that these same types of laws do not work necessarily in third countries, and, of course, they are not helpful for the counterfeiting problems that exist in China as such.

And so, some of the other programs that the prior panel talked about were an effort to try to deal with third country efforts to get other countries to beef up their enforcement, but clearly, this is the single largest problem in the bilateral relationship in terms of equity for U.S. producers in their efforts both for maintaining access in this market and foreign markets.

When you look at other trade remedies that exist, you all have talked a bit this morning about the product specific safeguard that was put into the protocol of accession with China as China joined the WTO. It is there for a period of 12 years, and not surprisingly, since China is the only country that has ever joined the WTO or

the GATT before that has had such a special safeguard, they have not been terribly pleased about this obligation and have worked very hard to see that countries do not bring cases against them, or if cases are brought against them that those cases do not resolve satisfactorily.

And so, the result, even though the Congressional purpose was to have a law that was much more user-friendly and much more likely to result in relief. The fact of the matter is that there have been five cases and all five cases have gone down. Three of them have gone down at the end of the day through Executive Branch review; all have been claimed to be on the basis of economic analysis. Two of the cases failed at the ITC in terms of the injury standard that's there.

So one of the principal architect items that was in our bilateral relationship with China that was designed not to provide an alternative to normal safeguard actions but was designed to provide industries with the opportunity to prevent being destroyed while China is adjusting—all right, because they have large areas where the prior administration and this administration believe that they will be making significant adjustments as the WTO compliance process moves forward—has proven to date to be ineffective.

You have the textile safeguard; I know you have a panel that deals with that. While it has been late in being implemented, the administration's results where there have been cases have been better there. You have four or five that have been upheld. You have a one-time phenomenon, which is whether or not you can use these laws for products that have not yet been integrated into the WTO system. That has been held up in court. The administration has announced that they are going to be taking a challenge to the court of appeals.

So while that remedy has been late in being used, its success rate to date has been reasonable. And however the court litigation works on the threat issue, there is very little doubt that the remedy will be there until 2008 for the textile industry of the United States. So one of two special items that were put into the China Accession Protocol have worked reasonably well.

The TRM, which is not a remedy but was intended to be a watchdog process, because it was the first time such a provision had ever been put into a protocol of accession, governments did not think through all of the issues. WTO is a consensus organization, and China has largely bristled at anything that is a China only obligation. TRM is a China only obligation; they have done what they can to minimize its relevance, and as a result, the process has not been terribly meaningful in terms of moving the process ahead.

If you talk to most governments that are part of the WTO, they will tell you that nonetheless that China just as the prior panel has said has been willing to work bilaterally with other members where there are issues of particular concern that are raised, and most other governments believe they have been able to address issues bilaterally although not immediately, over some period of time.

On other trade remedies that we have in the United States, the Executive Branch has chosen for the last 25 years not to apply to China one of them, and this is our countervailing duty law. Flowing from a case in the mid-eighties dealing with, at the time, Po-

land and Czechoslovakia, the Commerce Department decided that they weren't going to apply our U.S. countervailing duty law to nonmarket economies.

This decision was upheld in court as a reasonable construction of the statute by the agency. This is not required by the statute; this is an agency determination. Interestingly, with China, the prior administration and this administration spent a lot of time, including in this last year, identifying subsidy practices in China that are problematic to the United States, yet, we choose by executive action not to make one of the statutory remedies available to our industries to address these problems.

So you have three of four so far that are not usable. And the dumping law, which Mr. Wolff is going to review, that has been widely used. There are 60 orders that are on the books in the United States as of the beginning of this year that pertain to China. There are problems in terms of how well it works under the nonmarket economy methodology.

The issue that I raised in my prepared statement deals with the collection issue, and I know that this was an issue of some interest to some of the Members. The inability to collect duties is a complex problem. The way the statute is drafted, it has worked very well, or we believe it has worked very well for many years. But for CDSOA and the reports that Customs has to prepare for the Congress and that it releases publicly, no one would ever have known that there was a collection problem, certainly not a collection problem of the magnitude that there is.

It tends to have arisen on Chinese companies. They account for roughly 85 to 90 percent of the uncollected monies. They tend to appear largely in fragmented industry cases, agricultural cases or cases where you have hundreds or thousands of producers and hundreds of importers, and part of the problem is lack of attention from Customs on what are called the general entry bonds that merchandise comes in with.

If it comes in early, it may not be of sufficient value, so that if a company disappears, and in these smaller cases or smaller producer cases, you have many importers that simply disappear after merchandise has been brought in before final liability has been done. You heard Senator Byrd talk about the bill that was introduced last year to deal with some of the new shipper issues, and that is an important step.

There are other items; in one of the cases, cash deposits were posted, but they were relatively low. The final liability ended up being a lot higher. The import community basically bailed and disappeared, declared bankruptcy or otherwise; they were not found, and there was not sufficient bond coverage on top of that to help address it.

This has not been a problem as far as we can tell to any significant extent for any country other than China, and on China, it is limited to a number of cases, most of which involved highly fragmented industries. Mr. Wolff has been involved in the shrimp case; he hasn't yet gotten to that phase. They have just gotten orders, but if crawfish is a good example, they are going to have significant problems without attention being put on that issue.

So we have problems with the tools that the Congress has provided us, and it is important that there be meaningful tools both in the United States and abroad for our industries to have a fair chance. With that, I will stop.

[The statement follows:]

Prepared Statement of Terence P. Stewart, Esq.
Managing Partner, Stewart and Stewart

Members of the Commission, good morning. I appreciate the opportunity to again appear before the Commission as it reviews aspects of China's compliance with its WTO commitments and obligations after three years of WTO membership. My statement today addresses the effectiveness of available U.S. trade remedies vis-à-vis Chinese imports.

Introduction

Before turning to that topic, if I may, I would like to make some overall observations about China's WTO compliance. As I noted last year, China's accession to the World Trade Organization was a significant and historic event and it continues to be a great experiment. Thirty-seven months have now passed since China's accession. We are now capable of greater perspective as to how successful China has been, and is likely to be, in meeting the commitments it agreed to at accession.

Recently, as an update to previous reports, my firm prepared a report for the Commission on the status of China's compliance with its WTO commitments in 2004, the third year of China's WTO membership. The report covered a variety of topics including compliance deficiencies; the use of China-specific safeguard measures in the U.S.; whether China's exchange rate policy is susceptible to a WTO challenge; the non-market economy status of China in U.S. antidumping proceedings and the prospects for change of that status; the U.S. policy of not applying countervailing duty law to China and other non-market economy countries; the problems of infringement and lack of enforcement of intellectual property rights in China; areas where a WTO challenge should be considered due to China's non-compliance with commitments; and the operation and effectiveness of the Transitional Review Mechanism.

In 2004, China met its WTO commitments in numerous areas. However, there continued to be areas of non-compliance that caused concern to the U.S. Government and the U.S. private sector. A short review of the primary areas of compliance concerns in 2004 includes the following:

- *Intellectual property rights:* China has undertaken major efforts to revise its IPR laws and regulations but piracy remained rampant and enforcement seriously inadequate.
- *Trading and distribution rights:* China implemented its commitment to full trading rights ahead of schedule but concerns remain regarding distribution rights because China did not issue specific rules clarifying how distribution rights would be acquired.
- *Services:* In many services sectors, China met the letter of its liberalization commitments but frustrated the spirit by imposing new and burdensome licensing and operating requirements, such as high capital requirements and prudential rule requirements that exceed international norms.
- *Agriculture:* U.S. exporters experienced continued problems with market access and transparency.
- *Industrial policies:* In a number of areas, China has continued to employ policies that effectively limit or impose conditions on market access, or give preferential treatment. Some selected examples include:
  - discriminatory VAT policies
  - failure to provide national treatment with respect to price controls on medicines and drug reimbursement
  - preferential import duties to certain products (particularly from Russia)
  - discriminatory application of SPS measures
  - disparate standards testing of foreign products compared to domestic products
  - inadequate transparency for proposed technical regulations and conformity assessment procedures
  - development of unique standards for products in spite of existing international standards
  - inconsistent application of the China Compulsory Certification (CCC) mark

- investment laws and regulations that continue to "encourage" technology transfer
- auto industrial policy that discourages auto parts imports and encourages use of domestic technology
- government procurement policy that mandates purchases of Chinese-produced software to the extent possible

Available Trade Remedies: Are They Effective in Dealing With Imports from China?

WTO Members agreed to the accession of China to the WTO in December 2001 before China had achieved a fully WTO-consistent trade regime. A key element in granting early accession to China was the establishment or maintenance of a number of trade remedy measures or policies that other Members could use in the event that, during China's transitional period to full WTO compliance, imports from China caused market disruption or injury to their domestic industries.

In evaluating the effectiveness of available trade remedies, this paper focuses on the two China-specific safeguard measures (*i.e.*, the product-specific safeguard, known in U.S. law as Section 421, and the China textile safeguard), and the chronic problem of under-collection of antidumping duties on Chinese imports covered by antidumping duty orders. In addition, the paper addresses one trade remedy that is not currently available with respect to Chinese imports, but could and should be available—that is, the application of countervailing duty law to Chinese imports benefiting from countervailable subsidies.

1. Section 421 Safeguard

In Article 16 of its Protocol of Accession, China agreed that, for 12 years following China's accession to the WTO (or until December 11, 2013), WTO Members could use a general "product-specific special safeguard" measure with respect to Chinese goods. This product-specific safeguard is applicable to any type of product (both industrial and agricultural goods) and permits the U.S. and other WTO Members to take action to curtail imports of Chinese goods that cause or threaten to cause "market disruption" to a domestic industry producing similar goods. The transitional product-specific safeguard is unique to China. No other acceding country (either to GATT or the WTO) has been subject to such a special product-specific safeguard.

The U.S. and other WTO Members insisted on the China-specific, product-specific safeguard mechanism because they recognized that, at accession, China still remained a long way from fully meeting all obligations of WTO membership and would require a transitional period. The product-specific safeguard provides a measure of protection for other WTO Members from import surges during China's transition to a fully WTO-consistent trade regime.

The China product-specific safeguard was enacted into U.S. law by Section 421 of the Trade Act of 1974, as amended, 19 U.S.C. § 2451. Section 421 permits U.S. domestic industries and workers adversely affected by increased imports from China to seek relief. The Clinton Administration stated, and Congress understood, that the special safeguard measure ensured that, on the lowest showing of injury, the U.S. could take effective action against import surges from China that cause market disruption in the United States.[1] In enacting Section 421, Congress indicated that the measure should be applied vigorously to address import surges from China.

The rationale behind Section 421 was that U.S. industries should not lose jobs due to competition from Chinese imports at a time when China was adjusting to WTO obligations. Moreover, Congress expressly stated that "if the ITC makes an affirmative determination on market disruption, there would be a presumption in favor of providing relief."[2] Further, Congress said that Section 421 established "clear standards for the application of Presidential discretion in providing relief to injured industries and workers," and that the presumption in favor of relief could be overcome "only if the President finds that providing relief would have an adverse impact on the United States economy clearly greater than the benefits of such action, or, in extraordinary cases, that such action would cause serious harm to the national security of the United States."[3]

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[1] *See U.S.-China Bilateral Trade Agreement and the Accession of China to the World Trade Organization: Hearing Before the Committee on Ways and Means, House of Representatives*, 106th Cong., 2nd Sess. 48 (Feb. 16, 2000) (statement of Charlene Barshefsky, U.S. Trade Representative), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=106__house__hearings&docid=f:67129.pdf.

[2] *See* House Report No. 106–632, 106th Cong., 2d Sess. 18 (May 24, 2000).

[3] *Id*.

As of January 2005, only five Section 421 investigations have occurred: (1) pedestal actuators, (2) steel wire garment hangers, (3) brake drums and rotors, (4) ductile iron waterworks fittings (DIWF), and (5) innersprings. The last active investigation was completed almost a year ago, in March 2004. Unfortunately, no Section 421 proceeding has resulted in relief to any U.S. industry. The expectations of its utility as a measure to provide relief to U.S. industries injured from a surge in Chinese imports have not been realized.

Of the five Section 421 investigations so far, the ITC made an affirmative injury determination and recommended relief in three cases and made a negative determination in two cases. No case has resulted in relief to a domestic industry, however, because the President denied relief in the three affirmative cases.

Section 421 Investigations

Product	Investigation Initiated	ITC Determination	Recommended Relief	President's Determination
Pedestal actuators	August 19, 2002	Affirmative (3–2) October 18, 2002	Quotas	Denied relief on grounds of national economic interest (January 17, 2003).
Steel wire garment hangers	November 27, 2002	Affirmative (5–0) January 27, 2003	Additional duties	Denied relief on grounds of national economic interest (April 25, 2003)
Brake drums and rotors	June 6, 2003	Negative (5–0) August 5, 2003	Not applicable	Not applicable
Ductile iron waterworks fittings (DIWF)	September 5, 2003	Affirmative (6–0) December 4, 2003	3-year tariff-rate quota	Denied relief on grounds of national economic interest (March 3, 2004)
Innersprings	January 6, 2004	Negative (6–0) March 8, 2004	Not applicable	Not applicable

The last Section 421 petition was filed more than a year ago. The likely reason that there have been no new petitions in the past year is not because there has been a decrease in Chinese imports (which have continued to increase rapidly) but because U.S. industries have observed the results of the first five cases and have judged that the prospective relief to be gained from a petition is not worth the costs and time to bring it.

Moreover, it is likely that domestic parties have also been discouraged from bringing 421 petitions by the political tenor of the ultimate decisionmaking process. In each of the affirmative 421 determinations, the Chinese government has lobbied strongly to discourage the President from granting relief. For example:

- China's Vice-Minister for Trade, Long Yongtu, came to Washington and met with Commerce Department officials in December 2002, arguing that the use of Section 421 would undermine China's market access to the United States. *See Chinese Official Complains about China-Specific Safeguards*, ChinaTrade Extra.com, posted December 6, 2002.
- It was reported that some administration officials believed imposition of a safeguard measure on Chinese imports could have negative political consequences in that "a decision to impose the ITC remedy could lead to increased use of the China-specific safeguard, which could further complicate the bilateral trade relationship." *See U.S. Holds Door Open to Settlement in First China-Specific Safeguard Case*, Inside U.S.-China Trade, November 13, 2002.
- "Officials from China's Ministry of Commerce met this week with officials in the U.S. Trade Representative's Office in an effort to convince them to reject recommendations from the International Trade Commission that the U.S. impose a tariff, a quota or a combination of both in order to limit imports of Chinese ductile iron waterworks fittings (DIWF). Informed sources said MOFCOM officials would meet with USTR yesterday (Jan. 13), and said the MOFCOM delegation consisted of officials from its Bureau of Fair Trade." *See Chinese Officials Meet in U.S. to Argue Against 421, Furniture AD Case*, Inside U.S.-China Trade, January 14, 2004.

The one constant uncertainty in the Section 421 process is the element of discretion granted to the President as the ultimate decisionmaker regarding relief. Thus, three years into China's WTO membership, although there have been three cases in which the ITC found that a domestic industry was injured by a surge of Chinese imports and deemed relief to be warranted, no relief has been yet granted because the President exercised his discretion to reject relief.

In order to make Section 421 more available to and effective for domestic parties, there are several possible avenues:

- Congress could consider amending the statute to provide monetary relief (at least to the extent of covering legal costs) to those U.S. industries that bring a 421 petition, receive an affirmative determination and a recommendation for relief from the ITC but are then denied relief by the President. At a minimum, this small measure of compensation would assist U.S. industries (particularly those comprised of small- and medium-sized companies) to recover their costs when the elements of a Section 421 case have been demonstrated.
- Congress could amend the statute to provide that any relief proposed by the USITC would be mandatory as long as consistent with WTO durational limits.
- Administratively, the USITC itself appears to have burdened the process by adding obligations on domestic petitioning industries that are not contained in the statute and which appear to misapprehend the purpose of Section 421. For example, the ITC requires domestic industries to supply adjustment plans similar to a normal Section 201 safeguard action even though the premise of the statute is implementing rights under the accession protocol to deal with the transitional period when China is undergoing further significant legal and economic reform. Bringing USITC practice into conformity with the underlying purpose and intent of the statute would not require legislative activity but possibly Congressional oversight.

2. Textile Safeguard

The special China textile safeguard is authorized by paragraph 242 of the Working Party Report to China's WTO accession.[4] Under that provision, if a WTO Member believes (and can show) that imports of certain Chinese textile and apparel products are "threatening to impede orderly development of trade in these products" due to "market disruption," the WTO Member can, following prescribed procedures, impose a safeguard measure restraining imports of such products. When the safeguard is imposed, China has agreed that it will restrain exports of the covered product to no more than 7.5% above the amount entered during the first 12 months of the most recent 14 months preceding the safeguard. A special textile safeguard may be imposed for up to one year, with reapplication possible. The special textile safeguard provision, itself, expires on December 31, 2008.

In the United States, the textile safeguard was not implemented by statute. Rather, the Committee to Implement Textile Agreements ("CITA"), the official U.S. Government entity responsible for administering the *Agreement on Textiles and Clothing* ("ATC") implemented the textile safeguard by procedural rules issued in May 2003 which set out the procedural rules by which domestic parties could seek relief from Chinese imports by petitioning for a special safeguard action.[5]

The U.S. textile industry first attempted to use the textile safeguard mechanism in September 2002 when it filed petitions on 5 products (knit fabric; gloves; dressing gowns; brassieres; and textile luggage). These petitions were filed before CITA published procedural rules and CITA took no action on the petitions.

In May 2003, CITA issued its textile safeguard procedural rules which set out the eligibility criteria and informational and supporting data requirements for a petition. CITA also determined that the initial petitions would need to be re-filed in accordance with the procedural rules before CITA would address them.

In July 2003, the U.S. textile industry re-filed their petitions on four products: knit fabric; gloves; dressing gowns; and brassieres. In August 2003, CITA accepted three of the petitions (knit fabric, dressing gowns, and brassieres) and rejected the fourth (gloves). On December 23, 2003, CITA imposed safeguards on the three products for a one-year period.

Subsequently, in June 2004, U.S. producers of socks and other textile producers filed a safeguard petition covering cotton, wool, and man-made fiber socks from China, and CITA imposed a safeguard on October 29, 2004 for a one-year period.

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[4] *Report of the Working Party on the Accession of China*, WT/MIN(01)/3 (10 November 2001), para. 242.

[5] *See Procedures for Considering Requests from the Public for Textile and Apparel Safeguard Actions on Imports from China*, 68 Fed. Reg. 27787 (CITA, May 21, 2003).

In October and November 2004, anticipating the expiration of global textile quotas on January 1, 2005, a U.S. textile industry coalition filed a series of new special textile safeguard petitions covering a variety of products, including cotton trousers, man-made fiber trousers, man-made fiber knit shirts, man-made fiber and cotton shirts, cotton knit shirts and blouses, cotton and man-made fiber underwear, combed cotton yarn, synthetic filament fabric, and wool trousers. What distinguished the series of new petitions was that they were based upon the "threat" of increased imports rather than upon actual increased imports. CITA accepted the new threat-based petitions but has not yet acted upon them.

Retailer and importer groups, however, claimed that CITA lacked authority to consider petitions based upon threat alone. On December 1, 2004, the U.S. Association of Importers of Textiles and Apparel filed suit in the U.S. Court of International Trade challenging CITA's acceptance of textile safeguard petitions based on the "threat" of increased imports and requested that the CIT issue a preliminary injunction enjoining CITA from granting relief. Following briefing and oral argument, on December 30, 2004, the CIT granted the motion for a preliminary injunction and issued an order enjoining CITA from proceeding on the threat-based safeguard requests during the pendency of the court action.

Subsequently, on January 25 and 27, 2005, respectively, the U.S. Government appealed the CIT's preliminary injunction order to the U.S. Court of Appeals for the Federal Circuit and filed a motion to stay the preliminary injunction pending appeal, which the CIT denied on January 31, 2005.

Looking at whether the textile safeguard mechanism has been an effective trade remedy so far, the record is sparse. Since China's accession in December 2001, CITA has imposed only four textile safeguard measures, and the nine petitions filed since October 8, 2004 are now suspended as the result of a preliminary injunction issued by the Court of International Trade. Thus, a realistic assessment of the effectiveness of the textile safeguard as a remedial measure would be premature at this stage. One can say, however, that, prior to October 2004, CITA's acceptance of four of the five petitions filed preliminarily indicates that the textile safeguard is working as envisioned by the U.S. and other WTO Members.

The outcome of the present court challenge to CITA's authority to accept petitions based upon the threat of increased imports will be relevant in the short term to the ability of U.S. companies and their workers to obtain relief before a significant increase in imports occurs in fact for remaining textile products being reintegrated after expiration of the global quotas.

While the preliminary injunction may delay consideration of the merits of the threat-based petitions (which may result in the loss of both jobs and some companies), the industry and workers should be able to file petitions by the second half of 2005 if Chinese imports surge as anticipated.

3. Under-Collection of Dumping Duties on Chinese Imports

In U.S. law, the trade remedy of antidumping law applies to imports from China as well as to other countries. For non-market economy countries, such as China, U.S. antidumping law provides a special methodology for calculating normal value. Under the NME methodology, Chinese exporters are deemed to be operating within a centrally planned economy in which the government controls pricing and production decisions and Commerce treats all exporters as a single enterprise, except in cases where individual companies can demonstrate an absence of government control over their export activities. In applying the NME methodology, in calculating normal value, Commerce disregards prices and costs in the Chinese market and resorts instead to prices and costs in a comparable market-economy surrogate country. China's Protocol of Accession (Article 15) permits WTO Members to apply an NME methodology to Chinese imports subject to antidumping investigations for 15 years after China's WTO accession (or until December 11, 2016).

While antidumping law is an available trade remedy, in recent years, it has become apparent that, due to significant undercollection of dumping duties by U.S. Customs, particularly on Chinese products, U.S. industries that successfully petitioned for antidumping duty relief from Chinese imports have not received the full benefits of antidumping duty orders to which they are entitled under U.S. law.

In March 2004, in its FY 2003 annual report on the Continued Dumping and Subsidy Offset Act (CDSOA), the Customs and Border Protection Agency (CPB) reported that it had failed to collect $130 million of antidumping and countervailing duties, $103 million of which related to antidumping duties on Chinese imports, such as crawfish, paint brushes, iron castings, roller bearings, silicon metal, brake rotors, garlic and honey.

The reasons for the undercollection of duties are multiple and complex. Among the contributing causes are: (1) failure by importers to post adequate cash deposits or

bonds on entries, (2) failure by CBP to require a single entry bond on entries and instead allowing importers to post a continuous entry bond, (3) allowing importers to post continuous entry bonds that are too low to cover eventual dumping liability, (4) cash deposits that are posted on estimated duties are lower than finally-determined duties but the importer fails to pay the difference due to bankruptcy or disappearance, and (5) in the case of "new shipper" reviews, a "loophole" that allows importers to post a bond on estimated dumping duties rather than cash deposits.

In repeated cases, importers have failed to pay the full amount of duties owed and when CPB attempted to collect on the bonds or the duties owed in excess of cash deposits, the bonds were not sufficient to pay in full the amount of duties owed and CBP was unable to collect the additional duties owed due to the bankruptcy or disappearance of importers. It also appears that some Chinese companies have set up shell companies as a means to use the "new shipper" loophole. Senators Byrd and Cochran described the "new shipper" problem as follows:

> Under current U.S. trade law, some exporters are exploiting a loophole in the "new shipper" provision to undercut AD/CVD orders that are designed to protect U.S. agricultural and industrial industries from dumped and unfairly subsidized imports. U.S. law gives importers of goods exported by new shippers the privilege of posting either a cash deposit or a bond as security for the amount of duties that CBP may ultimately assess against the imports. Unfortunately, many "new shipper" importers are using the bonding privilege to evade the payment of *any* duties. If the U.S. Government determines that duties must be paid, the importer can evade payment by defaulting or dissolving the company. CBP has had particular problems collecting duties on imports from new shippers in China. In fact, in FY 2003, CBP was unable to collect $130 million in import duties, including over $100 million in uncollected duties relating solely to imports from China.[6]

In response to Congressional criticism, CBP proposed a series of reforms, including working with the Treasury Department to ensure that surety bond companies can cover defaults, enforcing the requirement to post single entry bonds for each entry of goods subject to antidumping duties, and closely monitoring continuous entry bonds that U.S. importers must obtain to cover antidumping duties. In addition, Commerce increasingly has required new shippers to post bonds at the higher "all others" rate rather than a zero rate.

Separately, to address the "new shipper" undercollection problem, Senators Byrd and Cochran proposed legislation that would delete the provision in U.S. law that allows importers of products from "new shippers" to post bonds to cover estimated dumping duties, which would ensure that all imports from new shippers would be secured by cash deposits, the normal practice in administrative reviews. Although the Byrd-Cochran bill passed the Senate in the 108th Congress, the legislation failed to get House approval.

Despite CBP's efforts to improve antidumping duty collection, the CBP's FY 2004 CDSOA Report showed an even larger gap in duty collection in 2004 compared to 2003. CPB reported in early January 2005 that, in FY 2004, it failed to collect $260 million in antidumping and countervailing duties, $224 million of which related to antidumping duties owed on Chinese imports.

Because of the annual report, the magnitude of the undercollection problem has been identified. It is clear that the bulk of the undercollection problem stems from Chinese product imports. Indeed, the 60 antidumping duty orders on Chinese products represent only 17 percent of all U.S. AD and CVD orders but 85 percent of the duty undercollection problem. It is critical that the full amount of duties owed be collected. Action by Congress, CBP, and Commerce are desperately needed to ensure the proper functioning of U.S. law.

4. Non-Application of Countervailing Duty Law to Imports from China

It is the present policy of the U.S. Commerce Department that countervailing duty law is not applicable to non-market economy countries. Because the U.S. considers China to be a non-market economy country, the Commerce Department views U.S. countervailing duty law as not applicable to China. In consequence of this policy, U.S. industries cannot petition for the imposition of countervailing duties when they are injured by reason of Chinese imports benefiting from government subsidies.

The U.S. first stated its current policy in 1984 in two antidumping proceedings involving steel wire rod from Czechoslovakia and Poland, both non-market economy (NME) countries at the time. Commerce's NME classification was founded on an

[6] Letter to Senate Colleagues from Senators Byrd and Cochran, May 14, 2004.

economic analysis that concluded that "markets" did not exist in countries that relied on government central planning to allocate resources and prices. Commerce therefore determined that CVD law is not applicable to exports from an NME country because subsidization is a market economy phenomenon and cannot exist in an NME where "markets" do not exist. The U.S. Court of Appeals for the Federal Circuit found that Commerce's determination was not unreasonable and therefore affirmed.

At present, the trade remedy of CVD law is not available to address problems caused by Chinese subsidies. The current U.S. position, however, is not required by the statute. Rather, it was established by an administrative determination (affirmed in court litigation) and could be reversed or changed by administrative action. Indeed, the U.S. position is bizarre at the present time in light of the heavy emphasis the U.S. placed on eliminating or limiting subsidies as part of China's accession process to the WTO. If subsidies in modern day China don't distort markets, why did the U.S. insist time and time again that such subsidies had to be eliminated, reduced, identified and/or reported? Moreover, in the most recent Transitional Review Mechanism, the U.S. identified a large number of Chinese subsidy programs that appeared to constitute either prohibited or actionable subsidies under the WTO Agreement on Subsidies and Countervailing Measures.[7]

The U.S. policy could be changed in two ways. First, Congress could amend the countervailing duty law to expressly provide that CVD law applies to non-market economy countries. In the 108th Congress, bills were introduced in both the House and Senate to make such a change. Second, Commerce could change its present policy on its own (which it has the discretion to do). Given that Commerce's policy is not required by statute, a change in policy would likely be upheld by the courts as long as Commerce supports the change with reasoned analysis.

Thank you for the opportunity to appear today. I would be pleased to respond to any questions.

Cochair MULLOY. Thank you, Mr. Stewart, and thank you both for your very really good prepared testimony, which will be included in the record of the hearing.

Mr. Wolff.

STATEMENT OF ALAN WM. WOLFF
PARTNER, DEWEY BALLANTINE LLP

Mr. WOLFF. Thank you very much, Commissioners. I appreciate the opportunity to be here today, actually for what I'm learning. Having sat through this morning's session, it's been very illuminating, and I very much appreciate the opportunity to hear the remarks of others and the questions that have been asked and the answers given.

Echoing what Commissioner Becker has said or thinking about reflecting on it, we've had a lot of trouble in the steel sector for a long time, and it didn't start with China; it started in a number of other places, and we've had a wholly inadequate response as a country to the problems of steel. And you could look around for the failures, but one of the failures was a lack of information, a lack of focus on what the problems were, and I'm glad this Commission exists so that there can be focus on a number of problems with respect to at least our growing major trade partner, China.

Similarly, if you look at Airbus, contrary or different to what we did in steel, steel, the industry was concerned and tried to be active; in Airbus, the U.S. industry was inert, and we paid a major price for that. And I'd like to not see that happen in a whole series of additional areas in trade going forward

So we could use a national commission on trade. We don't have one. We could use a commission on trade remedies; we don't have

[7] *See Request from the United States to China Pursuant to Article 25.8 of the Agreement on Subsidies and Countervailing Measures*, G/SCM/Q2/CHN/9 (6 October 2004).

one. We do have a commission on China, and I'm glad that you're focusing on the trade remedies, but I think there are issues that you are uncovering that are broader than simply China-related.

One thing I would hope is that you would have a list of specific legislative recommendations, maybe Executive Branch recommendations growing out of this hearing on how the trade remedies should be improved, because they certainly do need improvement in their implementation but also in what's on the books.

My testimony focuses primarily on the Byrd Amendment, but I'd like to broaden that a bit in oral remarks to a few other areas. In terms of enforcement, Mr. Stewart has talked about the problems of under collection of duties, and he has, in his testimony, a number of suggestions with respect to how that might be addressed. I think also, there's a question of mission of the agency enforcing a statute.

Years ago, 1979, the Treasury was taken out of the business of supposedly enforcing countervailing duties and antidumping, because it didn't, and it was given to the Commerce Department, and there was a vast improvement as a result. It may be that in this era of terror and the threat of terror that the Customs Bureau is really not ever going to be able to devote the resources necessary to track down the problems involved with under collection of duties and that assessment of duties should be a function that should be considered to be transferred to the Commerce Department, to Import Administration, to work in tandem, or maybe joint responsibility but work in tandem with Customs.

It is just not clear to me that we are ever going to get, from Customs officials who are responsible for making sure that nuclear devices don't come in in containers that they are going to be worried about whether crawfish reports are accurate or shrimp, for that matter, going forward. So one might look at who is doing what in our government with respect to areas of responsibility.

Mr. Stewart also mentioned the inapplicability by choice of countervailing duties to nonmarket economies. Clearly, I think it was actually an erroneous decision to bind ourselves in that way internally, to impose restrictions on how we are going to do things. There should be a study, not just of whether China qualifies as a market economy or how that would take place but what the transition would be so that countervailing duties would be effective if made applicable to China.

One can't say that all subsidies, as of yesterday and for 10, 15 years previously, don't exist as one moves to a system where countervailing duties might be applied. So I think the study of the Department and the study of this Commission should be—certainly, the Commerce Department study should be broadened beyond how do we give China something to how do we effectively maintain trade laws.

On the Byrd Amendment, I believe that the WTO's finding is fundamentally wrong; that the threats of retaliation are unwarranted and unwise; that the Byrd Amendment is, in fact, consistent with our international obligations, and it is a reasonable policy, and it ought to be retained. It's fully warranted that it ought to be retained. I think you will get the answer on where the negotiations stand on adopting a Byrd Amendment for the world in the WTO

regulations is no place. The U.S. agenda in Geneva is very slim with respect to trying to get more effective enforcement.

I don't fault the people in the Commerce Department who are attending these negotiations entirely at all. It's a hostile environment, but getting the WTO on our side on this one is something that's more of a political statement hope than something that could easily occur.

That having been said, there were no trade effects, no adverse trade effects on anyone from the Byrd Amendment. The notion that more industries in the United States bring cases, antidumping cases because there is a Byrd Amendment I think is unsupported by any evidence, totally flawed. And if anybody has worked on these cases, and two of us at this table have and many others have, industries are very seriously injured when they consider bringing an antidumping case. It's a very serious decision. It's quite a burden on companies to undertake bringing a case. A lot of executive time goes into it, and they're in trouble when they bring a case.

And Byrd duties, which are very welcome, are only a partial compensation, but they are hard to get. There may be no duties collected, for a variety of reasons. Under collection is a problem that came up in crawfish, or simply there is an adjustment of pricing so that there is no fund from which to pay duties.

So the amount of Byrd monies that have been distributed while very welcome and very necessary, as Senator Landrieu testified this morning has also been very, very, modest, a very slight amount, and it is simply not a motivation to bring cases.

The WTO's decision was ill founded. It's making law. The problem is not with U.S. law. The problem is with WTO dispute settlement. Obligations are being legislated by panels, and simply, it is not just an invasion of U.S. sovereignty but the sovereignty of other countries as well, and those who rejoice in something like the Byrd Amendment being condemned will find themselves in the dock at some point and find their domestic measures, how they spend their money, also subject to international restraints and review, and it is not something that we should see happen.

The Byrd Amendment is something that should be absolutely maintained, and I hope the Congress is steadfast in that resolve, because the administration, of course, is on the other side of that issue.

I would like to say a couple of things on the offense rather than the defense side as well. And that is that there have been a couple of successes. We have been involved in them in our firm this last year. China's ending of the discrimination in the value added tax on semiconductors was a step forward, as well as the wireless LAN standard for computer use, where a rather ill advised policy was abandoned.

The resolve of the government had a lot to do with it, and when I say the government, I'm including two branches of the government, the Congress and the Executive Branch. In the wireless LAN standard, the fact that the Secretary of State as well as the Secretary of Commerce was directly involved in the USTR made a difference, and in the value added tax case, getting some allies in the case made a real difference. Japan, the European Union, Mexico and others joined the United States in that complaint in the WTO.

Thank you very much. Happy to answer questions.
[The statement follows:]

Prepared Statement of Alan Wm. Wolff[1]
Partner, Dewey Ballantine LLP

The Byrd Amendment—A Reasonable Policy That Should Not Be Repealed

I thank the Commission for the invitation to testify today on this important topic.

The Continued Dumping and Subsidy Offset Act (CDSOA), commonly known as the Byrd Amendment, provides that the revenue collected pursuant to antidumping and countervailing duty orders is to be distributed on an annual basis to certain affected domestic producers for qualifying expenditures. Despite the fact that the WTO Agreements generally do not address what WTO Members can do with revenues collected under antidumping and countervailing duty orders, this statutory provision has been the subject of tremendous controversy, culminating in rulings by a WTO dispute settlement panel in September 2002 and by the WTO Appellate Body in January 2003 that the Byrd Amendment is inconsistent with U.S. obligations under the WTO Agreement on Antidumping ("the Antidumping Agreement") and the WTO Agreement on Subsidies and Countervailing Measures ("the Subsidies Agreement").

As I shall discuss further, the Byrd Amendment is not inconsistent with WTO obligations, is a reasonable policy and its retention is fully warranted. Accordingly, since the United States should not consider itself obligated to repeal the Byrd Amendment as a result of the WTO rulings, the United States should not do so. Instead, the United States should work toward negotiated changes in the Antidumping and Subsidies Agreements that explicitly allow distribution of revenues derived from antidumping duty and countervailing duty orders. Further, the trading partners of the United States that brought the case against the Byrd Amendment should refrain from any retaliation against United States products while this negotiation is taking place. Any threatened retaliation is misguided, wholly unwarranted, and ultimately undermines continued U.S. participation in the WTO.

The Byrd Amendment is Not Inconsistent With WTO Obligations

The Byrd Amendment creates a program whereby domestic producers that have been injured by dumped and/or subsidized imports may receive monetary compensation drawn from the revenue collected by the U.S. Government under WTO-consistent antidumping and countervailing duty orders. To the extent that one would question the WTO-legality of a program of this kind, one would normally begin with a review of the Subsidies Agreement. But the Subsidies Agreement only prohibits a very narrow category of subsidies—those contingent on export performance or on import substitution. All other subsidies are not prohibited, although a particular subsidy may be subject to countervailing duties or action at the WTO if it is "specific" to an industry or a small group of industries and causes material injury or other adverse trade effects.[2] Thus, the program created by the Byrd Amendment does not provide a prohibited subsidy under the WTO rules. Given this framework, it is clear that the WTO Appellate Body erred when it ruled that the Byrd Amendment is prohibited under WTO rules.

Citing Article 18.1 of the Antidumping Agreement and Article 32.1 of the Subsidies Agreement, the Appellate Body ruled that the Byrd Amendment violated WTO rules because it constitutes a "specific action against" dumping and/or a subsidy not permitted under those agreements.[3] Article 18.1 of the Antidumping Agreement

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[1] Alan Wm. Wolff is a former U.S. Deputy Trade Representative, with the rank of Ambassador, who served as Acting Head of Delegation of the U.S. Delegation to the Tokyo Round of Multilateral Trade Negotiations. He heads the International Trade Practice of Dewey Ballantine LLP, located in Washington, D.C.

[2] The WTO panel that considered the Byrd Amendment rejected a claim by Mexico that the Byrd Amendment is an actionable subsidy that causes adverse effects under Article 5(b) of the Subsidies Agreement. The panel concluded that Mexico had not shown that the Byrd Amendment is a "specific" subsidy that causes adverse effects. Report of the Panel at para. 7.115 and para. 7.132.

[3] It should be noted that the Appellate Body rejected a number of other claims against the Byrd Amendment that had been upheld by the WTO panel below. For example, the Appellate Body overruled the panel's conclusion that the Byrd Amendment violates the standing requirements of the Antidumping and Subsidies Agreements, as well as the panel's conclusion that the United States did not act in good faith with respect to its obligations regarding standing. The Appellate Body also rejected the panel's reasoning that the Byrd Amendment was WTO-illegal because it might facilitate or induce the exercise of the rights to seek antidumping and counter-

states that "no specific action against dumping of exports from another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement."[4] Article 32.1 of the Subsidies Agreement is virtually identical in its wording, except that it refers to "a subsidy" rather than "dumping." Nothing in either text prohibits the grant of a subsidy to a domestic industry. Indeed, as noted above, only export subsidies and import substitution subsidies are specifically prohibited under Article 3.1 of the Subsidies Agreement; all other subsidies are permitted. Yet, despite all this, the Appellate Body concluded that subsidies available only to domestic industries that have been adjudicated to have been injured by unfairly traded dumped and/or subsidized imports are prohibited under WTO rules.

The absurdity of this ruling is obvious. A non-prohibited subsidy granted in one country even if it causes injury in another does not contravene WTO rules, but the granting of a non-prohibited subsidy to an injured industry in the importing country is prohibited, under the theory that the Subsidies Agreement and the Antidumping Agreement forbid WTO Member governments from taking steps other than antidumping and countervailing duty actions to help the injured domestic industry, even if these other steps do not have an impact on the subsidized and/or dumped imports and do not violate any other WTO obligations. Nowhere does one find such restrictions in the text of the WTO Agreements.

The Byrd decision is the most egregious example of overreaching by WTO panels, which are legislating obligations where none were agreed by sovereign countries engaged in negotiation of the WTO rules and worse, where no adverse trade effects exist. Repealing the Byrd Amendment would not only remove a wholly legitimate and necessary measure from U.S. laws, it would give further encouragement to the bringing of non-meritorious claims against domestic legislation in the WTO and to a rogue WTO panel process to further expand the ambit of international regulation without the consent of the WTO Members afflicted with the new "obligations."

The Byrd Amendment is a Sound and Reasonable Policy

Beyond the issue of WTO consistency addressed above, the policy justification for maintaining the Byrd Amendment is strong: It permits companies, workers and farmers that have been found to be injured as a result of unfair trade practices to receive some monetary compensation from the proceeds of the antidumping and countervailing duties collected under WTO-sanctioned U.S. trade remedy laws.

In general terms, the Byrd Amendment operates much like trade adjustment assistance ("TAA") programs for workers, although with somewhat different criteria for receiving benefits and with a more circumscribed revenue source. For example, TAA benefits are authorized upon a finding that increased imports of like or directly competitive articles have contributed importantly to a firm's reduced sales or production, and to the separation or threat of separation of workers. In the case of the Byrd Amendment, benefits are authorized only where there have been final determinations of dumping and/or countervailable subsidies by the Commerce Department and of material injury or threat thereof by the International Trade Commission ("ITC"). Moreover, while TAA benefits are derived from general tax revenues, payments under the Byrd Amendment are limited to the proceeds of antidumping and countervailing duty collections for the product in question. These funds only become available if the affected exporters continue to receive subsidies or dump their product in the United States. If an exporter sells at a fair value, or stops receiving a subsidy benefit, no duties are collected. As a result, oftentimes there is little or nothing in the way of duties collected. For example, in fiscal year 2004, the Bureau of Customs and Border Protection ("Customs") monitored imports from 565 antidumping and countervailing duty orders and investigations, including 351 active orders, but liquidation of duties and distribution to domestic producers occurred in only 268 cases (47 percent).

A common criticism of the Byrd Amendment is that the affected domestic producers allegedly receive a double remedy, because they reap the benefits of higher prices in the market due to the imposition of duties on subject imports, plus whatever monetary payments later become available. But this criticism ignores the fact that any antidumping or countervailing duty relief is prospective only, and generally goes into effect only after the affected domestic industry has suffered several years of injury in the form of lost market share, operating losses, and the like. Antidumping and countervailing duty orders are prospective only, offering only potential relief in the future (provided the orders are effective). The orders themselves do

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vailing duties against injurious dumped and subsidized imports—rights that the Appellate Body noted are WTO-consistent.

[4] A footnote notes further that "this is not intended to preclude action under other relevant provisions of GATT 1994, as appropriate." Antidumping Agreement at footnote 24.

nothing to redress the past injury that has already been inflicted on a U.S. industry by the time an order is issued. Thus, the provision of payments under the Byrd Amendment may help to provide some much needed compensation for the prior injury caused by unfairly traded imports—compensation that is simply not available otherwise.

Nonetheless, it should be emphasized that Byrd disbursements are not intended to, and do not, provide full compensation for past injury. Byrd disbursements are made with respect to qualified investments by members of the affected industry. The qualifying expenditures are limited to expenditures incurred after an order is issued, and include categories such as expenditures for manufacturing facilities, equipment, research and development, training, technology acquisition, health care and pension benefits for employees, environmental equipment and training, raw material acquisition, and working capital. All expenses that an industry incurs to obtain relief from dumping and subsidies, including legal fees, are not qualifying expenditures. Byrd disbursements are not simply a pass-through of the duties collected under an order, and even if all of the duties collected were disbursed without limit to only qualified expenditures, the industry could not be made whole for the full amount of the injury.

Another criticism often heard is that the Byrd Amendment creates an inappropriate incentive to bring antidumping and/or countervailing duty cases. There are several responses to this argument: First, one must recognize, as did the WTO Appellate Body,[5] that there is nothing improper about facilitating or encouraging the exercise of rights that are WTO-consistent. Since the founding of the modern world trading system, the rules of both the GATT and its WTO successor have provided that injurious dumping is to be condemned and have authorized the imposition of antidumping and countervailing duties to offset dumping and subsidies that cause or threaten injury. Creating incentives to encourage domestic industries to take advantage of these internationally-recognized rights is not in any way inappropriate.

Second, on a practical level, it would be foolhardy to bring a case just in the hope of getting Byrd Amendment money at some distant point in the future. Antidumping and countervailing duty cases require an enormous effort to litigate, sometimes costing in the millions of dollars in direct outlays not to mention time of company executives and staff. A petition still must prove the existence of dumping and/or countervailable subsidies on the one hand, and material injury or threat of material injury on the other hand, neither of which is easily done. In fact, only 37 percent of cases successfully reach order. Even after an antidumping or countervailing duty order is issued, dumping or subsidization would have to continue before a petitioner would receive disbursements, and only after specific entries of the subject merchandise are liquidated. Only then would any funds be available for distribution. This generally means waiting for the completion of administrative reviews to determine final antidumping and/or countervailing duty assessments, as well as the conclusion of any court appeals. Thus, it can easily be and most always will be, several years before any funds are available for distribution under the Byrd Amendment. And even then, not all cases result in duties being assessed. Last year Customs distributed duties in less than half of the cases it monitored. If foreign exporters stop shipping or stop dumping, little or no duties will actually be collected, meaning no funds will be available for distribution.

This is largely the experience of the Byrd Amendment. In four years of Byrd, more than half of all cases received disbursements of less than $18,000 in a given year, a figure that is often split amongst three or more domestic producers. Thus, the risks associated with trade litigation provide a strong check against unwarranted antidumping or countervailing petitions.

Third, empirical evidence indicates that the Byrd Amendment has not encouraged petitions for new trade cases (defined here as antidumping and countervailing duty cases). The attached charts, based on data from the WTO, the U.S. Department of Commerce, and the U.S. International Trade Commission, show that as U.S. imports increased significantly, the number of U.S. trade cases initiated and measures imposed after the Byrd Amendment was enacted remain below historic levels (Charts 1 and 2). In fact, even though the United States is the world's largest importer of merchandise, the United States has one of the lowest ratios of trade measures to imports, and the Byrd Amendment has done nothing to change that fact, despite growing trade deficits (Charts 3, 4 and 5). Indeed, the ratio has declined since Byrd was enacted (Chart 6). Equally significant is that trade measures in foreign countries without a law analogous to the Byrd Amendment have increased in recent years as the number in the United States declined (Chart 7).

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[5] Appellate Body Report at para. 258.

The ratio of U.S. trade measures (orders) to imports steadily declined in the four years after the Byrd Amendment became law (2001–2004) compared to the four prior years (1997–2000). The number of U.S. trade measures per trillion dollars in imports fell from 25.5 down to 20.5, a 20 percent decline. Moreover, in 2004, the ratio was at its lowest level since the Commerce Department began administering the trade laws (Chart 8).

The ratio of trade case *initiations* to imports has also declined in the post-enactment period compared to the four years before Byrd was enacted. Again, comparing the four years before Byrd to the four years after Byrd, initiations of trade cases declined from 43.5 cases per trillion dollars in imports, down to 38.9 cases per trillion dollars. This post-Byrd ratio is lower than the European Union's average over the period 1996 to 2003, and is remarkably lower than many of our largest trading partners in recent years. For example, looking at available data for 2001 to 2003, the ratio of cases initiated per trillion dollars of imports was 67.2 for Canada, 56.5 for Mexico, and 69.3 for China.

The evidence does not support a contention that the Byrd Amendment has encouraged either increased petitions or increased initiations of cases. This fact is not surprising, considering that the amount of money disbursed under the Byrd Amendment has been quite modest in the overwhelming majority of cases. For the four fiscal years of 2001 through 2004, the median amount of money disbursed per case for the 37 percent of cases that reached order has been quite low: $11,000, $4,000, $8,000, and $74,000, respectively. Thus, there is no likely windfall of money waiting that would entice domestic producers to bring unwarranted trade cases.

Lastly, I can site the experience of our firm. We represent petitioners far more often than respondents. Our trade practice is one of the largest in the country, if not the world. Indeed, we have participated in litigation involving 59 percent of all U.S. antidumping and countervailing duty cases, by value, since 1985 ($33 billion of subject imports out of a total of $56 billion). I can say without qualification that the prospect of Byrd monies has never been, to my knowledge, a significant factor in the decision to bring an antidumping or a countervailing duty case. Moreover, we have not recommended and would not recommend that a prospective petitioner base its decision on whether or not to bring a case on the possibility of receiving Byrd revenues. To my knowledge, while there is a knee-jerk reaction against the Byrd Amendment by those who dump and academics who by and large erroneously view antidumping rather than dumping as a trade problem, there is no empirical evidence adduced by critics that the Byrd Amendment has been an important motivation in bringing trade litigation.

Threat of Foreign Retaliation Should Not Determine U.S. Policy

Eleven countries requested consultations with the United States at the WTO concerning the Byrd Amendment, and eight have been authorized to retaliate against U.S. exports.[6] The retaliation level is quite small. Retaliation is based on Byrd disbursements from the nearly 200 WTO-consistent cases brought by U.S. producers in which the eight complainants continue to subsidize their industry and/or dump their exports in the U.S. market and injure U.S. companies. The U.S. Government position has been that the Byrd Amendment has zero trade effect. At most, the United States suggested to a WTO arbitrator, the Byrd Amendment may affect two million dollars of trade out of roughly $800 billion in exports from the eight countries to the United States. The arbitrator, however, authorized total retaliation in the range of $120 million per year, depending on the level of disbursements, roughly half what was demanded by many of the complainants. Yet in the broad scheme of U.S. trade policy, even this figure is relatively small.

For fiscal year 2004, the total authorized retaliation represents only 0.027 percent of U.S. exports to the eight countries—one penny for every $3,700 in exports. As a percentage of U.S. imports from the eight countries (having it should be noted a $377 billion trade *surplus* with the United States last fiscal year) the retaliation is even less—fifteen thousandths of one percent (0.015 percent). Threatened retaliation at this level should not be allowed to result in the United States changing the Byrd Amendment or any other reasonable policy.

As a general matter, the United States is more open to imports than our exports are to the eight countries threatening retaliation. Imports from the eight countries face a weighted average U.S. tariff of 2.6 percent, but our exports to those countries

[6] Brazil, Canada, Chile, European Union, India, Japan, Korea, Mexico, Australia, Indonesia, and Thailand requested consultations. Australia, Indonesia, and Thailand did not request arbitration to retaliate (between Australia and Indonesia, only $48,000 in Byrd funds were distributed to U.S. producers in FY2004).

face a weighted average tariff of 3.3 percent.[7] There is something extraordinary in countries with a higher tariff than the U.S. tariff, which have a trade surplus of $377 billion with the United States, and which have been found to be presently violating U.S. trade laws in nearly 200 cases, threatening retaliation over a matter that has no demonstrated trade effects. Something is distinctly wrong with this picture.

Despite the threat of retaliation, U.S. antidumping and countervailing duty orders still provide targeted relief to domestic industries injured by unfair trade practices, without being unduly burdensome on foreign exporters or U.S. consuming industries. Fiscal year 2001 is the only year that Customs has provided data to determine a cumulative trade effect. Overall, the impact on U.S. trade is minimal—affecting less than half of one percent of imports. The trade-weighted average duty was only a reasonable 9.4 percent on subject imports (19.8 percent on imports from China, and 8.3 percent for all other countries). Duties distributed to U.S. industries were also small—less than one fiftieth of one cent per dollar of imports (0.0197 percent).

Increased Trade Cases Against China Are Not Attributable to the Byrd Amendment

While the period after the Byrd Amendment was enacted has seen fewer petitions and initiations of cases compared to total imports compared to prior years, trade cases against China have continued to increase. According to the USITC, at the beginning of this year, the United States was enforcing 351 antidumping and countervailing duty orders, and 60 of those orders, roughly 17 percent, were on products from China. The next most frequent object of our trade laws is Japan, with 29 orders in place, about half of China's total.

It is true that the frequency of cases against merchandise from China seems to be increasing. Of the last 22 products subject to the imposition of a U.S. antidumping duty order, sixteen of those products, more than 70 percent of the cases, were from China.[8]

It is not only in the United States where merchandise from China is receiving prominent attention. According to WTO statistics, WTO Members reported 2,537 total antidumping petitions filed from 1995 through June 2004, and China's exports are the leading subject of those petitions, with 386 cases initiated against Chinese merchandise during that period. The next most frequent target, South Korea, had only half as many cases initiated against its trade. Since 2001, nearly one in five new antidumping cases (18 percent) by WTO Members have been brought with respect to Chinese merchandise. During the same period, China accounted for just 6 percent of world merchandise exports.

Data from the USITC indicates that the worldwide trend in cases against China is mirrored in the United States. Since the passage of U.S. Permanent Normal Trade Relations ("PNTR") with China in 2000, one-half of the products that U.S. industries have sought antidumping relief from included products from China (48 percent of the products subject to antidumping petitions, fiscal years 2001–2004). Over this same period, imports from China only accounted for 11 percent of total U.S. imports. While U.S. imports from China increased 79 percent since PNTR, U.S. antidumping petitions against Chinese merchandise increased 157 percent over the previous four years. The increased focus of U.S. trade cases on China cannot be attributed to the Byrd Amendment. If the Byrd Amendment actually encouraged new petitions, we should expect to see more cases against all countries, not just China. Additionally, for other WTO Members—countries that do not have an analog to the Byrd Amendment—cases against China are also high and rising. Thus, there is no correlation between enactment of the Byrd Amendment and increased trade cases against imports from China.

Yet, even as antidumping duty cases against China are on the rise, the relief provided to domestic petitioner in these cases has been limited. According to statistics from Customs, for every $1 in antidumping duties collected and subsequently distributed in 2004 to domestic producers under the Byrd Amendment, 91 cents went uncollected. Imports from China account for 86 percent of the uncollected duties. This equates to $79.7 million in Byrd disbursements under orders on imports from China, but $224.4 million in uncollected duties under those same orders. The same thing occurred in fiscal year 2003, when Customs distributed $20.5 million in duties collected under orders against China, but $104.5 million in duties went uncollected.

There is some reason to believe that the Byrd Amendment will help in the enforcement of antidumping duty and countervailing duty orders. Prior to enactment

[7] Based on the World Bank's *World Development Indicators 2004*. This analysis assumes each countries' exports are in representative tariff categories.

[8] Under current U.S. practice, China is not subject to countervailing duty investigations.

of the Byrd Amendment, the effectiveness of the orders and the collection of duties was not easily monitored. Domestic parties had a far lesser stake in the duty collections, and Customs' record-keeping was not as detailed as it has been under the Byrd Amendment. With the enactment of Byrd, domestic parties supporting antidumping and countervailing duty petitions have a cognizable future interest in the duties that are collected, which in turn has led to increased scrutiny of duty collections. Customs has responded by paying more attention to efforts to evade duties. The system is now more transparent, and the potential recipients of collected duties under the Byrd Amendment have played a valuable role by demanding more effective enforcement of antidumping and countervailing duty orders. The increased scrutiny on the collection of antidumping and countervailing duties encouraged by the Byrd Amendment should support enhanced enforcement of orders on imports from China in the future, thus providing yet another reason why the law should not be repealed.

The United States Should Use the "Doha Round" to Negotiate Rules Allowing Distribution of Antidumping and Countervailing Duty Collections

As discussed above, the Byrd Amendment was ruled a violation of the Antidumping and Subsidies Agreements because a WTO panel and the Appellate Body found it constitutes "specific action" against dumping/subsidization not authorized under the Agreements. The Byrd Amendment is a payment program. It is neither a prohibited subsidy nor, as the panel correctly found, an actionable subsidy. As the United States itself has stated, the Appellate Body "created a new category of prohibited subsidies that had neither been negotiated nor agreed to by WTO Members."[9] This is of great concern because, as a matter of national sovereignty, WTO Members should be allowed to spend their own monies and provide non-trade distorting subsidies to their domestic industries freely, in accordance with rules that are clearly established in the WTO Agreement. The Appellate Body's decision has muddied the waters in an area where clarity of the obligations is necessary. The Doha Round of negotiations presents an opportunity for the United States to correct this and other erroneous dispute settlement decisions, as well as to achieve other improvements, such as the inclusion of rules to address circumvention of antidumping and countervailing duty orders. The United States should ensure that its right to distribute collected antidumping and countervailing duties is clearly established in the Antidumping and Subsidies Agreements as a result of the Doha Round rules negotiations, as both Congress and the USTR have sought.

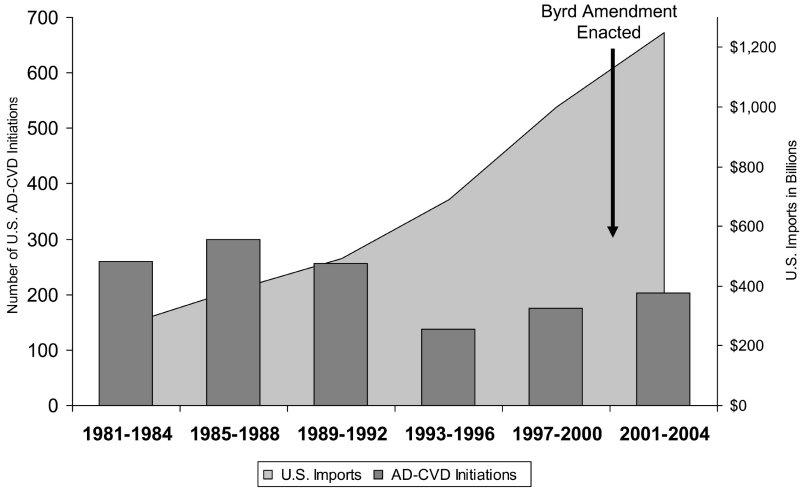
Conclusion

In sum, the Byrd Amendment is a legitimate mechanism for providing compensation to domestic producers injured by unfair trade practices long condemned by the international trading system. The Byrd Amendment does not encourage petitions for antidumping and countervailing duty investigations, the law is not inconsistent with WTO rules, and the legal foundation upon which the contrary WTO panel and Appellate Body decisions rest is very weak. The strained legal and policy objections that have been raised against the Byrd Amendment simply do not stand up to scrutiny and certainly do not justify termination of this program. Clearly, there is no compelling reason to repeal the Byrd Amendment. The flaws in the WTO Appellate Body's reasoning in its ruling against the Byrd Amendment do, however, emphasize that the WTO dispute settlement system is in need of reform, and that WTO rules need to be clarified specifically to prevent the WTO rules from being held as preventing WTO Members from adopting the kind of domestic programs represented by the Byrd Amendment.

[9] Dispute Settlement Body—Minutes of Meeting—Held in the Centre William Rappard on 27 January 2003, WT/DSB/M/142, para. 55 (March 6, 2003).

Chart 1

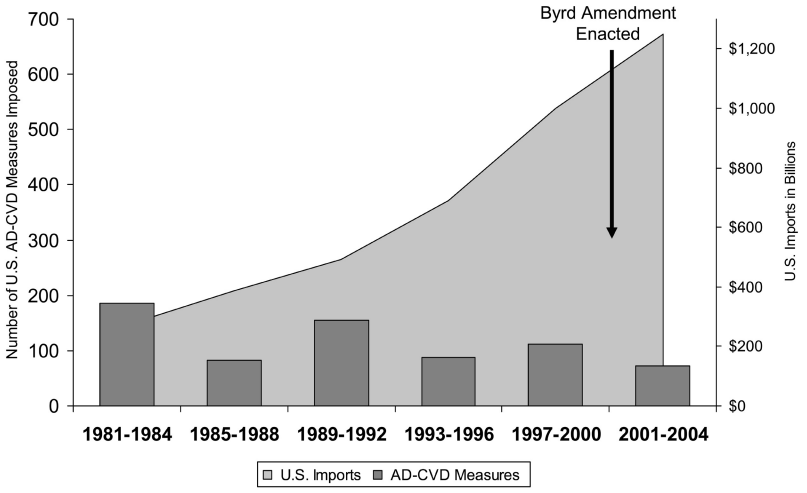
While U.S. Imports Increased Rapidly, the Number of U.S. AD-CVD Initiations Post-Byrd Remains Low



Sources: U.S. Department of Commerce; U.S. International Trade Commission, Dataweb.

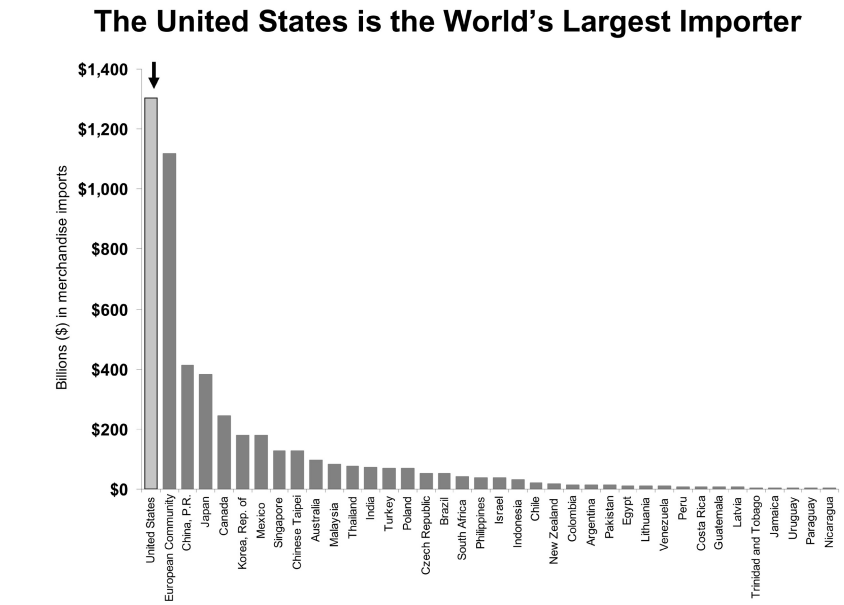
Chart 2

The Number of AD-CVD Measures Post-Byrd, Has Also Remained Low In Light of Increased Imports



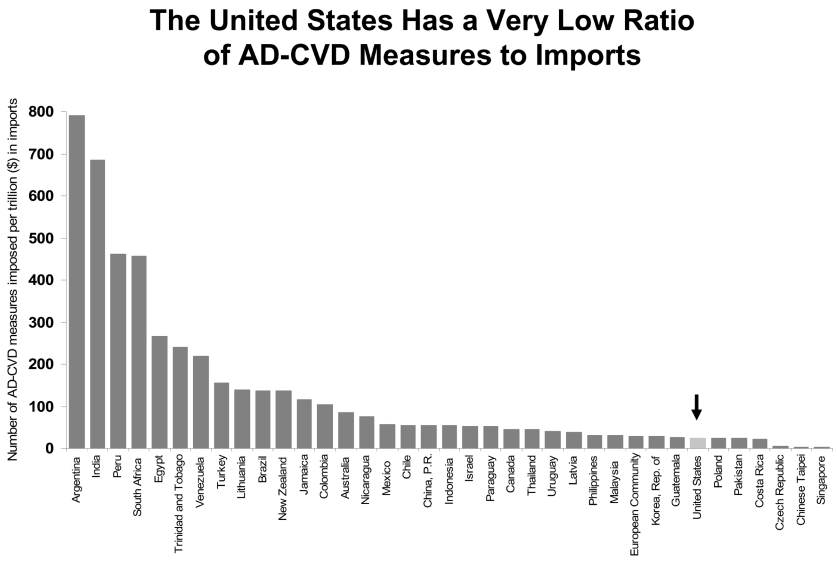
Sources: U.S. Department of Commerce; U.S. International Trade Commission, Dataweb.

Chart 3



Source: WTO. Data for year 2003. Other countries are those reporting the use of AD-CVD measures to the WTO.

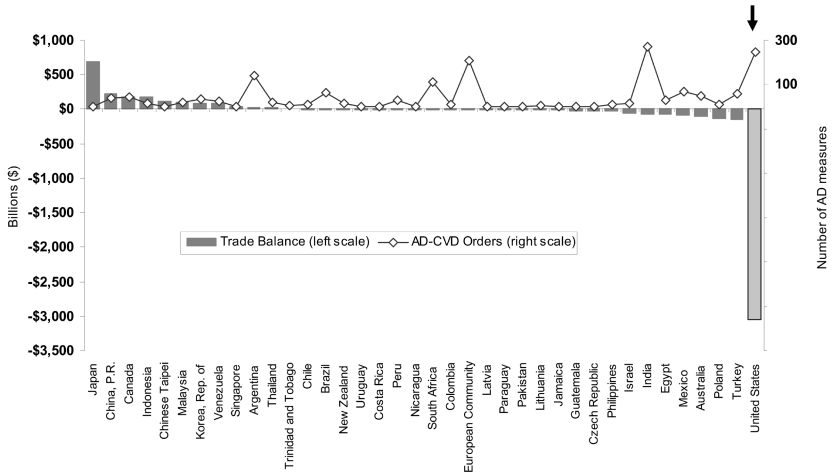
Chart 4



Source: WTO. Data for years 1996-2003. For China, data is only available for years 2001-2003.

Chart 5

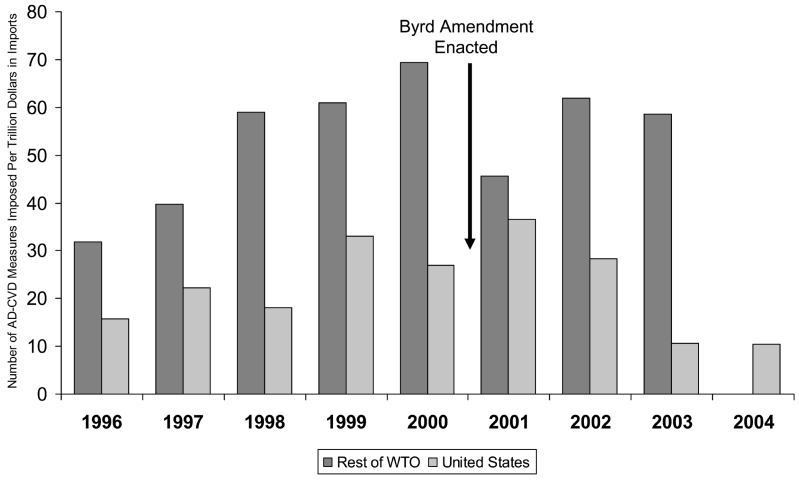
The United States' Use of AD-CVD Measures Is Moderate Compared with U.S. Trade Deficit



Source: WTO. Data for years 1996-2003. Trade balance is the difference between merchandise imports and merchandise exports.

Chart 6

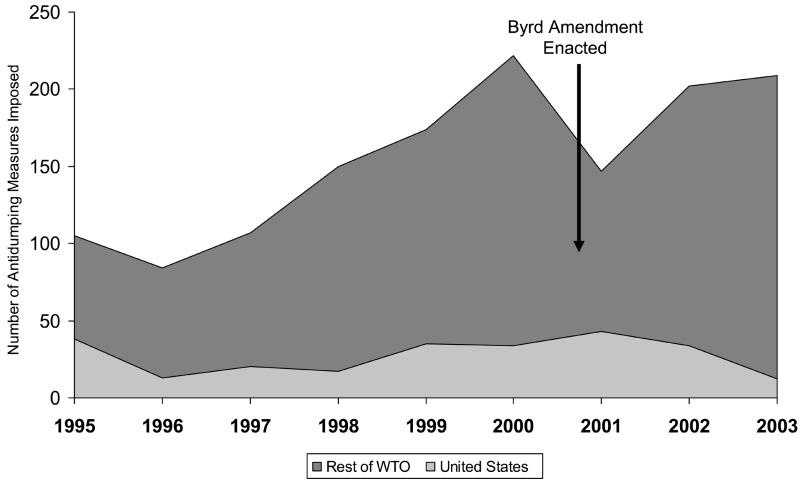
The U.S. Ratio of AD-CVD Measures to Imports Is Below the WTO Average and Is Falling Post-Byrd Amendment



Source: WTO (for 2004, USITC import data was used, similar 2004 data for WTO members is not yet available).

Chart 7

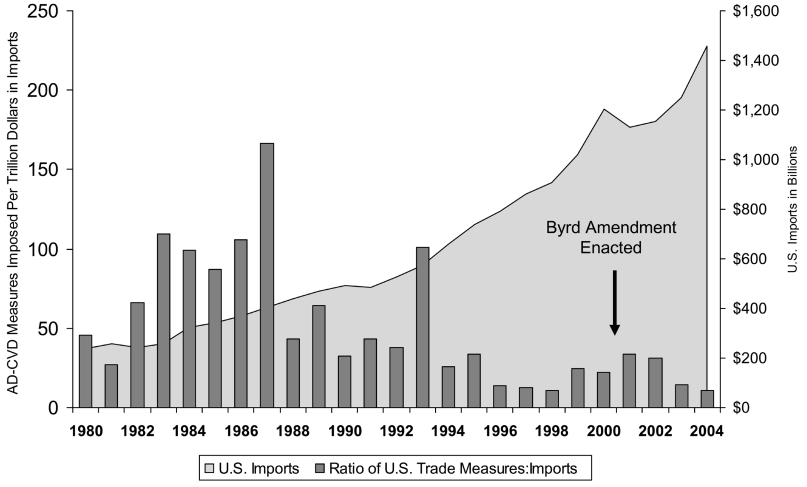
The Number of U.S. AD-CVD Measures Per Year Declined Post-Byrd Amendment



Source: WTO.

Chart 8

The Ratio of U.S. AD-CVD Measures to Imports Is At a Historic Low, Post-Byrd Amendment



Source: WTO.

Panel II: Discussion, Questions and Answers

Cochair MULLOY. Thank you very much, Mr. Wolff.

Commissioner Reinsch has some questions.

Commissioner REINSCH. Mr. Wolff, on the Byrd Amendment first, I've never personally been all that excited about it, solely because I don't believe in earmarking revenue. I think it's a bad precedent. I think it's better left to the appropriators, ironic in view of who created the Byrd Amendment.

But anyway, I do agree with your legal analysis. I think it was a really poor decision by the Appellate Body, and I think you're right about what they decided to do, but here we are. It may well be that we end up maintaining it, and it also may well be that sooner or later, somebody decides that some action is necessary, and in that regard, I wanted to ask your views about the only alternative that I've heard proposed, aside from doing nothing, which is this idea that the money be given not to the victim companies but to the affected communities and therefore presumably the workers to facilitate adjustment.

And I guess I have two questions about that: one, what do you think of that as a solution, recognizing it's an inferior solution to maintaining the Byrd Amendment, but what do you think about it on the merits? And second, if that were to happen, do you think that would pass muster with the Appellate Body in light of the decision they made on the existing Byrd Amendment?

Mr. WOLFF. Well, taking the last point first, what would pass muster with the appellate body is sort of hard to fathom, because they are used to legislating and creating obligations.

Commissioner REINSCH. I'm not arguing with you about that.

Mr. WOLFF. They have a dismaying record. So—but whether it should be, since I feel the Byrd Amendment should not have been found illegal, as you suggest or inconsistent with U.S. obligations, payment to communities should be a very mild alternative from the point—a victory for the other side, in effect. But as being a mild alternative, it is also going to be less effective.

We should be giving money to communities to adjust. I feel that the loss of U.S manufacturing particularly to unfair trade practices is a very serious problem for this country. But do I think that that would be as effective? Antidumping is a prospective remedy only. You set the years of injury, and there is no compensation.

To give money to communities really means that will have—perhaps job training; perhaps families would be a little better off. They won't have the jobs in the industries that have disappeared as a result of not being more aggressive with respect to helping those who are directly affected.

Commissioner REINSCH. I think that's right. The idea is that they might have new jobs that the money helps communities draw in, but fair point.

Mr. Stewart, maybe you can elaborate just a bit. Commissioner Bartholomew and I have been sort of puzzling over this under-collection issue, and I want to ask you one question and get your opinion on something Mr. Wolff said about enforcement, because it does seem to me that it's an enforcement issue.

But if part of the problem here is bonds, and then, the Chinese don't simply pay the duties, isn't the surety company left holding

the bag, and what do they do in those circumstances? Why do they keep issuing bonds?

Mr. STEWART. Well, there are several aspects of it, as I understand. Customs has tried to get a handle on it based on the 2003 initial finding that there was $130 million that hadn't been collected, and as I started off saying, it's a complex issue.

To the extent you have a single entry bond, it depends on what the cap on that liability is, because that's the maximum liability the surety will have. The same thing is true with the continuous bond. And oftentimes, the sureties that are being used in these types of cases are not major sureties, and so, they, themselves, may go bankrupt or may disappear, so you have all three of those aspects.

Commissioner REINSCH. Oh, I see.

Mr. STEWART. So if you have a continuous bond at $20,000, and the merchandise has come in not under a single entry bond but a continuous bond, that's the maximum liability the surety has if the importer disappears or is unable to pay. If it's a single-entry bond, it will depend on what the face value of the single-entry bond, because that's all the liability that the surety has.

Customs has the authority to protect the revenue of the United States, and what Customs has talked about and may or may not be doing extensively is trying to do reviews in those cases where there are significant amounts not being collected to see if the sureties are viable entities, whether the bonds that are being posted are of sufficient value, but that is a lot of detail work.

Commissioner REINSCH. No, I appreciate that. That's very useful. The more you talk, the more it sounds like this is an enforcement/implementation problem, and in that regard, maybe you can say 10 words about Mr. Wolff's suggestion that perhaps it's appropriate to move the enforcement function somewhere else.

Mr. STEWART. Because the work that's going on is being done at the ports, you would need to have a large number——

Commissioner REINSCH. Exactly.

Mr. STEWART. —of people put in. I think that my experience when we have had problems in trade cases over time with regard to the enforcement side, it's a question of trying to get down to the ports, because the Customs people, this is a low priority as a general matter. If they understand that there's major revenue that the U.S. Government is not collecting because of this type of activity usually will snap to and put a focus on it until they get it corrected.

Commissioner REINSCH. I once ran Commerce's larger enforcement operation, the smaller one being the fish police, which I don't think is appropriate in this case, and I'd suggest you might want to think twice about the wisdom of that particular move, if only for the reason you stated; that is, you need a presence at the port of entry.

Thank you, Mr. Chairman.

Cochair MULLOY. Thank you, Commissioner Reinsch.

Commissioner Wessel.

Commissioner WESSEL. Thank you to both of you for not only your testimony today but also for your ongoing advice and counsel to the Commission. It is deeply appreciated. The area that we're talking about now is highly complex, and having those who practice

in the field on a daily basis provide us with information and their insights is valuable, and we appreciate it, and I hope we will be able to continue to call on you in the future.

I have a couple of questions that I'd like to ask if possible. Last year, as part of our annual report, we highlighted the problem of nonperforming loans, of which, at that point, there were roughly $550 billion estimated on the books of China; that number is rising, we've found, as you well know, since you both know the steel industry well, that there continue to be loans given out to that sector as their capacity increases.

We had suggested that nonperforming loans potentially be viewed as a subsidy that our laws, of course, subject to executive review, actually whether they want to respond to it, is worth looking at. What is your view on that? Are nonperforming loans some kind of subsidy, and is it something that we should view as actionable in the future?

Mr. STEWART. I think the issue is more if you have a government providing new loans to a company that has nonperforming loans, then, you are most likely to find, at least under U.S. practice, and I believe under WTO practice, that that would be viewed as an actionable subsidy, and if it's going to a company that is to cover operating losses, then, it potentially is a prohibited subsidy as well.

So those are issues that certainly should be pursued. One of the problems the U.S. is having and other trade partners are having is that three years into WTO accession, China has not complied with its obligation to supply a report on the ongoing subsidy programs that are being provided or to respond to questions in the subsidy area, such as the size of the nonperforming loans.

Commissioner WESSEL. You had indicated, I apologize, one of you had indicated as part of your testimony that China has bristled, I think was the term used, at anything that's specific to them. Yet, if I remember, that is part of what they agreed to as part of their accession to the WTO.

As we look forward at the Doha Round, which could confer new benefits on all WTO members in the nonagricultural area or otherwise, should we look at their history of noncompliance as we move forward to potentially conferring new benefits? Is there—understanding it would have to be a new approach in the WTO—some way of staging benefits that a country will receive in the future while we wait to see whether the past benefits are actually achieved?

Mr. WOLFF. I would think that would be a difficult thing to do in the WTO context given the most favored nation clause. I think there has to be a focus on the areas of noncompliance one by one and see what might be done.

In intellectual property protection, for example, we have not found a formula to have effective enforcement. In Mr. Stewart's testimony, there's a section that covers this in part, but the problem is not just loss of the U.S. market with respect to counterfeit goods; it's the loss of the Chinese market or third country market, so trademarked goods, whether they are an overnight run, an overrun of the legitimate daytime producer of those goods that has been offshored, farmed out, or just knocked off by someone who is not licensed to produce it, we're losing those markets.

So I think that we're going to have to have tailored reactions to each area of noncompliance. And some areas in intellectual property, compliance is relatively good in the court system, part of the court system, anyway, in Shanghai. It's not true in the rest of the country. How can we get that to be spread further?

My understanding is the State Department has funds or the U.S. Government has funds for support of legal reform that it does not expend in China because there is a human rights requirement that the Secretary of State has not found himself able to certify to. It may be self-defeating not to have funding of more improvement of judicial reform of the court system in China.

Cochair MULLOY. Thank you, Commissioner Wessel.

Commissioner Becker.

Commissioner BECKER. Yes, I appreciate hearing from both of you. It's been a long time since we sat across the table from each other.

I was at the Doha Round, the ministerial meetings, and we were assured at that round by the USTR that our trade laws, our antidumping, countervailing duties or safeguards, were not on the table for bargaining, and this is the same assurance that we had all the way back to Mickey Kantor.

And again, at Cancun, we entered into the same kind of discussions, and we now find out that the trade laws are on the table for negotiation. My question to you, then, is, how serious is this? How would this affect industry? How vital is this for the viability of our industry continuing if these laws were stricken or substantially reduced?

Mr. STEWART. The framework that was struck in Doha theoretically requires that whatever agreement comes out leave the laws usable, leave the agreements usable. The reality is that the framework doesn't really matter once you get into the negotiations.

It's unclear when we get into the formal negotiation side. If you were to take a snapshot as to where the process and rules is in Geneva at the moment, it is heavily weighted against countries that have an interest in maintaining usable trade remedies. We are losing great ground because of the long series of adverse decisions coming out of the dispute settlement body in the rules area, and that would be greatly exacerbated if the rules negotiations contain the balance that the existing proposals suggest.

Obviously, the objective of the people on our side who want to see that there are usable trade remedies in the United States and within the WTO is we need a dramatically different approach to the negotiations and the remainder of the process and what has happened to date. Every industry in America at some time has needed the trade remedies, whether it's semiconductors, computers, automobiles, agricultural products. And if you take away the remedies that the system has been built upon, you will undermine the support for liberalized trade, and I think we have that risk.

Mr. WOLFF. I would just add, the trend is very disquieting. The balance is against us in Geneva by far. Every case that comes down, there might be a 1 percent loss in the effectiveness of our trade laws. Almost without exception, every case is negative in some respect when our trade laws are reviewed in Geneva, and in a negotiation, you could lose 10 or 15 or 20 percent of the effective-

ness of the law; I don't think all of it but a lot of it, and that would be unacceptable.

What gives one a little bit of hope is that the Congress cares, and that helps our negotiating position, I think, but also that other countries are to some extent, I wouldn't overemphasize this, but to some extent waking up to the fact that they have a problem in trade as well. With the loss of the Multifiber Agreement, it has been discovered by a number of developing countries that perhaps they have to rely on antidumping duties as well, antidumping regime, so that there may be a shift.

People may be learning that actually, the WTO system, the GATT system, while imperfect in giving us some rights to use trade remedies is better than not having those rights to have trade remedies.

Commissioner BECKER. Could this be accomplished, our trade laws being watered down, at the WTO trade meetings in Geneva, or would this have to go through the ministerial meetings and then back to Congress?

Mr. STEWART. It comes down to the final agreement, Commissioner. If the final agreement comes back that has significantly less rights to use it, if the Congress were to adopt and implement those new agreements, then, our laws would be less effective. So it has to come back to Congress, has to go through an up or down vote under fast track if that happens in that timeframe.

Commissioner BECKER. Thank you.

Cochair MULLOY. Thank you, Commissioner Becker.

Commissioner Bartholomew.

Commissioner BARTHOLOMEW. Thanks very much, and thank you to our witnesses. I join Commissioner Wessel in saying thank you for appearing today and also the ongoing counsel that you provide to us.

I always marvel at your ability to be able to talk about these very technical issues in a way that is comprehensible to those of us who aren't specialists in this, so we are particularly appreciative that you can talk in a way that a broader audience can understand.

Two comments, and then, I will go into my questions. First comment, Mr. Wolff, the provision that you were referring to on human rights, if I remember properly, is a provision that requires a certification that a country is not a gross violator of human rights in order to receive foreign assistance. And if I remember properly, there is also actually a waiver provision in there. It's just that this administration or the previous administration has never chosen to exercise it.

Mr. WOLFF. I think that's right.

Commissioner BARTHOLOMEW. So the point is they don't want to have to either certify that China is not a gross violator of human rights or waive it, which is, in essence, saying it doesn't matter, but there is an option there for them to move forward.

I was also particularly struck about the comment about a trial period when we were—I worked on the House side during the MFN debates and the lead-up to PNTR, and I remember that there were some discussions about the possibility of trying to require some sort of a period to see how China complied with its bilateral accession obligations before its full WTO membership and PNTR kicked in.

The business community, in its ardor to get this over and done with, pushed right through us when we were doing that. It is ironic that a number of the same associations and the same companies that pushed so hard are now coming back and saying that we have a whole lot of problems with what's going on. It's an observation more than anything. But there was some discussion about trying to test it out and see how things were going, and it didn't carry.

Mr. Stewart, in particular, I was really struck by what you said about the companies that need to pursue trade remedies are companies that are in serious trouble already. It is like a patient with cancer having to decide whether they're going to put themselves through the chemotherapy, and it becomes a cost-benefit analysis whether it is worth it to undertake it.

I wondered if either one of you could give us some general numbers on how much, on average, does it cost a company to pursue some sort of trade remedies? Are there any U.S. Government programs to help those companies, particularly small and medium-sized businesses, to undertake them? How long does it take? And what are their odds at succeeding?

Mr. WOLFF. It can cost millions of dollars in a major case, and it depends on the complexity of the case.

In steel, hot rolled steel or commodity products, one can have 12 or 15 countries that are causing the problem, causing you to have to investigate; it's not a multiple of 12 or 15 times the expense, but it's a very heavy burden going forward. The government, I think, would seek to be helpful, but the fact of the matter is it's not in a position to investigate in the first instance, to come up with the information that is necessary to bring a case.

It is not a very practical solution to have the Commerce Department or the ITC try to do this on their own. It's been done to some degree on some occasions but with still a fair amount of help from industry, so it's an enormous hurdle.

Mr. STEWART. I think both the Commerce Department and the ITC have offices that will help industries or companies that are looking at cases where they are trying to do them on their own. Those cases seldom end up well, because it's a complex area of law, and it is difficult to mount the effort if you don't have some assistance.

Cases, in terms of the time horizons, depend on the statute. A Section 421 start to finish is six months; four months at the ITC, two months in the interagency process. A dumping case typically to get from a petition filing to an order is normally 13 months. A countervailing duty case can be slightly shorter than that.

So it will depend, and the cost can go from perhaps a couple hundred thousand for a small case to many millions of dollars if it is a humongous case with billions of dollars in trade.

Mr. WOLFF. Can I just add one thing, and that is that the number of law firms on the other side is very large, so that if you bring a case against a particular product from even one country like China, you may still have half a dozen law firms on the other side with things that have to be answered, points that have to be rebutted, and that's a pretty tough burden for a company that would be only getting assistance from the Department.

Commissioner BARTHOLOMEW. So there are threshold problems in the sense that not only do we look at inadequate enforcement, compliance, all of these things, but it's extremely difficult, especially for small industries and smaller companies to even be able to embark on what should be a trade remedy.

Mr. WOLFF. Exactly.

Commissioner BARTHOLOMEW. Okay, thank you.

Cochair MULLOY. Thank you, Commissioner Bartholomew.

Chairman D'Amato.

Chairman D'AMATO. Thank you very much, Mr. Chairman, and I want to thank both of you for your excellent testimony.

Mr. Stewart, I also want to thank you for the excellent report that you gave the Commission here on WTO, year three, and recommend it to my fellow Commissioners if anyone hasn't read it yet; it's very, very good. It's kind of juicy, because it looks kind of like a menu for about 15 really good WTO dispute settlement cases against the Chinese, you know, just go right on one by one there. So I thank you for that. I also want to commend you, Mr. Wolff, for your excellent testimony.

And I must say that if I didn't realize it before, I come away from this hearing with a deeply disturbed sense of what is going on in Geneva. I have the impression that basically, this rulemaking or legislating by appellate bodies is an exercise in political bias against the United States, that we are in an organization that we have no control over that is a consensus-built organization that is essentially working against our interests. That's the impression I get.

Senator Byrd in his statement referred to overzealous, pointy-headed WTO pseudo intellectuals.

I don't know whether that's true or not.

So we have this case on the Byrd Amendment, which has no basis at all in the treaty, and it looks like a political attack on the United States. And the question I have is this: when we got into this debate about whether to get into the WTO or not, Senator Dole had a proposal which didn't ever become law, but he had a proposal for a commission of judges that would look at the cases that we were a party to in the WTO and try to make a judgment whether there was abuse of discretion, whether there was political bias, as looks like in this case, and I think his commission was called three strikes and you're out, as I recall, three bad cases, and we're out of the WTO.

In any case, Senator Baucus apparently offered legislation the last time that is a half of a loaf: put together a commission, but it doesn't end up with any kind of final denouement or decision. What is your impression of the advisability of dusting off that proposal by Senator Dole to have a commission of jurists or attorneys in the United States that would look at and make judgments for us about what kind of cases are being decided in Geneva and what their relationship is to our interests and whether there is a bias?

Mr. WOLFF. I think there is a very, very strong need for the Dole Commission or the Baucus Commission to be put into place. Actually, it was Dole and Moynihan who originally sponsored it, and President Clinton said that he would support it. Now, nothing came of it.

Chairman D'AMATO. Yes.

Mr. WOLFF. Now, the fact is, it would give an independent basis—it wouldn't be a one-way street for—if a domestic industry had its cause lost in Geneva, it may be that three judges, independent judges sitting on a commission in the United States would say the decision in Geneva was correct; we lost fair and square, and that would be the end of it, so it's not without some risk.

I don't think it would work only for domestic interests, but we need it to get an independent read on what's taking place in Geneva. You will not get an independent read out of any administration. They will tend to say we have a lot invested in this international organization, and we win some, we lose some, but on balance, we're doing pretty well.

If you look at our commercial interests, we are not doing very well in dispute settlement. We adopted, I think, binding dispute settlement in error. Two administrations, Republican and Democratic, favored it in order to attack the problems of the Common Agricultural Policy. We have had zero success with regard to the major underlying features of the Common Agricultural Policy. We have had a lot of problems with respect to enforcing our rights and protecting our trade remedies.

Chairman D'AMATO. Thank you.

Do you have a comment on that, Mr. Stewart?

Mr. STEWART. Yes; thank you, Mr. Chairman.

I agree with Alan that the process could be a useful one. We also have at the moment kind of running parallel to the Doha Round a review of the dispute settlement understanding and modifications.

Many of the decisions that have gone against the United States, much of the overreaching that has been done by the appellate body can be boiled down to several types of instances. Because it's a new institution, if one were being charitable, maybe one could say these problems arise because of the novelty, and we're 10 years in, and we have a better understanding.

But historically, in the GATT, dispute settlement did not have panelists deciding that silence or a gap meant they had an authority to interpret. Many of the decisions constitute filling gaps or interpreting silence when, in fact that should be left to the province of the negotiators.

So there is also a major opportunity in the context of the DSU review to tackle some of the primary problems we've been having in Geneva in dispute settlement. That won't be easy for the reasons that Mr. Wolff reviewed before. The U.S. has teed up a proposal with Chile that could be useful. It hasn't been fleshed out and needs to be.

Chairman D'AMATO. Thank you very much.

Cochair MULLOY. Thank you, Chairman D'Amato.

Commissioner Dreyer.

Cochair DREYER. Thank you both very much. This was extremely frank and refreshingly uncliched testimony, and I really appreciate it.

A quick comment for Mr. Wolff about the funds for judicial reforms, which you think are self-defeating. My own hunch is that it would be money wasted, because of the tremendous amount of cor-

ruption in the court system. My observation is that these people know what they should do, and certain numbers of them know what they would like to have accomplished, but that the corruption and the local protectionism are just so ingrained everywhere else but Shanghai, which is not exactly corruption free either, that it might just be money wasted. Again, just my thought.

Mr. Stewart, I was pleased to read the book, actually, that you prepared for us. I really learned a lot from it. As a novice in the trade policy field, I was simply amazed to read that the countervailing duty law is not applicable to exports from a nonmarket economy. I read the explanation you gave, which is, of course, the explanation that was given, not your explanation.

It strikes me that there have been so many egregious cases; we heard one in Akron that involved a candle company that discovered that Chinese candles were being sold in the United States for less than the cost of the paraffin that went in to them. There are so many egregious, clear-cut cases like this that they could be used as the basis to change this agreement; you indicate in your book that you think it is possible.

Do you have any idea why there has not been more impetus for changing it? I know how Commissioner Reinsch feels about the Commerce Department, but I hate to hint that it sounds like a lack of will in the Commerce Department.

Mr. STEWART. Well, I think that late last year, there were some signals out of the Commerce Department that a case alleging subsidies against a nonmarket economy wouldn't be thrown out out of hand; that people would at least take a look at the arguments that were made.

As is true with most organizations, government or private, where you have a longstanding policy, you have a lot of internal resistance to change. The meetings that I've had at Commerce on this very issue, it hasn't been the political appointees who come in with a view; it is the staff who have been there for decades, who were part of the fight back in the mid-eighties and who believe that the approach they took has been vindicated in the courts, and so, why should they change it. I think that that is part of the problem.

I think that when you look at what happened in China's accession, that subsidies were a major issue of the United States Government wanted to be addressed, and we fought and fought and fought to get China to undertake commitments, that the policy of not going after nonmarket economies for subsidies makes sense no longer, assuming it made sense 25 years ago or 30 years ago, and I would agree with Alan that I think it was a bad decision when it was made.

So through legislation or through administrative action, it can be changed. There has been some indication that if someone is willing to spend all of that money to get a case prepared that maybe it would be looked at. You know, maybe there will be an industry that comes forward and gives it a test.

Mr. WOLFF. We did so some years back, brought probably the last case which discouraged others because it was turned down with respect to multiple exchange rates, because we said look: at least when there are multiple exchange rates—this was with respect to China in textiles—that is external to the Chinese economy,

and even by your own logic, that it's a nonmarket economy, so you can't really find a subsidy internally, this is external, and it's measurable, and that did not find favor.

I hope that Terry's report is correct, that the administration would entertain a case, but I wouldn't advise a lot of investment in it.

Cochair DREYER. Thank you.

Cochair MULLOY. Yes, Vice Chairman Robinson.

Vice Chairman ROBINSON. Thank you, Mr. Chairman.

Thank you both again. I will just add my voice to those expressing appreciation for all that you've done for the Commission.

When we agreed to China's entry into the WTO, we likewise agreed to a schedule of tariffs that allow the Chinese to maintain fairly tariffs high levels, while we lowered ours to near zero. The thinking was that it would take years for the Chinese to develop a modern manufacturing sector.

Now, in hindsight, it strikes us as having been a particularly unwise idea that's cost us tens of thousands of jobs in the balance. So two questions: first, can we go back, in effect, and fix this problem so that we achieve some kind of level playing field where both sides face the same tariff levels. Second, in terms of modalities, can we use the upcoming vote on whether we stay in the WTO to at least seek to remedy this serious problem?

Thank you.

Mr. STEWART. Vice Chairman Robinson, let me start: China, which views itself as a developing country, perceives that it was asked to lower its tariffs more than other developing countries, and factually, that is correct. They are not as low as the United States tariffs, and there were examples given earlier in certain sectors such as automobiles where obviously, the bound tariffs the United States has are a tiny fraction of what China has maintained.

What we are at risk of in the Doha Round, where we stand at the moment is China doing less and our doing more in the next—in this current round. Within the nonagricultural market access negotiations, the U.S. and other countries have committed to a framework, which says there will be larger reductions for high tariffs than small tariffs, and developing countries will have to do less, and there will be special provisions requiring less of newly acceding countries. This was insisted upon by the Chinese and a few other new members of the WTO.

So the reality is what we face in the next year is an agreement in which there will be further liberalization, and there may be some additional liberalization in China, but it won't be going back the way you envision it. While there is an opportunity in the WTO to raise tariffs on an MFN basis by renegotiation, that is seldom used, and if it is used, it is used on one or two tariff items and can happen every three years.

So there is no easy answer, having let them into the club, unless one were to withdraw from the club and set up a different club, we're pretty much stuck with the bindings that have been negotiated on a multilateral basis.

Mr. WOLFF. My feeling is that we have to ask for a substantial amount of movement on the part of other countries and China in particular.

We have given pretty much all we have to give. Our tariffs are near zero already, and our trade imbalance is grotesque and unsustainable. And if the rest of the world wants to maintain an open trading system, then, they have got to move a fair distance in order to give us—a word that's gone out of fashion—reciprocity. Somehow, that became a term that could no longer be used.

I would say that in selected cases, and semiconductors was one of them, we got the Chinese to go to zero, and they didn't have to. We convinced them that it was in their own self-interests to go to zero in terms of their own economic development interests. If they imported semiconductors, it would be cheaper to make cell phones. So occasionally, one can make a little bit of progress, but it's tough.

I would hope that the WTO debate would be a serious debate in the Congress, not a foregone conclusion. That doesn't mean that we won't go along with continuing membership in the WTO. I don't think the result is in real doubt, but it should be a time where there is a real assessment of the benefits and the costs of this organization and where it needs to be improved. And there is an imbalance: an imbalance in benefits and an imbalance in costs.

Cochair MULLOY. Every five years, the Congress gets an opportunity under our legislation which we joined the WTO to decide whether to stay in or not, and this is that year in the United States, so that debate is going to be very helpful.

I have three quick questions. We have another panel beginning at 2:00, but I want to get them on the record: Mr. Stewart, when I asked the administration whether there was any lobbying or political influence about using Section 421, so think about that issue and whether that statutory standard is—I don't see how they meet it.

Secondly, I have a question for Mr. Wolff: are we required under our WTO commitment to repeal the Byrd law, or can we just decide to keep it? People say we've got to repeal it, because we have an international obligation. I'm not sure that's correct. I just want your view on it.

Third, when Chairman D'Amato and I were in Geneva recently, I picked up a handbook on WTO dispute settlement in their bookstore. It says that the rulings of the appellate body are intended to reflect and correctly apply the rights and obligations as they are set out in the WTO agreement that countries agreed to; that is a treaty. They must not change the WTO law that is applicable between the parties or add to or diminish the rights or obligations provided in WTO agreements.

From what I hear about what you're saying about the Byrd Amendment and maybe some other cases, the panels are not following the agreement and that they're not being strict constructionists, as we here in America, and as President Bush wants to put on the Supreme Court, they're letting other people interpret these laws much more broadly than maybe the parties agreed to.

I'd just like maybe your views on those three quick points. Mr. Stewart.

Mr. STEWART. I'll take your last point first.

That is exactly the debate. It's not that that language in Article 3–2 or 19–2 for the appellate body isn't known by the panelists and the appellate body, and they will often recite it. They just disagree

as to what it means with regard to things such as silence or gaps. They construe their obligation or their authority to go and fill those.

So it is, in my view, the major problem in the dispute settlement understanding, and whether it's biased against us or not, it is a fairly constant in the dispute settlement system; frankly, I've forgotten question one and two.

Cochair MULLOY. The Section 421 and whether the——

Mr. STEWART. 421, the standard that was put in after the legislative history says that there's a presumption you should get relief, the standard that's put in is nebulous enough that economists will always say that if you impose a remedy that there's at least equal cost to the consumer as there is benefit to industry, and so, that always gives any administration the option to say I'm not going to give relief, and it is designed, at the end, to be a political process, so the fact that it's a political process doesn't say there's wrongdoing going on, and the fact that the Chinese in our system throw a lot of money at bringing a lot of lobbyists to bear on cases to get the outcome they want is their right under our system.

It doesn't take away the fact that China has made a major effort internationally to see that the special rights that countries negotiated don't actually get used against them, and they put a lot of energy into that, as is also their right to do. But it means that things that industries or Congress may have thought were there to protect them, in fact, have proven to be unusable.

Cochair MULLOY. Mr. Wolff.

Mr. WOLFF. On the three points, what we're seeing is—you quoted language which is as good language as anyone could draft to try to get to the objectives that were sought, namely, on the appellate body that they would not make law; that they would administer laws, interpret the laws, the rules of the WTO.

We're not going to get better language. That's why I think the Dole Commission would be actually a very good thing to put into effect, to have an independent review in the United States of whether those appellate body decisions are correct, whether they are applying their standards that have been set forth.

On 421, I would make it automatic. I think when there is political discretion, you're going to get a political decision, and it may be an issue on North Korea that week that one is seeking the help of the Chinese on or something else. Political decisions will be made. That is the nature of government. It really has to be taken out of the White House, in my view. Whether it's in the ITC or whether it's like the Committee on Implementation of Textile Agreements or someplace else, it has to be administered elsewhere.

And on Byrd, the Byrd Amendment, you're quite right that we are not under an obligation to repeal it. There will be, there has been, authorized retaliation. There will be retaliation probably. The Canadians have published an enormous list, as has the EU. It's become sort of a hobby of other countries to do that. And we'll have to deal with it.

Cochair MULLOY. Mr. Stewart, did you want to add anything?

Mr. STEWART. On the CDSOA, that's absolutely right. We have no obligation. Under the WTO, you can bring yourself into conformance, pay compensation or face retaliation. To date, the United

States has not brought itself into conformance. Retaliation has been authorized.

Many countries that have lost issues in the dispute settlement have been pursuing modifications to the underlying agreements in the Doha Round negotiations. That's what Congress has asked the administration to do here, and to the administration's credit, they have at least teed the issue up.

What we need to have happen here is for that negotiation process to move forward and be intensified.

Cochair MULLOY. Okay; before we close, Commissioner Wessel has a quick comment.

Commissioner WESSEL. Just a quick comment, and Mr. Mulloy raised it earlier, and I thought I heard—I was out of the room for a portion—discussion by the State Department.

My understanding is there was somewhat unequal access, if you will, in the 421 process between domestic counsel and counsel for the respondents. Do either one of you have a comment on that?

Mr. STEWART. We were involved in the very first 421 case, and we were representing a very small company from New Jersey. And because it was the first 421 case, I believe there were three law firms and two government relations firms hired by the Chinese to make sure that this never got done, and the Chinese government approached the U.S. Government at every level that they had contact. So obviously, we would not have had the same level of access.

In the context of a government versus a company, you will never have equal access, and I'm not suggesting there's impropriety in that. But just as Mr. Wolff said, as long as it's a political process, and you have small companies seeking relief, they will be trounced if it is not automatic.

Cochair MULLOY. The reason the Chinese government would do that, though, is if they can knock off these cases early on, then, we don't get a lot of new cases brought, because there's an expense involved; is that correct?

Mr. STEWART. That's exactly what's happened. There's been no new case in a year. On a remedy that's supposed to have the lowest standard and to be quasi-automatic, you've had no successes and only five brought in three years.

Cochair MULLOY. I can't thank you both enough. Commissioner Becker has a comment.

Commissioner BECKER. Yes; I just want to make sure I understood both of you when we were talking about the countervailing and the antidumping duty laws that we have. It's under severe attack, and you're both somewhat concerned that they won't survive in the state they're in now. Is that right?

Mr. WOLFF. Absolutely, we have a real problem. We're playing defense in Geneva.

Commissioner BECKER. Is the government supporting us on this, or are they hand in glove with watering this down?

Mr. STEWART. I think that the statement I made earlier, Commissioner Becker, was that—if you look at what had been presented in Geneva to date, it is a highly lopsided plate that has been served up. There have been 187 submissions, I think, about 175 of which are harmful to maintaining strong laws, and there have been

about a dozen, most of which are from the U.S., which could be viewed as consistent with the Doha mandate.

What we don't know because we haven't gotten into the negotiations is how much of that is left on the table. If the administration cranks up its efforts, we can end up with something that's probably okay. We are a long way from that, and this has not been the lead horse in this race.

Commissioner BECKER. What do you think is the time line on this the way it's running now?

Mr. STEWART. The message out of Davos last week was that they very much intend to—their objective is to get to modalities by December in the Hong Kong ministerial and that what the modalities mean is agriculture, non-agriculture market access, services, and the rules.

Commissioner BECKER. Go ahead.

Mr. WOLFF. I would just add that the line negotiators, the people who go to these meetings on a regular basis from the Department of Commerce are seeking to maintain the effectiveness of U.S. law and the rules permitting the effectiveness of U.S. law to be maintained. They are not seeking major changes that would improve the laws a great deal, improve the effectiveness.

So we differ on tactics. But they're not working to weaken the laws. Now, at the end of the day, does the USTR say, well, look, I got something over here in agriculture; I got something over here on intellectual property protection, and you've asked me for something on the rules side so that we have less effective trade remedies. Is that deal struck? That's a risk.

Commissioner BECKER. Is Congress advised of the pace or how this is coming out from meeting to meeting?

Cochair MULLOY. They're participating.

Mr. STEWART. Yes.

Mr. WOLFF. There was a meeting yesterday afternoon of the Congressional Oversight Group with the U.S. Trade Representative, the first one. So there are Congressional advisors to these talks.

Cochair MULLOY. Is there anything else?

[No response.]

Cochair MULLOY. We're going to have to clear the room now, because we're going to have to eat lunch here and then resume at 2:00 with the exchange rate issue, but thank you again, both of you so much for your help on this morning panel.

[Whereupon, at 1:25 p.m., the meeting was recessed, to reconvene at 2:07 p.m., this same day.]

AFTERNOON SESSION, 2:08 P.M.
THURSDAY, FEBRUARY 3, 2005

PANEL III: STRATEGIES FOR ENFORCEMENT—EXCHANGE RATE POLICIES

Cochair MULLOY. We're going to come to order and start the afternoon panels.

We're very fortunate in having on this panel three esteemed experts on the matter of exchange rates and the legality under the WTO and IMF of some of the exchange practices of China and the impact of misaligned exchange rates on the American economy and American workers and families and communities.

We're fortunate to have on this panel Dr. Fred Bergsten, Director of the Institute for International Economics; Mr. Frank Vargo, the Vice President for International Economic Affairs at the National Association of Manufacturers and a man who I am delighted to call a former colleague and mentor; and finally, Mr. David Hartquist, who is a partner with the law firm of Collier Shannon Scott.

We thank you all for taking time out of your busy schedules to be here with us today. We had a very, very productive morning, a lot of Members' interest in the issues that we're talking about today. And this will be of great help to us as we try to put together some recommendations from the Congress.

Why don't we just go from left to right? We'll start with Dr. Bergsten then Mr. Vargo and then Mr. Hartquist.

Thank you.

STATEMENT OF C. FRED BERGSTEN
DIRECTOR, INSTITUTE FOR INTERNATIONAL ECONOMICS

Mr. BERGSTEN. Thank you, Mr. Chairman. It's a pleasure to be back with the Commission and to testify again on the exchange rate. I will lay the economic foundation and be happy to weigh in on some of the legal and trade remedy issues later on.

By almost any metric, China is the most competitive economy in the world. It has grown at 9 to 10 percent for the past 25 years and has accounted for 20 percent of the total increase in world trade over the last three or four years. Last year, its trade grew more than India's total trade. It got more inward foreign direct investment last year than India has gotten in the entire period since its independence in 1947. China is now again running a large global current account surplus, which exceeded 4 percent of its GDP last year. When you correct for the fact that it's growing so rapidly, its fundamental structural surplus is probably 5 or 6 percent of its GDP.

For all these reasons, it is highly inappropriate, extremely counterproductive for the world economy and extremely antisocial behavior for China to have become substantially more competitive over the last three years by engineering a significant decline in the exchange rate of its currency, the renminbi.

China, of course, pegs to the dollar, and over the last three years, as the dollar has declined by a trade-weighted average of 10, 15 percent, China has ridden the dollar down versus almost every other currency in the world and become even more competitive. The trade-weighted average decline of the renminbi over the last three years has been about 10 percent, which probably explains a good bit of the increase in China's global current account surplus.

The obvious remedy is a sharp revaluation of the currency, not, repeat, not a float, as urged by the U.S. Treasury and the G–7. A float is not practical in the short to medium run given the weakness of China's banking system, and if China actually did it, the renminbi might weaken further—which would not do anything with trade—because there has been a huge buildup of renminbi wealth in China over its 25 years of rapid growth. All that money has been kept internally because of the capital controls.

If those controls came off, and the rate floated, there would probably be a big outflow for portfolio diversification reasons; the

renminbi would weaken and make the trade situation even worse. So what we need is a one-shot revaluation of the renminbi. I would estimate at least 25 percent to make a significant contribution to the big global imbalances correction.

You may recall that I testified along these lines to the Commission 18 months ago, but there have been three or four major changes since then that make the situation much worse. First, there has been a further very large increase in the U.S. current account deficit. On the latest numbers, our deficit has now reached 7 percent of our GDP. We are thus in the range of Mexico in 1994 and Thailand in 1997, having gone way beyond our own previous record of 3.8 percent in 1985, which triggered a 50 percent decline of the dollar in the next two years.

The U.S., to finance that deficit and our own foreign investments, must import $5 billion of capital from the rest of the world every working day, and if we don't get that $5 billion per working day, happily, at existing interest rates and exchange rates, then, the dollar goes down, interest rates go up, and nasty things can happen to our economy.

As a result of that big external deficit, we get accelerated protectionist trade policies here in the United States, and I'm sure you've talked about that this morning. China is being hit by protectionist barriers—if not every week, pretty frequently—on a wide range of textile and apparel products (with more to come), color TVs, semiconductors, wood furniture, shrimp, you name it. China is being hit and will be increasingly hit, whether one wants it or not, as a result of the massive currency imbalance and underlying unsustainabilities.

So the situation is clearly unsustainable not just in one but in two senses: one is the international financial unsustainability of continuing to borrow $5 billion a day. Incidentally, our projections show the U.S. current account deficit continuing to deteriorate by about a percent of GDP a year, which, incidentally, also takes a percent of U.S. economic growth off of the economy.

In the fourth quarter, a 3.1 percent growth rate was reported, but the trade balance deteriorated another 1.7 percent of GDP at an annual rate. Domestic demand rose almost 5 percent. It would have been a boom quarter if not for the further increase in the trade deficit, the bulk of which is with China. So our situation has gotten worse.

Two, the Chinese economy has clearly overheated. China has been experiencing investment to GDP ratios of close to 50 percent, the highest in recorded history. Its money supply has been growing 25 percent a year. On any indicator, it is overheated.

So a revaluation of the currency would be exactly what the doctor ordered in domestic terms. It would slow the growth rate by dampening the demand for exports; that's what the authorities say they want. It would reduce inflation, which has hit 8 to 9 percent in China on the inter-corporate goods transfer indicator, which is the best one, and it would limit the inflow of speculative capital, which is ballooning the money supply by $15 billion a month and making it impossible to keep inflationary pressures under control. So for purely internal reasons, they need a revaluation.

Third, the decline in the renminbi that I talked about is significantly hurting the rest of the world, not just the U.S. The fact that the renminbi goes down improves their competitive position against everybody else. Moreover, it means that the dollar decline is foisted onto the countries that have truly floating currencies: the euro, the pound, the Swiss franc and developing countries such as Chile and Colombia. Countries with truly floating rates must then be the counterparties of the U.S. dollar decline if the Chinese not only block any decline in their currency but also ride the dollar down.

And that, of course, takes most of Asia out of the adjustment pictures, because the other Asians are terrified of letting their rates go up against the renminbi; therefore, they won't let them go up against the dollar. Therefore, they won't let them go up against the dollar. Therefore, they all intervene massively—from Japan all the way around Asia as far as India.

So the situation has gotten much worse than we talked about 18 months ago. U.S. policy remains both incorrect and inadequately pursued. The Chinese are coming to breakfast tomorrow at the G–7 Finance Ministers' meeting in London. I expect a further polite protest to them.

The situation is getting extremely serious. The risk of a hard landing for the dollar and the U.S. economy is becoming more acute, and I suggest that the time is coming to get much more aggressive and much more action-oriented in getting our Chinese trading partners to take some action that will correct these problems.

Cochair MULLOY. Thank you, Dr. Bergsten.

Mr. Vargo?

STATEMENT OF FRANKLIN J. VARGO
VICE PRESIDENT, INTERNATIONAL ECONOMIC AFFAIRS
NATIONAL ASSOCIATION OF MANUFACTURERS
ON BEHALF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. VARGO. Thank you very much, and I'm very pleased to be here on behalf of the NAM today, and it's a particular pleasure to appear before Commissioner Patrick Mulloy, who was my boss at the Commerce Department and a very good boss indeed. I have a statement for the record and some brief remarks at this time.

China is simultaneously the greatest concern of many of our Members and also the fastest growing market for other of our Members. So it is really at the center of the NAM's trade agenda and trade concerns, and this week, when the NAM released its new overall trade agenda, the issue was so important that we also issued a separate China trade agenda, which I have attached to my prepared statement and which I hope the Commission will look at very carefully.

Now, when the NAM first started calling for China's currency to move about a year and a half, a little bit more than a year and a half ago, you know, hardly anybody could spell yuan or renminbi, except for Fred, of course, and everybody was disagreeing. There was no agreement on whether the yuan was undervalued and whether this was a problem.

Today, there is virtually no disagreement in the United States or around the world that this is an extremely serious problem. Now, we're very pleased that President Bush has made China's rigid un-

dervalued peg a priority, and we're most grateful for the effort and attention that Treasury Secretary Snow has been devoting to this. We also see a rising understanding of the significance of the issue in Europe, Japan and Canada.

I would like to make two points at this stage of my testimony. First of all, the rapidly rising trade imbalance with China is a very serious problem for us, but it's far from the largest factor affecting U.S. manufacturing. Rising domestic costs, slowly recovering U.S. exports, structural factors, regulatory pressures and other issues are also at work.

Second, the NAM seeks a positive and a mutually beneficial trade relationship with China. The trade relationship, however, must reflect the economic fundamentals, and it must be as free of government distortions and intervention as possible. Competing against low wages is one thing, but attempting to compete against a highly undervalued managed currency that tilts the playing field so sharply is entirely a different matter.

Now, before discussing the yuan, let me say that the NAM worked very hard to support and obtain China's accession into the World Trade Organization, and when China joined the WTO, it committed to lowering trade barriers significantly and taking far-reaching market access moves, and this was virtually at no cost to the United States, since we were already giving them most favored nation treatment, our normal trade relations, albeit on a year by year basis.

So the U.S. market had been open, and we had allowed the Chinese market for too many years to be closed, and there is no doubt in my mind that if China had entered the WTO 10 or 15 years earlier, we would not have the size now of the trade deficit now that we actually do.

China has made a lot of progress in implementing its WTO commitments, but I hope the Commission will take a close look at some very serious areas where it is very deficient, particularly counterfeiting, intellectual property protection, and also a growing problem in standards, technical barriers to trade.

Now, the NAM believes that the yuan's 10-year-old peg has resulted in a currency that is undervalued perhaps by as much as 40 percent, and that yuan is certainly exacerbating the trade deficit, which we believe when the figures come out later this month will have been $160 billion in 2004, up $35 billion from where it has been in 2003.

Now, a very good measure of the degree of undervaluation is foreign reserve accumulation, and China is now sitting on $610 billion of currency reserves, mostly in dollars. They built it up $200 billion last year. As Fred mentioned, this is no good for China either. It fuels inflation; it distorts the economy. You know, you would think that having a more properly valued currency would be a win-win situation.

I want you to note that China's currency reserves, this $600 billion, are equivalent now to 40 percent of China's entire annual GDP, its output of goods and services. And the $200 billion that China added to its reserves last year significantly exceeded the entire increase in China's GDP.

We believe that eliminating the severely undervalued yuan is very essential to not just rectifying our trade situation with China but with the rest of Asia as well. Would it make a difference? A lot of our member companies say jeez, if we could just have a 20 percent difference with China that would radically change the competitive situation. Some companies, some industries, frankly, will not be able to compete with China no matter what the exchange rate.

But wages are only part of the factor, and when you look at the Census Bureau figures, production worker wages and benefits only average 11 percent of the final cost of the overall or the average U.S. manufactured good, so there are other factors at work here.

Certainly, the preferred step would be for China to allow the yuan to be market determined, but I agree with Fred: that is not in the cards in the near future. But China could take several actions immediately, including repegging the yuan. They devalued it what? 30, 40 percent overnight in 1994; you know, they could reverse that; they could move it up overnight.

Now, clearly, more has to be done. Again, we really appreciate the effort that Secretary Snow is taking. He's been to the NAM discussing this several times, saying keep my feet to the fire. And we are. And we are looking for additional ways to put some more logs on the fire.

Clearly, more has to be done, and we are looking to have the Treasury begin by recognizing currency manipulation, China's currency manipulation and perhaps others in its next semiannual report to the Senate, and we believe that the Treasury Department needs to begin urging the International Monetary Fund to exercise the surveillance authority that it ought to be doing.

We cannot support actions that violate the global trade rules, but clearly, we have to look for additional ways to convince China it has to move. If the surveillance activities of the IMF do not move them, then, the IMF should be prepared to cite China under Article IV if progress is not made in consultations.

I want to conclude, however, by returning to an earlier point, and that is that we won't succeed in preventing the migration of our manufacturing base to China or anywhere else, though, if we don't address some of our domestic factors: the high cost of manufacturing in the United States. A fairly valued Chinese currency is absolutely essential, but we must not forget that the bulk of our problems are homegrown.

Thank you, Mr. Chairman.

[The statement follows:]

Prepared Statement of Franklin J. Vargo
Vice President, International Economic Affairs
National Association of Manufacturers
On Behalf of the National Association of Manufacturers

CHINA'S EXCHANGE RATE PRACTICES

Mr. Chairman and Members of the Commission, I am pleased to testify today on behalf of the National Association of Manufacturers (the NAM) at this hearing regarding China's compliance with its World Trade Organization (WTO) obligations. I am particularly pleased to appear today before Commissioner Patrick Mulloy, who was my boss at the Commerce Department when he was Assistant Secretary of Commerce for Market Access and Compliance.

The National Association of Manufacturers is the nation's largest industry trade association, representing small and large manufacturers in every industrial sector and in all 50 states. No other trade subject comes close to commanding the attention that China is getting from both large and small NAM member companies. China is simultaneously the greatest concern of many of our import-competing members and the fastest-growing global market for many exporters large and small and for companies that operate internationally.

This week, in fact, when the NAM released its overall 2005 trade agenda, it also released a special China trade agenda, and I would like to discuss that agenda today. The NAM seeks a positive and balanced trade relationship with China that reflects market forces as closely as possible. There is no question that the Chinese currency is seriously undervalued and is having a major effect on U.S. bilateral trade and on the trade of other nations as well. However, the undervalued currency is not the only concern with China, and I would like to address some of the other issues as well.

In so doing, I want to state up front that while the rapidly-rising trade imbalance with China is a growing factor affecting U.S. manufacturing production and employment, it is far from the largest factor. Domestic costs, slowly-recovering U.S. exports, dollar overvaluation with other currencies, structural factors, regulatory pressures, and other issues are also at work. China must not be viewed as a "scapegoat" and an excuse for not tackling the other problems. Nonetheless, the China currency situation and other factors feeding our deficit with China must be addressed.

THE NAM'S CHINA TRADE AGENDA

The NAM's trade agenda for China is focused on strengthening manufacturing in America and improving the international competitiveness of our manufacturing industry in the worldwide economy. In pursuing this agenda, the NAM expects that U.S. and international trade law will be administered so as to effectively level the trade playing field with China in order to achieve recognizable gains for manufacturing in the United States. These measures would result in a reduced trade deficit in manufactured goods with China and the world. The trade agenda for China complements the NAM's overall trade agenda and priorities in reducing domestically imposed costs.

China's emergence as a leading world economy has meant significant new opportunities for many NAM members, including increased export and investment. However, these opportunities are not fully realized by all NAM members despite the many constructive steps taken during the first term of the Bush Administration to ensure China's compliance with its WTO commitments.

The NAM believes there is substantial potential for Chinese economic growth to lead to a corresponding growth in the U.S. manufacturing economy. But that potential is far from realization. Of the $413 billion of goods China imported in 2003, only 8 percent were from the United States, including agricultural products. In contrast, the European Union (EU) and Japan have been significantly more successful selling into the Chinese market. During 2004, U.S. imports from China grew almost 30 percent, contributing to the largest bilateral trade deficit with any country, at nearly $160 billion, up almost $35 billion from 2003.

Trade generally, and with China specifically, has to be put in the context of a recovery in many sectors of the U.S. manufacturing economy over the past 18 months. But, despite this recovery, a number of manufacturing sectors that have borne the brunt of China's emergence as an industrial power have continued to lose revenue and jobs. Thus the China challenge not only continues to be at the center of the NAM's trade agenda, but also is central to how U.S. manufacturing defines its own future.

We believe full implementation of the NAM's China trade agenda would open markets, improve productivity and begin to slow the growth of the China trade deficit and reduce it to more sustainable levels, and be beneficial to China as well insofar as China would begin to focus more on domestic-led growth rather than export-led growth.

While it is important that the U.S. Government address our overall trade deficit, our deficit with China is so huge that an overall reduction cannot be done without examining our substantial imbalance with China. An essential objective of U.S. trade policy and trade diplomacy must be to undertake concrete steps aimed at improving U.S. competitiveness that will achieve a substantial and sustained reduction in the global and China trade deficits.

Accordingly, after extensive discussion over a period of months, NAM member companies, including both large and small companies, multinationals and local pro-

ducers, agreed on pursuing a China trade agenda comprised of the following elements:

- Revaluation of the Chinese Yuan To Reflect Economic Fundamentals
- Enforce and Enhance Intellectual Property Laws
- Retain China's Non-Market Economy Status as Negotiated in PNTR
- Eliminate Chinese Administrative, Regulatory and Standards Barriers
- Expand Exports to China
- Promote Fair Competition

CHINA'S WTO COMPLIANCE

The NAM worked very hard to support and obtain China's accession to the World Trade Organization (WTO). When China joined the WTO, it committed to lower trade barriers significantly and to take far-reaching market-opening moves. This was basically cost-free to the United States, which was already open to China and did not change its import policies at all when China joined. Thus, China's accession to the WTO for the first time began to level the playing field for American companies. Prior to that time, the U.S. market had been open to Chinese products, but China's market had been among the most closed in the world to U.S. products.

In fact, there is no doubt in my mind that had China entered the WTO 10–15 years earlier, we would not have a trade deficit with China nearly as large as we actually do. Had we had access to China earlier, by now our exports to China would have been much larger than they are today.

China's accession to the World Trade Organization in December 2001 was an important positive development because it brought China under the same international trade rules as the United States and almost all of our other trading partners. China has made progress in implementing its WTO commitments and market-opening pledges but problems persist and some are of a very serious nature that have far-reaching effects on U.S. manufacturers.

Two of the most serious problems relate to lack of effective enforcement of intellectual property protection and the central government's policy of currency undervaluation, which we believe violates the WTO principles. Additionally, we have concerns about the application of China's "CCC" mark and its compatibility with China's obligations in technical barriers to trade.

The NAM will continue to participate in the USTR's annual review of China's WTO commitments and welcomes the dedication of both the Bush Administration and the Chinese government to accelerating progress. The NAM believes both governments should continue to increase the resources they dedicate to the bilateral Joint Commission on Commerce and Trade (JCCT). Nevertheless, we believe bolder steps are required to improve the situation and allow American companies to compete effectively with China in the global and U.S. economies. There is a growing sense of urgency that many dimensions of the Chinese relationship need renewed attention in the early days of the second term of the Bush Administration.

These are covered in detail in the NAM's trade agenda for China. I will focus my statement today on China's currency, and will cover the other elements of the NAM's strategy only briefly. I have, however, appended this agenda in its entirety to my statement; and I urge the Commission to review it carefully.

CHINA'S UNDERVALUED CURRENCY

China's currency has been fixed at an exchange rate of 8.27 yuan per dollar since 1994. The NAM believes that the yuan is undervalued by as much as 40 percent. The undervalued yuan effectively taxes U.S. exports and subsidizes imports from China, exacerbating the growing bilateral trade deficit. In 2004, the bilateral trade deficit with China was close to $160 billion, the largest with any country and, at current growth rates, will almost triple in five years. Furthermore, the undervalued yuan makes foreign investment in productive capacity in China cheaper and more attractive, thus encouraging the migration of investment to China.

China devalued its currency by about 30 percent in 1994 and has maintained that value for the last ten 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. The currency is controlled by the government, and there is no marketplace for the yuan. The degree of upward pressure that the yuan would feel, however, is amply indicated in the amount of reserves that the Chinese government has to accumulate to maintain its artificial peg.

Foreign exchange reserve accumulation has been accelerating. Reserves grew a phenomenal $200 billion last year—to a total accumulation of $610 billion. The growth of foreign exchange reserves requires China to convert those holdings to

yuan, thereby increasing the money supply by 15–20 percent annually. Increases of that magnitude have accelerated inflation, expanded bank lending and fueled growth to more than 9 percent annually, contributing to an overheated economy.

I would like to put China's reserve accumulation in the perspective of China's economy—which is about $1.5 trillion. That means China's $600 billion of currency reserves (mostly in dollars) is equivalent to 40 percent of China's entire annual output of goods and services. That is an enormous amount to have in Treasury securities earning a couple of percentage points when China could be using those funds internally to build up the poorer parts of its economic infrastructure and stimulate domestic-led growth. Moreover, the $200 billion that China added to its reserves in 2004 significantly exceeded China's entire increase in GDP that year. Yet China has no choice but to continue this huge buildup of reserves so long as it insists on maintaining such a sharply undervalued currency.

It should be noted that, while a currency peg *per se* does not contravene International Monetary Fund (IMF) requirements, IMF Article IV proscribes "manipulation of exchange rates to gain unfair competitive advantage over other members—and this includes protracted large-scale intervention in one direction in the exchange market." With foreign currency reserves more than $600 billion, China's action is clearly incompatible with the intent of IMF Article IV.

The NAM believes that eliminating the severely undervalued yuan is essential to creating more balanced and sustainable trade flows and giving U.S. companies a more stable period to adjust to changing economic relationships. In addition, a revaluation of the yuan to reflect underlying economic fundamentals would create more favorable conditions within Asia, enabling other countries to free their currencies to better reflect market conditions. These multiple currency misalignments artificially depress U.S. exports to a substantial portion of the world economy and reduce the competitiveness of U.S.-based manufacturing in the U.S. market.

The Chinese currency is the key, not just because of the huge bilateral imbalance, but also because other Asian countries are all looking over their shoulders at Chinese competition and are reluctant to allow their currencies to move up against China's. Once China's currency appreciates, though, they will be less reluctant to allow theirs to move upward as well.

Would a considerably stronger Chinese yuan have beneficial effects? Many of our member companies tell us that a 20 percent or more price shift would change the competitive situation dramatically. Others say their problems go beyond that. Some commentators state that Chinese wages are so low that no amount of appreciation would make a difference. Labor costs, however, are only one factor in the production process. In fact, production worker wages and benefits are only 11 percent of the cost of U.S. manufactured goods, on average. An exchange rate reflecting market forces would shift the competitive equation so that some Chinese industries would remain extremely competitive, while others would find their artificial advantage diluted. U.S exports would also grow more rapidly, helping to bring about a more sustainable trade position.

Additionally, it is important to recognize that not all of China's rapid export growth to the U.S. market necessarily competes with U.S. production. For example, Japan's share of U.S. imports has fallen as China's has risen—implying the possibility of considerable substitution of Chinese for Japanese goods.

The Administration recognizes the importance of having a Chinese currency that reflects market forces, and the NAM applauds last week's statement by the President that China's pegged currency remains a top priority. We also appreciate the work that Treasury Secretary Snow has been doing to obtain progress, and hope that the London G7 meetings this weekend will result in China gaining a sufficient understanding from U.S. and other G7 country officials that the time has come to act.

Certainly the preferred step by China would be to allow the yuan to be market determined, by ending the practice of pegging it to the dollar and by ceasing its huge sustained purchases of dollars. Chinese officials have said this is their eventual goal, but have expressed great concern that all the problems with their banking and financial system must be fixed first.

Others disagree, pointing out that currency flexibility and capital account liberalization are two different things and need not be implemented simultaneously. Capital account liberalization may indeed be a step that must await banking system reform, but currency flexibility can be implemented without capital account liberalization. This argument is laid out, for example, in a recent International Monetary Fund (IMF) Policy Discussion Paper entitled, "Putting the Cart Before the Horse? Capital Account Liberalization and Exchange Rate Flexibility in China."

China could take several actions immediately, including unpegging the yuan from the dollar and relating it instead to a basket of major trading partner currencies,

establishing a large band around its current rate, and moving its peg upward. When we talk about revaluation, we see significant moves in this direction as being most desirable, but believe as a minimum that China could simply repeg its currency upward to a significant degree.

China's action in sustained one-way purchases of dollars to maintain its peg are inconsistent both with its obligations in the IMF to avoid currency action for purposes of gaining a trade advantage, as well as with its obligations in the WTO to avoid frustrating trade liberalization through exchange rate action and to avoid subsidization of exports or impairment of trade benefits.

The NAM urges the Administration to work with China and other countries to realign exchange rates and thus avoid the dangers that misaligned exchange rates pose to the United States, China, Asia and the global financial system. The G7 meetings later this week in London pose an excellent opportunity for seeking a change in China's policy.

Additionally, we will press the Treasury Department to recognize currency manipulation in its semi-annual report to Congress. It has declined to do so in earlier reports, but we believe China's massive currency purchases in 2004 clearly fall within the definition of manipulation. We also believe the Treasury Department should urge the International Monetary Fund to exercise its surveillance authority over exchange rates. We hope this will result in positive action, but if it does not, the IMF should be prepared to cite China under Article IV if progress is not made in consultations.

OTHER ELEMENTS IN THE NAM'S CHINA TRADE AGENDA

Let me again call the Commission's attention to the NAM's China Trade Agenda, which is attached to my statement. I will briefly summarize some of the main points in that agenda and state that the NAM looks forward to working with the Commission on this in the future.

Strengthen and Enforce Intellectual Property Laws

Next to the exchange rate, the most serious problem NAM members have with China is its failure to curb intellectual property theft—particularly copyright piracy and product counterfeiting. China has become the world's epicenter of counterfeiting, costing billions of dollars, thousands of legitimate jobs, and threatening health and safety as individuals purchase bogus products that do not do what they are supposed to.

Despite bilateral and multilateral agreements with China to protect intellectual property rights, China's record of enforcement has been inadequate and seriously flawed. China has been taking positive steps, particularly in working with the energetic initiatives proposed by the U.S. Trade Representative and the Commerce Department. China's Vice Premier Wu Yi has succeeded in getting some beneficial changes that lower the threshold for criminalization of intellectual property theft, but we need to see these new tools actually used, with counterfeiters thrown in jail and the volume of counterfeiting significantly reduced.

Retain Non-Market Economy Status

The NAM believes that the Administration should proceed carefully in its examination of China's status as a non-market economy country. China's economy has significant distortions that prevent market forces from acting efficiently and effectively at the present time.

Eliminate Administrative, Regulatory and Standards Barriers

While tariffs have fallen significantly, U.S. manufacturers doing business in China still face many administrative, regulatory and standards-related barriers that are difficult and costly to overcome. The NAM urges the U.S. Government to give a high priority to removing these barriers by pressing Chinese authorities to streamline administrative and regulatory processes, making them more transparent and open to stakeholder input, and applying regulations consistently throughout the country. The NAM is particularly concerned that China's CCC Quality Mark system is in effect a trade barrier, and urges the Commission to look into this closely, with a view toward generating positive suggestions that would facilitate trade and particularly U.S. exports.

Expand Exports to China

The Chinese marketplace holds vast potential for U.S. manufacturers. With annual growth rates in the 8–9 percent range for more than a decade, China is the fastest growing economy in the world and one that is increasingly open to trade with the world.

China is the third largest import market in the world, after the United States and Germany, with more than $500 billion in imports. The United States, however, captured only 8 percent of that market or $35 billion in 2004, substantially less than either Japan or the European Union and a decline from the 9% of market share in 2002.

To reverse this trend and help U.S. manufacturers reach their export potential in China, a new and greatly expanded export promotion initiative is needed. Current U.S. Government export promotion programs offer useful assistance but are not on the scale needed to make a sufficient difference in overall export trends. The U.S. Government and private sector must work together to launch a more ambitious program that provides more on-the-ground assistance in China and more trade outreach to potential U.S. exporters.

We believe that if this is done, we could see an increase in U.S. exports of 33 percent annually during the next four years—or a three-fold increase—to more than $100 billion by 2008. We believe this is attainable, but only with a major new public-private effort. To implement a program of this scale, the NAM will seek to obtain a doubling of the Commerce Department's China-specific trade promotion budget for FY2006.

The NAM also believes that, as part of this effort, expanded export financing is needed and the United States should seek to eliminate China's still high industrial tariffs to levels comparable to the United States, the EU, and Japan—utilizing the Doha Round of WTO negotiations.

Open China's Public Procurement and Internal Market

China committed in its WTO accession agreement to negotiate entry into the government procurement agreement. The NAM urges the United States to give high priority to promoting China's government procurement accession with the objective of making China's government procurement practices more transparent and open, in which a diversity of manufacturers and exporters can compete on a level playing field with the widest possible range of product options being made available.

Improve the Export Administration Act and Procedures

The U.S. Government imposes export controls on a wide range of goods and technologies, particularly those destined for China, on grounds of national security. The current control system is inefficient and costly to our economy, and the NAM seeks updated export administration procedures that meet U.S. needs in the post-Cold War era.

Address Visa Delays for Chinese Business Visitors

Changes since 9/11 in U.S. procedures for obtaining visas have made it increasingly difficult for Chinese business and government officials to visit the United States for meetings with U.S. companies, business conferences and trade fairs. As a result of visa difficulties, many Chinese companies appear to be turning to other non-U.S. suppliers for their purchases of manufactured goods.

Apply Countervailing Duty Laws to China

There are concerns that China's industrial development may benefit from a wide array of subsidies, including currency manipulation, government bank lending to enterprises without creditworthiness, export-based tax incentives, and the discriminatory application of tax rates and rebates. The WTO Subsidies and Countervailing Measures (SCM) agreement allows countervailing import duties to offset such subsidies.

While these provisions apply to imports from nearly all WTO members, the Department of Commerce, based on a decision in 1984, does not apply countervailing duties against imports from non-market economy countries such as China.

The NAM supports reversal of the Commerce Department's 1984 decision in light of the SCM Agreement and the terms of China's accession to the WTO, and supports legislation such as that which was introduced last year in the House by Rep. English and Davis and in the Senate by Senators Collins and Bayh.

Apply Safeguards and Make Trade Cases More Affordable

Because China's economy is still in transition from a command economy to a market economy, trade with China will be characterized by periods of market disruption in various commodities. Special provisions were incorporated in China's accession to the WTO to address the disruption that documented surges in China's exports to other markets may cause. The NAM believes these provisions should be used when the circumstances fit the requirements, for without relief from market disruption, small manufacturers face surges in imports from China because China does not have the market mechanisms in place to prevent overproduction and overcapacity.

Many smaller U.S. companies cannot afford the high costs of preparing and filing trade cases. The Department of Commerce and other relevant agencies should consider self initiation of trade cases when small companies or the industry is not financially in a position to prepare and file a trade case, and should explore other ways of making the provisions of U.S. trade law more practically available to smaller firms.

CONCLUSION

I want to conclude by reiterating that we will not succeed in preventing the migration of our manufacturing base to China and other foreign countries if we do not address the high cost of manufacturing in the United States. A fairly valued Chinese currency is important, but we must not forget that the bulk of our problems are home-grown. U.S. industry is burdened by legal and regulatory systems that retard growth and destroy jobs.

Rapidly rising health care costs are a constant worry, particularly for small manufacturers. Uncertainty over sources of energy supply has led to price volatility. Research and development need to be expanded to assure U.S. technological leadership. And shortages of skilled workers have many manufacturers wondering how they can expand in the future.

Additionally, bilateral, regional and WTO trade agreements must be negotiated as quickly as possible to get foreign trade barriers eliminated, or at least down to our own low level. U.S. tariffs on manufactured goods average less than 2 percent, while in many parts of the world U.S-made goods face tariffs 10–15 times higher—or even more.

Unless these challenges are also addressed, we can expect a significant further 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 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.

THE NAM TRADE AGENDA FOR CHINA

2005

The NAM trade agenda for China is focused on strengthening manufacturing in America and improving the international competitiveness of our manufacturing industry in the worldwide economy. In pursuing this agenda, the NAM expects that U.S. and international trade law will be administered so as to effectively level the trade playing field with China in order to achieve recognizable gains for manufacturing in the United States. These measures would result in a reduced trade deficit in manufactured goods with China and the world. The trade agenda for China complements the NAM's overall trade agenda and priorities in reducing domestically imposed costs.

- **Revalue the Chinese Yuan To Reflect Economic Fundamentals**
- **Enforce and Enhance Intellectual Property Laws**
- **Retain China's Non-Market Economy Status as Negotiated in PNTR**
- **Eliminate Chinese Administrative, Regulatory and Standards Barriers**
- **Expand Exports to China**
  - **Expand and Strengthen Export Promotion Programs Toward China**
  - **Expand Export Financing**
  - **Eliminate China's High Industrial Tariffs**
  - **Open Public Procurement and China's Internal Market**
  - **Improve Export Administration Act and Procedures**
  - **Reduce Visa Delays for Chinese Business Visitors**
- **Promote Fair Competition**
  - **Apply Countervailing Duty Laws To China to Address Subsidies**
  - **Apply China Safeguard (Section 421)**
  - **Make Trade Cases More Affordable**

China is the single most important trade challenge facing U.S. manufacturing growth and competitiveness. China's emergence as a leading world economy has meant significant new opportunities for many NAM members, including increased export and investment. However, these opportunities are not fully realized by all NAM members despite the many constructive steps taken during the first term of the Bush Administration to ensure China's compliance with its WTO commitments.

The NAM believes there is substantial potential for Chinese economic growth to lead to a corresponding growth in the U.S. manufacturing economy. But that potential is far from realization. Of the $413 billion of goods China imported in 2003, only 8 percent were from the United States, including agricultural products. In contrast, the EU and Japan have been significantly more successful selling into the Chinese market. During 2004, U.S. imports from China grew almost 30 percent, contributing to the largest bilateral trade deficit with any country, at nearly $160 billion, up almost $35 billion from 2003.

Trade generally and with China has to be put in the context of a recovery in many sectors of the U.S. manufacturing economy over the past 18 months. But, despite this recovery, a number of manufacturing sectors that have borne the brunt of China's emergence as an industrial power have continued to lose revenue and jobs. Thus the China challenge not only continues to be at the center of the NAM's trade agenda, but also is central to how U.S. manufacturing defines its own future. Full implementation of the NAM's China trade agenda would open markets, improve productivity and begin to slow the growth of the China trade deficit and reduce it to more sustainable levels.

The National Association of Manufacturers is the nation's largest industry trade association, representing small and large manufacturers in every industrial sector and in all 50 states. Headquartered in Washington, D.C., the NAM has 10 additional offices across the country. Visit the NAM's award-winning web site at www.nam.org for more information about manufacturing and the economy.

Among the concerns our membership repeatedly cites with respect to China trade are its unsustainable currency practices, inadequate intellectual property safeguards and subsidies. When these China-specific factors are combined with increasingly burdensome U.S. structural costs, many segments of the U.S. manufacturing economy find constant "restructuring" and "reinvention" inadequate to allow them to be competitive.

The NAM believes that addressing a wide range of bilateral trade issues is as critical for China as it is for the United States. It is a priority for the NAM, and we believe should continue to be a priority for the second Bush Administration. While it is important that the U.S. Government address our overall trade deficit, our deficit with China is so huge that an overall reduction cannot be done without examining our substantial imbalance with China. An essential objective of U.S. trade policy and trade diplomacy must be to undertake concrete steps aimed at improving U.S. competitiveness that will achieve a substantial and sustained reduction in the global and China trade deficits.

The President's Export Council (PEC) is currently undertaking an analysis of the U.S.-China trade imbalance, an important step in understanding the measures needed both in the manufacturing sector and in partnership with the government to address the causes and devise the cures. An important part of that study should be an analysis of the U.S. sectors being most adversely affected and the reasons why U.S. exports to China have not grown as rapidly as those of other high cost economies like the EU and Japan.

During the first term of the Bush Administration, China made significant progress towards fulfilling its WTO accession commitments and, while deficiencies still exist, progress is continuing. The NAM will continue to participate in the USTR's annual review of China's WTO commitments and welcomes the dedication of both the Bush Administration and the Chinese government to accelerating progress. The NAM believes both governments should continue to increase the resources they dedicate to the Joint Commission on Commerce and Trade (JCCT).

We believe bolder steps are required to improve the situation and allow American companies to compete effectively with China in the global and U.S. economies. There is a growing sense of urgency that many dimensions of the Chinese relationship, especially those listed in this document, need renewed attention in the early days of the second term of the Bush Administration.

REVALUE THE CHINESE YUAN TO REFLECT ECONOMIC FUNDAMENTALS

China's currency has been fixed at an exchange rate of 8.27 yuan per dollar since 1994. The NAM believes that the yuan is undervalued by as much as 40 percent. The undervalued yuan effectively taxes U.S. exports and subsidizes imports from China, exacerbating the growing bilateral trade deficit. In 2004, the bilateral trade deficit with China was close to $160 billion, the largest with any country and, at current growth rates, will almost triple in five years. Furthermore, the undervalued yuan makes foreign investment in productive capacity in China cheaper and more attractive, thus encouraging the migration of investment to China.

The effects on China are equally disruptive. Foreign exchange reserves have grown to almost $610 billion, over one-third of China's GDP. The growth of foreign exchange reserves requires China to convert those holdings to yuan, thereby increasing the money supply by 15–20 percent annually. Increases of that magnitude have accelerated inflation to more than 5 percent (compared to the previously deflationary period in the late 1990s), expanded bank lending and fueled growth to more than 9 percent annually, contributing to an overheated economy.

It should be noted that, while a currency peg *per se* does not contravene International Monetary Fund (IMF) requirements, IMF Article IV proscribes "manipulation of exchange rates to gain unfair competitive advantage over other members—and this includes protracted large-scale intervention in one direction in the exchange market." With foreign currency reserves more than $600 billion, China demonstrably violates the intent of IMF Article IV.

The NAM believes that eliminating the severely undervalued yuan is essential to creating more balanced and sustainable trade flows and giving U.S. companies a more stable period to adjust to changing economic relationships. In addition, a revaluation of the yuan to reflect underlying economic fundamentals would create more favorable conditions within Asia, enabling other countries to free their currencies to better reflect market conditions. These multiple currency misalignments artificially depress U.S. exports to a substantial portion of the world economy and reduce the competitiveness of U.S.-based manufacturing in the U.S. market.

The NAM urges the Administration to work with China and other countries to realign exchange rates and thus avoid the dangers that misaligned exchange rates pose to the United States, China, Asia and the global financial system.

NAM Key Objective:

Immediate revaluation of the yuan by up to 40 percent.

Actions:

- ***Press the Treasury Department to urge the International Monetary Fund to exercise its surveillance authority over exchange rates and cite China under Article IV if progress is not made in consultations.***
- ***Encourage the Administration to work with the G–7, G–20, APEC and other international organizations to press the Chinese government to revalue the yuan.***
- ***Press the Treasury Department to recognize currency manipulation in its semi-annual report to Congress.***

STRENGTHEN AND ENFORCE INTELLECTUAL PROPERTY LAWS

The NAM welcomed China's announcement in December 2004 that it will more aggressively pursue criminal prosecutions for counterfeiting and copyright piracy while raising fines and penalties. While this is a significant step forward, these actions do not totally resolve the problem of Chinese counterfeiting. There is still much to be done enforcing tough anti-counterfeiting laws, particularly at provincial and local levels. The Administration must press China to put into practice this new interpretation of its anti-counterfeiting laws in an effective manner, with real prosecution of counterfeiters.

Despite bilateral and multilateral agreements with China to protect intellectual property rights, China's record of enforcement has been inadequate and seriously flawed. The lack of transparency and cooperation with government agencies, high thresholds for prosecution, weak administrative sanctions, local protection and corruption, coupled with a general lack of resources and training, have weakened China's enforcement of its laws and regulations governing intellectual property rights. The April 2003 visit of Vice Premier Wu Yi yielded some positive commitments on enforcement efforts in China. In addition, the Administration instituted the Strategy Targeting Organized Piracy (STOP) that establishes a more comprehensive approach to addressing piracy, particularly for the import of pirated products into the United States.

Nevertheless, intellectual property piracy in China continues at excessively high levels and, because China is a major world exporter, those pirated products are appearing in markets throughout the world. An inadequate IPR enforcement structure within China will also hamper the development and success of Chinese branded products in the future. Moreover, counterfeit products create health and safety hazards not only for Chinese citizens but for unwitting consumers around the world. The Administration and the NAM need to ensure that China continues to reduce and eliminate piracy and counterfeiting by increasing enforcement at the central, provincial and local government levels in China and at its borders to prevent those pirated products from being exported or imported.

NAM Key Objective:

A dramatic acceleration of initiatives to reduce and eliminate Chinese intellectual property rights violations.

Actions:

- ***Encourage the Administration to press China to put into practice the newly announced interpretation of its anti-counterfeiting laws.***
- ***Declare China a Priority Foreign Country and consider taking it to the WTO if the out-of-cycle Special 301 Review being done by the USTR in early 2005 does not show sufficient Chinese progress in meeting JCCT and WTO commitments.***
- ***Engage other countries to implement a program comparable to the recently announced U.S. STOP program to address Chinese counterfeiting.***

RETAIN NON-MARKET ECONOMY STATUS

The NAM believes that the Administration should proceed carefully in its examination of China's status as a non-market economy country. China's economy has significant distortions that prevent market forces from acting efficiently and effectively. For example, the closed capital market in China prevents the adoption of a more market-determined exchange rate. These market imperfections mean that

China is more prone to excess capacity, excess production and excess exports that adversely affect foreign markets. U.S. companies, particularly small- and medium-sized companies (SMMs), need to employ alternative methodologies in order to determine anti-dumping margins when they are being injured by unfairly priced imports from China. Since China's economy is not governed by market forces (*e.g.*, exchange rates are not determined by underlying economic fundamentals), using Chinese prices that are not market determined would disadvantage U.S. manufacturers in the United States when faced with competition from Chinese products that are sold at less than fair value.

NAM Key Objective:

Retain China's non-market economy status (NME) for the full 15 year period negotiated in PNTR unless statutory requirements for market economy status are fully and consistently met.

Actions:

- ***The U.S. Government should set up an industry advisory group on NME status to include the NAM.***
- ***Congressional oversight of China's progress in fulfilling its statutory requirements should be established. The Commerce Department should provide the appropriate congressional body with an annual report of its progress.***

ELIMINATE ADMINISTRATIVE, REGULATORY AND STANDARDS BARRIERS

While tariffs have fallen significantly, U.S. manufacturers doing business in China still face many administrative, regulatory and standards-related barriers that are difficult and costly to overcome. The NAM urges the U.S. Government to give a high priority to removing these barriers by pressing Chinese authorities to streamline administrative and regulatory processes, making them more transparent and open to stakeholder input, and applying regulations consistently throughout the country. In reforming administrative and regulatory processes, China should take into account internationally accepted norms and practices to the fullest extent possible. This would make it easier for U.S. firms, particularly small- and mid-size manufacturers (SMMs) in regulated industries, to sell their products in China. The U.S. Government also needs to be alert to the development of national technical standards and conformity assessment procedures that deviate from international practice or otherwise create unreasonable restrictions on trade.

NAM Key Objective:

Undertake a vigorous, sustained effort to eliminate the growing number of barriers resulting from trade-related administrative directives, regulatory policies and technical standards, make the process more transparent, and apply regulations uniformly across the country.

Actions:

- ***Establish a U.S.-China regulatory policy and standards forum to facilitate dialogue on technical trade barriers, promote openness and transparency in regulatory and standards development, and encourage harmonization where possible.***
- ***Press for reforms of China's CCC quality mark system to permit U.S. testing bodies to offer CCC certifications and make the process timelier and less costly to U.S. exporters, particularly small- and mid-size companies.***

EXPAND EXPORTS TO CHINA

Expand and Strengthen Export Promotion Programs Toward China

The Chinese marketplace holds vast potential for U.S. manufacturers. With annual growth rates in the 8–9 percent range for more than a decade, China is the fastest growing economy in the world and one that is increasingly open to trade with the world. China is the third largest import market in the world, after the United States and Germany, with more than $500 billion in imports. The United States, however, captured only 8 percent of that market or $35 billion in 2004, substantially less than either Japan or the European Union and a decline from the 9% of market share in 2002. U.S. imports from China, on the other hand, continue to grow rapidly. More than 30 percent of all Chinese exports go to the United States. The U.S. trade deficit with China, as a result, reached a new record in 2004, close to $160 billion.

To reverse this trend and help U.S. manufacturers reach their export potential in China, a new and greatly expanded export promotion initiative is needed. Although China has reduced its external tariffs and opened its internal market to U.S. and other foreign businesses, it is still an unusually challenging market, particularly for small- and mid-size manufacturers (SMMs). Current U.S. Government export promotion programs offer useful assistance but are not on the scale needed to make a sufficient difference in overall export trends.

The U.S. Government and private sector must work together to launch a more ambitious program that provides more on-the-ground assistance in China and more trade outreach to potential U.S. exporters. Key elements include:

(1) New American Trade Centers in major interior commercial centers;
(2) Greater support for U.S. exhibitions at China trade fairs;
(3) A robust Global Supply Chain Initiative;
(4) An expanded China Business Information Center (CBIC);
(5) Expansion of the Market Development Cooperator Program that provides U.S. industry associations with partial grants to open market-development offices in China;
(6) Support for Export Trading Companies in specific manufacturing sectors;
(7) Additional funding for feasibility studies that the Trade Development Agency could undertake in partnership with NAM member companies; and
(8) More joint government-private sector outreach to potential U.S. exporters.

We believe that, if this is done, we could see an increase in U.S. exports of 33 percent annually during the next four years—or a three-fold increase—to more than $100 billion by 2008. We believe this is attainable, but only with a major new public-private effort. To implement a program of this scale, the NAM will seek to obtain a doubling of the Commerce Department's China-specific trade promotion budget for FY2006.

To help guide this export promotion initiative and our China trade policy more broadly, the NAM also recommends that the Commerce Department, in coordination with the President's Export Council, the NAM and other business groups, analyze the following: (1) Which sectors of the U.S. manufacturing economy are most adversely affected by Chinese imports? (2) What are China's largest categories of manufactured goods imports? Which countries are most successfully penetrating these Chinese markets? Are these patterns likely to be sustained? (3) Why have the European Union and Japan in particular, been more successful in exporting to China? What can U.S. companies learn from their experiences? (4) Which sectors of the U.S. manufacturing economy have strong competitive advantages and how can they best use these advantages to expand U.S. exports to China?

This analysis, which should be completed by June 2005, will help the Administration and Congress to have a better understanding of the opportunities and challenges of expanded trade with China and the kinds of export promotion programs that are likely to be most effective in significantly expanding U.S. exports to China.

NAM Key Objective:

Expand U.S. exports to China by 300 percent by 2008* (i.e., *to more than $100 billion), particularly higher valued added manufactured products.

Actions:

- ***Strengthen and expand export promotion and financing programs, particularly for small- and mid-sized manufacturers.***
- ***Double the Commerce Department's China-specific trade promotion budget for FY2006.***
- ***Redeploy Commerce Department commercial service resources and personnel to focus on the China market.***
- ***Assist the Commerce Department to tailor export promotion programs to the needs of key manufacturing sectors.***
- ***Conclude by June 2005 analysis of (1) comparative export performance by country and manufacturing sector to better gauge China trade opportunities and challenges* (See details in text above); *and (2) techniques of the European Union, Japan and other competitors in their export promotion programs to China in order to emulate global best practices.***

Expand Export Financing

In addition to expanding Commerce Department export promotion programs, it is essential that there be increased export financing targeted specifically for U.S. sales to China. Existing Export Import (Ex-Im) Bank and Small Business Administration

(SBA) programs should be expanded significantly to allow U.S. producers, especially small- and mid-size companies, to take advantage of opportunities for exporting to China.

The NAM believes that Ex-Im should do special monitoring of large public works projects as well as large industrial products in China in order to ensure that foreign companies are not unfairly benefiting from tied-aid credits (subsidized financing from foreign governments) that are not available to U.S. suppliers. Special funds should be appropriated to match tied-aid credits to China from other countries. In the absence of this matching financing, China will source from manufacturers outside the United States.

NAM Key Objective:

Increased funding that matches or exceeds that available to foreign companies competing with U.S. companies in China.

Actions:

- ***Ex-Im Bank should greatly expand its programs to expedite financing for exports to China, including for smaller U.S. exporters.***
- ***Set up Small Business Administration Capital and Export Funds for expanding exports to China.***
- ***Special funds should be appropriated by Ex-Im Bank to match tied-aid credits to China from other countries.***

Eliminate China's High Industrial Tariffs

In 2001, China entered the WTO, making commitments to reduce overall industrial tariffs to about 10 percent. China implemented tariff cuts in each of the years following accession with the result that nearly all scheduled tariff reductions have been fully implemented. Only a few tariff cuts remain for products upon which extended reductions were agreed. Even with those tariff cuts, China's overall tariff level remains high, especially when considering the competitive position of Chinese products in the U.S. market. In some sectors, such as plastics, Chinese tariffs are exceptionally high. China is reported to have said that it is not prepared to make further tariff cuts considering the extensive reductions that China implemented as part of its accession agreement.

The NAM believes that the United States should seek the broadest and deepest reductions in Chinese tariffs on manufactured goods as part of the WTO Doha Round. The rising trade deficit, coupled with the slower absolute increases in U.S. exports to China (compared to imports), all indicate that China is both commercially competitive in the U.S. market and capable of opening its manufacturing market to levels comparable to industrial markets such as the United States, Japan and Europe.

NAM Key Objective:

Further reduction in China's industrial tariffs in keeping with its stature as a major industrial market.

Action:

- ***U.S. negotiators should use the Doha Round to press China to reduce tariffs and other trade barriers to levels comparable to the United States, the European Union and Japan.***

Open China's Public Procurement and Internal Market

China committed in its WTO accession agreement to negotiate entry into the government procurement agreement. The NAM urges the United States to give high priority to negotiating China's government procurement with the objective of making China's government procurement practices more transparent and open, in which a diversity of manufacturers and exporters can compete on a level playing field with the widest possible range of product options being made available.

Chinese provinces and local governments permit a variety of measures that restrict trade from outside those regions and localities. The net result is that distribution costs in China are about 16 percent compared to the average 4 percent in OECD countries. Provincial and local barriers to internal trade make it more difficult for companies to sell products within China. The NAM believes that the United States should seek agreement by China to eliminating those barriers that would expand market access for U.S. exported products and expand markets within China for all companies, Chinese and foreign.

NAM Key Objectives:

China's entry into the WTO government procurement agreement.

Elimination of Chinese provincial and local barriers to internal trade that affect market access for U.S. exported products.

Action:

➢ ***Include government procurement and internal market access barriers as part of bilateral negotiations with China.***

Improve the Export Administration Act and Procedures

The U.S. Government imposes export controls on a wide range of goods and technologies, particularly those destined for China, on grounds of national security. The current control system is inefficient and costly to our economy, and the NAM seeks updated export administration procedures that meet U.S. needs in the post-Cold War era. These new procedures must promote timeliness, efficiency and transparency in the control process; exempt mass-marketed items; and recognize that unless a new control system is built upon comparably implemented multilateral agreements, U.S. national security will not be protected. Unilateral U.S. export controls on technologies available from foreign sources merely divert sales to foreign competitors and risk having technology leadership move offshore. Additionally, the NAM seeks the improvement and streamlining of licensing and other procedures implemented by the Administration, including progress in updating items on the U.S. Munitions List (USML).

NAM Key Objective:

Streamline the licensing of high-technology products to China to enable U.S. manufacturers to compete against foreign suppliers while also working cooperatively to protect U.S. national security interests.

Actions:

➢ ***Reform the outdated requirements of the Export Administration Act (EAA) to improve efficiency and reflect advances in technology and changes in market availability while also protecting U.S. national security.***

➢ ***Streamline and improve the licensing procedures for items on the U.S. Munitions List (USML).***

Address Visa Delays for Chinese Business Visitors

Changes since 9/11 in U.S. procedures for obtaining visas have made it increasingly difficult for Chinese business and government officials to visit the United States for meetings with U.S. companies, business conferences and trade fairs. Chinese business visa applicants often experience long delays in getting interviews with visa officers and in receiving a response to their application. A much higher percentage than in the past is rejected after a Security Advisory Opinion (SAO) review in Washington, apparently because their technical qualifications and/or professional interests fall within the "Technology Alert List" (TAL) criteria. The TAL is intended to screen out applicants that may be seeking access to sensitive U.S. technology. But many companies are puzzled by the rejection of Chinese business contacts and even their own Chinese staff who have no apparent access to or known interest in such technology. As a result of visa difficulties, many Chinese companies appear to be turning to other non-U.S. suppliers for their purchases of manufactured goods. The U.S. Government needs to make greater efforts to improve the efficiency of the visa process and more carefully target individuals that might harm U.S. national security.

NAM Key Objective:

Improve the efficiency of the visa process and ensure that the screening process targets only those applicants that are a clear threat to U.S. national security.

Actions:

➢ ***Seek a review of the Technology Alert List to improve the screening process and tighten the criteria.***

➢ ***Work with the State Department as it implements its new U.S.-China Business Initiative to see that the timeliness of the visa application process is significantly improved.***

PROMOTE FAIR COMPETITION

Apply Countervailing Duty Laws to China to Offset the Effects of Chinese Subsidies

There are concerns that China's industrial development may benefit from a wide array of subsidies, including currency manipulation, government bank lending to enterprises without creditworthiness, export-based tax incentives, and the discriminatory application of tax rates and rebates. The size of China's industrial sector and its huge foreign exchange reserves should dictate that greater subsidy discipline be applied. Once specific, targeted benefits are eliminated, China's development can proceed on a fairer, more market-oriented basis with reduced exposure to countervailing measures by trading partners.

The World Trade Organization (WTO) recognizes that subsidies (such as government payments to reduce production costs) can distort trade flows and can cause adverse effects on competing foreign companies. The WTO Subsidies and Countervailing Measures (SCM) agreement allows countervailing import duties to offset such subsidies. While these provisions apply to imports from nearly all WTO members, the Department of Commerce, based on a decision in 1984, does not apply countervailing duties against imports from non-market economy countries such as China. The WTO SCM agreement, however, defines how to measure a subsidy and China's WTO accession agreement includes special provisions for calculating subsidies in a non-market economy country, provisions that are consistent with the WTO Appellate decisions.

The NAM supports reversal of the Commerce Department's 1984 decision in light of the SCM Agreement and the terms of China's accession to the WTO.

NAM Key Objective:

Elimination of artificially created and maintained competitive advantages through WTO-inconsistent subsidization or other means.

Actions:

- ***The Bush Administration should endorse, as a priority in the first session of the 109th Congress, legislation that would clarify the intent of Congress to apply countervailing duty provisions to both market and non-market economy countries.***
- ***The Commerce Department's new Unfair Trade Practices Group should undertake and publish an analysis of Chinese subsidization practices.***

Apply China Safeguards (Section 421)

Because China's economy is still in transition from a command economy to a market economy, trade with China will be characterized by periods of market disruption in various commodities. Special provisions were incorporated in China's accession to the WTO to address the disruption that documented surges in China's exports to other markets may cause. Those provisions were incorporated in U.S. law under Section 421. This provision allows the United States to apply quotas or tariffs on a product basis when market disruption occurs. Of the five cases that have been filed, the International Trade Commission (ITC) found in favor of market disruption in three cases. However, the Administration denied relief in all three cases. The NAM believes that this provision should be used, for without relief from market disruption, small manufacturers face surges in imports from China because China does not have the market mechanisms in place to prevent overproduction and overcapacity.

NAM Key Objective:

Appropriate use of Section 421 to address documented Chinese import surges as negotiated in PNTR.

Action:

- ***The Administration should apply appropriate 421 remedies when the ITC has ruled that requirements of the statute have been met.***

Make Trade Cases More Affordable

For many industries, the surge in imports from China has injured small- and mid-sized U.S. companies such that they cannot afford the high costs of preparing and filing trade cases. The Department of Commerce and other relevant agencies should self initiate trade cases when small companies or the industry is not financially in a position to prepare and file a trade case. Section 731(a)(2) of the antidumping law authorizes Commerce to institute special import monitoring programs and self initiate cases, in limited circumstances. That provision has never been used and has

no equivalent in the CVD law. The NAM believes that AD and CVD laws should be amended to remedy these shortcomings. In the interim, Commerce should, as a matter of policy, use its existing statutory authority to self initiate cases in consultation with industry. This mechanism would support domestic manufacturers' access to trade laws designed to protect U.S. industry and agriculture from surges in imports that disrupt markets.

NAM Key Objective:

Make available appropriate use of U.S. trade law when companies, especially small- and mid-sized, cannot afford the high cost of bringing cases.

Actions:

- ***The Commerce Department should institute special import monitoring programs.***
- ***The Commerce Department should make use of its existing statutory authority to self initiate AD, CVD and Section 421 cases in consultation with industry.***

Cochair MULLOY. Thank you, Mr. Vargo.

Mr. Hartquist.

STATEMENT OF DAVID A. HARTQUIST, ESQ.
PARTNER, COLLIER SHANNON SCOTT PLLC
ON BEHALF OF THE CHINA CURRENCY COALITION

Mr. HARTQUIST. Thank you, Commissioner Mulloy, and let me say it's a pleasure to appear on this panel with Fred Bergsten. Fred, I think we cited in our 301 petition comments of yours on this issue back to 1997.

Mr. BERGSTEN. At least.

Mr. HARTQUIST. At least 1997, and of course, we've worked with Frank Vargo and the NAM on this issue as well, so it's a pleasure to be with this group.

I'm David A. Hartquist with Collier Shannon Scott, and I'm serving today as counsel to the China Currency Coalition, which is a group of trade associations, companies, labor unions, all in support of the objective of accomplishing a revaluation of the yuan. I'd like to highlight a few points made in my written statement, which you have.

First, China has relied heavily for its economic progress on government control and manipulation of its currency, and you have a wealth of information supporting that. During the eighties and into the early 1990s, the yuan was overvalued to facilitate imports of capital goods considered necessary for China's development.

Since 1994, the reverse has happened, and the yuan has been undervalued in order to slow the growth of imports and we believe subsidize increased exports. From China's perspective, this policy of manipulation has been very beneficial in creating about 20 or 25 million new jobs annually—annually—and in shoring up state-owned banks burdened by onerous and extensive nonperforming loans, some say $500 billion of bad debt.

Second, the historical record reflects the entrenched belief by China's leadership that China will be better served if the yuan's exchange rate is set by the government rather than by market forces. In our view, there is no indication that China intends to change its policy any time soon. The yuan's undervaluation has been playing an integral role in stabilizing China's economy and financial institutions and thus in avoiding political and social unrest in the coun-

try with a low standard of living and poverty for many of its 1.3 billion people.

Third, based on the trade data reported by China's primary trading partners, including the United States, we believe that the yuan is undervalued, as Frank has indicated, by 40 percent or more. These data show very sizable and growing annual trade surpluses by China with the United States and substantial annual trade surpluses by China in the aggregate with its other top 40 trading partners.

In contrast, China's own reported data consistently understate its annual trade surpluses with the U.S. and in the last several years have shown increasing annual deficits in the aggregate with China's top 41 trading partners. In our judgment, China's own data are entirely unreliable, both because of the discrepancies in the data with China's major trading partners are regularly so large and because China has been attracting record levels of foreign direct investment and accumulating enormous foreign exchange reserves. China simply blatantly rigs the numbers, and the world shouldn't accept this.

Fourth, China's persistent manipulation of the yuan amounts to a beggar-thy-neighbor policy. The yuan's undervaluation is undercutting the ability of the United States to maintain a healthy and vibrant balanced economy that encompasses not only high technology production and services but also basic manufacturing, as vital today as it always has been in the United States.

Fifth, the Chinese government's undervaluation of the yuan is doing great harm to the rules-based system of the World Trade Organization and the IMF. In one fell swoop, the yuan's undervaluation comprehensively provides a prohibited subsidy to all of the Chinese exports and also acts as a discriminatory tax, an added import duty, and a quantitative restriction on imports into China.

This frustrates the intent of the WTO's General Agreement on Tariffs and Trade and disregards the provisions of the IMF's Articles of Agreement against manipulation of exchange rates in order to gain an unfair competitive advantage and against disruptive and discriminatory currency arrangements.

In summary, China presents an extreme case of currency manipulation. And this is important: China is distinguishable from other countries that manipulate their currency. It's doing considerable damage. Last September 9, 2004, the China Currency Coalition filed a petition asking that the United States request dispute settlement on the issue within the World Trade Organization.

Within several hours, I think it was four hours after we filed the petition, the petition was rejected by the U.S. Trade Representative on the ground that such an approach would hamper rather than advance a solution. This is the petition. It's about 250 pages of legal scholarship. My firm was a primary drafter; Terry Stewart, who testified before you, offered very helpful comments and critiques of this document, and I had what I call two other secret Santas at other law firms who didn't want to be identified but who also looked at it and gave us their views on the petition.

What I'm saying is this is a very credible legal document, which I think the finest trade lawyers in Washington have looked at and agree with. The Treasury Department and the USTR is full of very

intelligent and wise people, but I don't think they can read this and analyze it in four hours and then reject the petition.

A similar petition was filed very much like this petition on September 30 by the Congressional China Currency Action Coalition. Likewise, that petition, as you know, was rejected. It just took USTR a couple of weeks longer to do it. Maybe they read the Congressional petition.

We just disagree, as Fred has indicated, with the administration's strategy, which has led to no progress. China is not moving. Last fall, they gave indications that they were going to make some changes. They have not. Their position seems to be hardening.

We think that China doesn't have the self-discipline or the ability to get its way out of this fix at this point. They don't have the will to do it. And we think the only way to get them to do it is to take the issue, a very novel and unusual issue, to the WTO and let them determine whether the rules of the trading system are being violated by what the Chinese are doing.

Thank you very much.

[The statement follows:]

Prepared Statement of David A. Hartquist, Esq.
Partner, Collier Shannon Scott PLLC
On Behalf of the China Currency Coalition

Introduction

Good afternoon. I appreciate being able to appear before the Commission today on behalf of the China Currency Coalition ("CCC"), a group of U.S. industrial, service, agricultural, and labor organizations that are extremely concerned with China's exchange-rate regime. In our view, as the result of manipulative policies by the Chinese government, China's currency is substantially undervalued by as much as 40 percent and perhaps more, and this undervaluation is generating dangerous and increasingly damaging economic imbalances for the United States, for the global community, and for China itself. Further, in our judgment, this undervaluation violates fundamental international legal obligations that China has assumed at the World Trade Organization ("WTO") and the International Monetary Fund ("IMF").

Acting upon this conviction, the CCC on September 9, 2004, filed a petition with the Office of the U.S. Trade Representative ("USTR"), seeking commencement of an investigation under 19 U.S.C. §2412(a)(1) and resort to dispute settlement at the WTO absent immediate revaluation of the yuan by China. Our petition was rejected by USTR within several hours on the very same day. A comparable petition by the Congressional China Currency Action Coalition was filed on September 30, 2004, and was likewise rejected. In a notice published on December 30, 2004, at 69 Fed. Reg. 78,516, USTR conclusorily stated its view that an investigation would not be effective and "would hamper, rather than advance," USTR's efforts to address with China the currency valuation issues cited in the petitions. For the reasons set out below, we respectfully disagree.

What is urgently needed, in our opinion, in keeping with China's obligations at the WTO and the IMF, is a prompt, substantial revaluation by China to reflect the yuan's true strength in the global marketplace. Such action will greatly facilitate constructive, mutually beneficial integration of China into the world's economy. For everyone's sake, the sort of "beggar-thy-neighbor" practices that so plagued the early twentieth century should be avoided as much as possible in the twenty-first century. China, however, disputes that the yuan is undervalued and causing adverse effects and seems prepared out of perceived self-interest to continue undervaluing the yuan indeterminately into the future. USTR's strategy has led to no apparent progress. If anything, China is resisting revaluation of the yuan more than ever, and invaluable time is elapsing with nothing gained.

Historical Perspective of China's Foreign-Exchange Regime

China has long been wedded to a foreign-exchange regime characterized by significant and wide-ranging (if not complete) oversight, intervention, and manipulation by the central government. It is fair to say from this behavior that China has a deep-seated aversion to allowing the yuan to be governed by market forces. This

distrust in the past was perhaps rooted to some extent in Communist doctrine, but probably has always been due primarily to the Chinese government's concerns that instability to its financial institutions and economy might occur and generate political and social unrest in a country with a low standard of living and poverty for many of its 1.3 billion people.

At least since 1979, and particularly since 1994, China's interventions in its foreign-exchange system have increasingly resulted in serious distortions and imbalances within China. Furthermore, since China's accession to the WTO on December 11, 2001, these adverse repercussions have more and more negatively affected other countries' economies as China's trade with the rest of the world has expanded.

The most distinctive and consistent feature of China's exchange-rate policies during the past quarter of a century has been intentional and persistent manipulation of the yuan, either overvaluation at times (as in the 1980s) to facilitate imports of capital goods considered necessary to China's development, or undervaluation (more recently and to the present) in order to slow the growth of imports and subsidize increased exports. The common thread throughout has been the Chinese government's attempts to strengthen China's economy, regardless of the expense to others. This policy has been most pronounced and its impact has been most damaging outside China generally and to the United States, in particular, since the end of the Asian financial crisis and China's accession to the WTO.

The emergence of financial instability in Asia can be traced to 1994 when China took two related steps in 1994 that have been integral factors over the last decade in bringing about China's ever-rising trade surpluses, foreign-direct investment ("FDI"), and foreign-exchange reserves. First, China established a much-devalued exchange rate of 8.70 yuan to the dollar. Second, to enforce that undervaluation, China renewed a requirement (since relaxed somewhat, but basically still in effect) that export earnings by domestic enterprises and foreign currency for FDI be surrendered to the Chinese government via designated foreign-exchange banks. By the end of 1995 and early 1996, the Chinese currency's pegged rate of exchange was effectively fixed at 8.28 yuan to the dollar, the rate that is still in effect today.

China's single-mindedness in manipulating the yuan over the last two and one-half decades and particularly since 1994 is underscored (1) by the ill-matched type of exchange arrangement that China has adopted under Article IV(2)(b) of the IMF's Amended Articles of Agreement, (2) by the disequilibria that have resulted in China's trade surpluses, foreign-direct investment, and foreign-exchange reserves, and (3) by the lengths to which China has been forced to go—and has been willing to go—in order to maintain the yuan's undervalued, fixed peg to the dollar.

With respect to China's chosen exchange arrangement, there are altogether about thirty countries, including China, that have opted to peg their currencies to a single foreign currency. There also are ten additional countries that peg their currencies to a basket of two or more foreign currencies. In either case, whether a given currency is pegged to a single foreign currency or to a basket of foreign currencies, such an exchange arrangement is considered a "conventional-fixed peg." For some years, China inaccurately and confusingly referred to its peg of the yuan to the dollar as a "managed float," but since 1999 the IMF correctly has classified China's exchange arrangement as the "conventional-fixed peg" that it is.

The first point to be highlighted here is that China's exchange arrangement is atypical. With the exception of China, the forty or so countries that employ a "conventional-fixed peg" are small, generally lesser-developed nations that have insignificant trade flows with the United States and that are dwarfed by China. By the same token, China is the only one of the top trading partners of the United States—such as Japan, the European Union, Canada, and Mexico—that does not have some kind of floating exchange regime vis-à-vis the U.S. dollar. In both contexts, China is going against the current.

Second, China's "conventional-fixed peg" of the undervalued yuan to the dollar is unsuitable to achieve the sort of balanced growth in international trade that both the WTO and the IMF are meant to foster for all member states. Instead, due to China's size and economic importance, China's policies increasingly have contributed to destabilizing extremes.

Perhaps the most dramatic excesses attributable to the undervalued yuan are China's substantial and increasing annual trade surpluses. It appears that China's own reported data consistently have understated its surpluses. In order to obtain a solid grasp of the size of China's annual trade surpluses, both with the United States and globally, it is necessary to turn to the data reported by China's principal trading partners. Why is the accuracy of China's trade data so important? Simply put, trade data serve as the basis for determining whether and to what degree a currency is undervalued. If a country consistently underreports its trade surplus, estimates of undervaluation are significantly understated.

Attached to this statement are tables setting forth (a) in Table 1 China's balance of trade with the United States since 1995 and (b) in Table 2 China's balance of trade between 1999 and mid-2004 with its top forty-one trading partners (identified in Table 4), including the United States, that together accounted for approximately 89 percent or more of China's total trade in each year during that period. These tables compare China's own reported data to the data reported by the United States and then by China's top forty-one trading partners.

Review of these data shows that China invariably has reported the respective values of its exports to the United States and to the forty-one countries in the aggregate as having been considerably less than the values that the United States and the forty-one countries have reported for their corresponding imports from China. At the same time, China (with one small exception as to the forty-one countries in 1999) has reported the respective values of its imports from the United States and from the forty-one countries in the aggregate as having been somewhat more than the values the United States and the forty-one countries have reported for their corresponding exports to China.

The first major result of these discrepancies is that—in each of the years covered—China's own reported data show only relatively modest trade surpluses with its top forty-one trading partners in aggregate, while the data of the United States and China's top forty-one trading partners' aggregated data consistently reveal far greater trade surpluses for China.

Thus, for example, Table 1B details that between 1995 and 2003, data compiled by the U.S. Department of Commerce record China's annual trade surplus with the United States as having ranged from U.S. $33.8 billion in 1995 to U.S. $124.9 billion in 2003, while China's data in Table 1A record China's annual trade surplus with the United States as having ranged from just U.S. $9.4 billion in 1995 to U.S. $60.3 billion in 2003. During the first half of 2004, the divergence was similarly striking, with U.S. data reporting China's trade surplus with the United States as U.S. $69.1 billion and China's data reporting China's trade surplus with the United States as being far lower at U.S. $32.5 billion. Cumulatively, from 1995 through June 2004, Table 1B's U.S. data show China's trade surplus with the United States at U.S. $715.1 billion, but China's data in Table 1A report China's surplus with the United States at U.S. $280.5 billion, a difference of U.S. $434.6 billion.

A comparable picture emerges from Table 2 of China's trade surplus with its top forty-one trading partners, including the United States, during the years for which data to make this comparison are available. Thus, between 1999 and 2003, the forty-one countries' aggregated data in Table 2C record China's trade surplus with the forty-one countries as having ranged from U.S. $139.7 billion in 1999 to U.S. $209.9 billion in 2003, while China's data in Table 2B record China's annual trade surplus with the forty-one countries in aggregate as having ranged between just U.S. $28.0 billion in 1999 and U.S. $29.9 billion in 2003 after hitting a peak in 2002 of U.S. $31.8 billion. During the first half of 2004, the divergence was even more extreme, with the forty-one countries' aggregated data reporting China's trade surplus with the forty-one countries as U.S. $112.6 billion, but China's data reporting China's trade surplus with the forty-one countries in aggregate as being a mere U.S. $2.5 billion. Cumulatively, from 1999 through June 2004, the forty-one countries' aggregated data in Table 2C show China's trade surplus with the forty-one countries at U.S. $990.8 billion, but China's data in Table 2B report China's surplus with the forty-one countries in aggregate at U.S. $148.9 billion, a difference of U.S. $841.9 billion.

The second major discrepancy in these two sets of data is, if anything, more striking than the first. As summarized in Table 3A, China's own reported data show that between 1999 and mid-2004 China had a modest annual trade surplus (in 1999) and thereafter an increasing annual deficit in aggregate with its top forty trading partners apart from the United States. It is these data reported by China and the resulting trade surplus and deficits on which the IMF and the U.S. Treasury Department, as well as China, have been relying in good measure for the proposition that the yuan is not undervalued and that the low U.S. savings rate accounts for the U.S. trade deficits with China.

These claims, however, are undercut when China's trade balance with its top forty trading partners is calculated from the aggregated data of China's top forty-one trading partners less the data reported by the United States on its trade with China.

Thus, in 1999, China's own reported data in Table 3A show a surplus by China of U.S. $4.4 billion in aggregate with its top forty trading partners, but the data of those top forty trading partners in Table 3A show an aggregate surplus by China of U.S. $70.7 billion, a difference of U.S. $66.3 billion per Table 3B. This disparity has grown substantially over the last several years. Since 1999, according to China's

own reported data in Table 3A, China has had a string of annual deficits with its top forty trading partners in aggregate of U.S. $0.2 billion in 2000, of U.S. $3.3 billion in 2001, of U.S. $12.3 billion in 2002, of U.S. $30.4 billion in 2003, and of U.S. $30.0 billion during the first half of 2004. In sharp contrast, the reported data of China's top forty trading partners in Table 3A have shown a string of large surpluses by China of U.S. $86.4 billion in 2000, of U.S. $85.1 billion in 2001, of U.S. $84.4 billion in 2002, of U.S. $85.0 billion in 2003, and of U.S. $43.5 billion during the first half of 2004. As noted in Table 3B, China's rising deficits as reported by China's own data since 2000, of course, compared to China's substantial and relatively steady surpluses since 2000, as reported by China's top forty trading partners, display a greater and greater divergence. In 2003, for example, the disparity was U.S. $115.4 billion. During the first half of 2004, the disparity was U.S. $73.5 billion.

The conclusion drawn from Table 3 is that the data of China's top forty trading partners (excluding the United States) confirm that China has been running a very sizeable surplus annually with those countries since at least 1999, in contrast to the modest surplus in 1999 and increasing annual deficits since 2000 that China's own reported data suggest. Cumulatively, from 1999 through June 2004, the forty countries' aggregated data show China's trade surplus with the forty countries at U.S. $455.2 billion, but China's data report a combined deficit during this period by China with the forty countries in aggregate of U.S. $71.8 billion, a difference of U.S. $527.0 billion.

Thus, China's trade surplus with its top forty trading partners between 1999 and mid-2004, as reflected in the data reported by those forty countries, is in addition to the trade surplus that China has had with the United States during that same period and that is reflected in the data reported by the United States. Based upon the data in Table 1A reported by the United States, China's cumulative trade surplus with the United States from 1999 through June 2004 was U.S. $535.6 billion. As set forth in Table 3A in data reported by China's top forty trading partners apart from the United States, China's cumulative trade surplus from 1999 through June 2004 with those forty countries was U.S. $455.2. The sum of these two cumulative surpluses is equal to China's total cumulative surplus of U.S. $990.8 billion with its top forty-one trading partners between 1999 and mid-2004, as confirmed by the data reported by China's top forty-one trading partners in Table 2C.

Just recently, in an article by "Inside U.S.-China Trade" on January 12, 2005, it was reported that officials of the U.S. Treasury Department are working with representatives of the Chinese government (who are said in the article to have admitted that China's collection of trade data needs to be better) in order to improve China's reporting of its trade data in the hope of leading to greater international confidence in the accuracy of China's reported data. These efforts are to be applauded and should be helpful to the extent they prove to be successful. In the meantime, reliance should be placed upon the data of the United States and of China's other forty-one top trading partners, and these data document extremely worrisome trade surpluses by China with both the United States and with China's other forty-one top trading partners.

The second serious imbalance to which the yuan's undervaluation has contributed is the burgeoning annual foreign-direct investment in China that has occurred since 1994, from U.S. $33.77 billion in 1994 to U.S. $40.72 billion in 2000 (a jump of almost 21 percent), and from U.S. $40.72 billion in 2000 to U.S. $53.51 billion in 2003 (a further jump of 31 percent). Last week, China reported a record level of foreign-direct investment during 2004 of U.S. $60.63 billion, an increase of 13 percent over the previous annual high in 2003. This further rise occurred despite restrictions initiated by China last year on investment in certain sectors such as the steel industry.

The third serious imbalance due to the yuan's undervaluation follows from both China's trade surpluses and the foreign-direct investment that has been taking place in China. This imbalance is China's rapid accumulation of foreign-exchange reserves since 1994. By 1996, within two years after the yuan's undervaluation was instituted in 1994, China's foreign-exchange reserves had tripled from U.S. $26 billion to U.S. $78 billion. These sums have only multiplied on a larger absolute scale since then. As reported by the "Wall Street Journal" on January 12, 2005, China's foreign-exchange reserves jumped during 2004 by more than U.S. $200 billion to almost U.S. $610 billion. This figure includes U.S. $95 billion in speculative inflows anticipating a revaluation of the yuan. As reported by the "Financial Times" on January 26, 2005, however, it now appears from a statement by Li Deshui, head of China's National Bureau of Statistics, that China has no intention of revaluing the yuan to coincide with the G–7 meeting of finance ministers and central bankers later this week on February 4th and 5th.

In short, China's selection of a "conventional-fixed peg" with an unrealistically undervalued yuan has led to huge and growing imbalances in China's trade surpluses, foreign-direct investment, and foreign-exchange reserves. Rather than allow the market to correct these imbalances, China has been printing greater and greater quantities of yuan to exchange for the surfeit of dollars that must be turned over to the state-owned banks. In turn, these banks at the Chinese government's direction have been removing this flood of yuan from circulation, at least temporarily, through the issuance of domestic bonds. It was reported in the "Wall Street Journal" on January 12th that China undertook its biggest "sterilization" to date on January 11th by debt issues of 95 billion yuan (U.S. $11.5 billion). In addition, last week China's National Bureau of Statistics announced that China's economy grew by 9.5 percent during 2004, its fastest pace in eight years. China has proceeded with its strategy and remains willing to assume risks such as inflation and an over-heated economy in order to gain the benefits it seeks from keeping the yuan at its undervalued rate of 8.28 yuan to the dollar. Among these advantages in China's judgment has been China's ability to disburse periodically large amounts of its foreign-reserve dollars to shore up state-owned banks burdened by onerous and extensive non-performing loans.

As long as China insists upon manipulating its currency by maintaining a fixed peg of 8.28 yuan to the dollar, the trends of the past ten years' imbalances can reasonably be expected to become more pronounced, and China will be left to take the same sorts of measures it has been engaging in, namely, printing yuan to exchange for the dollars from exports and foreign-direct investment, followed by the issuance of yuan-denominated government bonds to control the quantity of yuan in circulation in China. How long this pattern can be sustained by China, and the repercussions once it cannot, remain to be seen. In the meantime, the Chinese government gives every indication of an unwavering intent to continue relying upon its undervalued yuan to subsidize exports and domestic sales by China's companies and to spur foreign-direct investment in China.

China's Failure to Uphold Its International Legal Obligations

China presents an extreme and unique case of currency manipulation. The sheer magnitude of China's economy, the far-reaching repercussions and huge and destabilizing imbalances that the undervalued yuan is causing in China and around the world, and China's political importance and obdurate persistence in maintaining the yuan's substantial undervaluation are proving to be a potent combination. From an international legal perspective, this unprecedented predicament poses a challenge to the WTO's agreements that govern international trade as well as to the IMF's Articles of Agreement that focus on international monetary matters, including orderly exchange arrangements.

Under the circumstances, the temptation might be to see China's undervalued yuan either as a trade issue for the WTO or as a monetary issue for the IMF. The trade and monetary aspects of the yuan's manipulation, however, are so intertwined that both the WTO and the IMF have their respective responsibilities and roles to fulfill. Indeed, it is evident from the texts and underlying negotiations of the General Agreement on Tariffs and Trade (the "GATT") and the IMF's Articles of Agreement that their drafters recognized that currency manipulation could have terribly harmful effects on both international trade and monetary affairs at the same time. As a result, the drafters incorporated in these documents provisions designed to avert and, if necessary, discipline currency manipulation.

From the standpoint of the GATT and the WTO and its other agreements, China's manipulation of the yuan runs directly counter to and seriously weakens and impairs a series of the basic principles that have been the cornerstones of the international trading system since World War II.

First and foremost, the yuan's undervaluation constitutes a prohibited export subsidy. Every good and every agricultural product exported from China to the United States or anywhere else in the world effectively receives from the Chinese government a financial contribution derived from the yuan's manipulation. The benefit enjoyed from this financial contribution is equal to the difference between what the yuan would be worth if its value were set by the market and its understated value as the result of China's manipulation. Moreover, receipt of this subsidy occurs only if there is exportation, and so is specifically contingent upon exportation. China's currency-manipulation scheme is a prohibited export subsidy, therefore, under Articles VI and XVI of the GATT, Articles 1, 2, and 3 of the Subsidies and Countervailing Measures Agreement, and Articles 3, 9, and 10 of the Agriculture Agreement.

China's undervaluation of the yuan also violates Article XV:4 of the GATT. This Article proscribes exchange action that frustrates the intent of the GATT's provisions and proscribes trade action that frustrates the intent of the IMF's Articles of

Agreement. In the past, there have been only a relatively few occasions on which Article XV:4 has been considered or invoked, essentially because there never previously has been a situation that has been remotely of the magnitude of China's manipulation of its currency. Likewise, there has been little amplification in practice upon Article XV:9 of the GATT, which states generally that the GATT does not preclude the use of exchange controls or exchange restrictions that are in accord with the IMF's Articles of Agreement.

What evaluation and use of Article XV:4 there have been in the past, however, indicate that (a) measures that are monetary in form but that have some effect on trade can be considered under the GATT's rules as far as the trade effect is concerned; (b) even when a monetary measure is regarded by the IMF as being necessary, that measure can be considered and treated under the GATT as an inappropriate, trade-restrictive measure; and, correlatively, (c) a measure that is arguably both financial and trade in character will be subject to scrutiny to ensure that it is consistent with both the GATT and the IMF's Articles of Agreement. In addition, the relationship between Article XV:4 and Article XV:9(a) of the GATT is a question that has been left for empirical consideration if and when particular points arise that have a bearing on that relationship, and general principles on that relationship have yet to be set. Within this framework, analysis demonstrates that China's undervalued exchange-rate regime violates Article XV:4.

Thus, under Article I of the GATT and its principle of most-favored-nation ("MFN") status, imports into China from the United States are to be treated no less favorably than imports into China from any other Member State of the WTO. China's undervalued exchange-rate regime, however, undercuts this principle of nondiscrimination. While the U.S. dollar has been losing strength over the last year or so against most other countries' currencies, to the extent the U.S. dollar does appreciate against a third country's currency, the yuan automatically appreciates as well against that third country's currency, but not against the U.S. dollar due to the strict pegging of the yuan to the U.S. dollar. As a result, the third country's products become more attractively priced and competitive than U.S. products for export to China. Imports into China from the United States consequently are disadvantaged vis-à-vis imports from other countries and denied MFN treatment.

Similarly, under Article II of the GATT, China's tariff bindings are not to be exceeded. China's ad valorem customs duties, however, when applied to the inflated, yuan-denominated prices of imports into China that result from China's undervaluation of the yuan, yield similarly inflated amounts of yuan-denominated customs duties. In a perverse fashion, the weakening of the U.S. dollar means a commensurate weakening of the yuan and a corresponding increase in the amount of yuan-denominated customs duties that the Chinese importer must pay. China's tariff bindings become unacceptably elastic and uncertain and effectively exceeded as a result.

Again, under Article III of the GATT, China is obligated not to apply to domestic or imported products any laws, regulations, and requirements that affect the internal sale, offering for sale, purchase, transportation, distribution or use of products so as to afford protection to domestic production. China's inflexible and extreme pegging of the yuan to the U.S. dollar and currency controls, however, negate or erode this non-discriminatory principle of national treatment by so inflating the yuan-denominated price of imports into China from the United States that U.S. products are either excessively or prohibitively expensive and Chinese-origin products are favored and protected.

As touched upon earlier, under Articles VI and XVI of the GATT, China has committed to abide by the principle that export subsidies are prohibited. The Chinese government's persistent undervaluation of the yuan as compared to the U.S. dollar, however, acts in fact to subsidize all products exported from China to the United States.

Under Article XI of the GATT, China is barred generally from imposing measures other than duties, taxes or other charges that prohibit or restrict imports into China of any product from the United States. China's undervaluation of the yuan, however, variously serves to prohibit and restrict imports into China of products from the United States by so increasing the yuan-denominated prices of U.S. products that Chinese importers either cannot afford to import the U.S. products at all or can only import lesser quantities of the U.S. products than would be the case were the yuan commercially valued realistically against the U.S. dollar.

By way of recapitulation as to the GATT and the WTO's disciplines, therefore, along with the undervalued yuan's constituting a prohibited export subsidy, by the expedient of manipulating and undervaluing its currency as it has, China also has dramatically frustrated the intent of the GATT in contravention of Article XV:4. This exchange action by China at once is undercutting all of the GATT's principal concepts that together have formed the backbone of the international trading system

over the last half century and more. In Article XV:4's terms, China's undervaluation of the yuan appreciably departs from the intent of the foregoing provisions of the GATT. In actuality, China's refusal to set a realistic rate based on market conditions or to allow the yuan to seek its own market-driven balance against the U.S. dollar is having a most insidious impact on the GATT's principles with debilitating effects both for the United States and the global economy as a whole.

From the standpoint of the IMF's Articles of Agreement as well, China's manipulation and undervaluation of the yuan are at odds with China's international legal obligations. In 1980, China assumed Taiwan's seat in the IMF and received one seat on the Board of Executive Directors. In 1996, two years after China had unified and realigned its exchange rate, China removed exchange restrictions on its current-account transactions by accepting Article VIII of the IMF's Articles of Agreement. As observed above, since late 1995 and early 1996, China has maintained its exchange rate at 8.28 yuan per dollar, a severely and persistently undervalued pegging of the yuan and an extreme case of currency manipulation. China's policy of maintaining an undervalued exchange-rate regime violates its obligations under Articles IV and VIII of the IMF's Articles of Agreement.

Article IV requires that each IMF member shall: "(iii) avoid manipulating exchange rates or the international monetary system in order to . . . gain an unfair competitive advantage over other members." First, China's fixed exchange-rate system requires that it intervene in every export transaction in order to maintain the fixed exchange rate, constituting manipulation. In addition, China has instituted capital controls further to enforce the fixed-exchange mechanism. Evidence of the extent of the practice is the accumulation of the massive foreign-exchange reserves recounted earlier. Second, China's policy of maintaining an undervalued exchange rate has given China and particularly China's exports an unfair competitive advantage in trade with the United States and other members of the IMF. China's undervalued exchange-rate policy subsidizes China's exports to the United States and other countries and denies the United States and other countries equal treatment as provided for under Articles I and III of the GATT. China's undervalued exchange rate system causes yuan-denominated prices of U.S. products in the Chinese market to be higher than what would prevail under market conditions and causes U.S. dollar-denominated prices of China's products to be lower in the U.S. market than what would prevail under market-determined exchange rates. This subsidized practice gives China's products a powerful advantage whether competing with U.S. products in the Chinese marketplace, in the United States, or in third-country markets, contrary to the obligations under the IMF's Article IV, section 1(iii).

China's policy of maintaining an undervalued exchange-rate system also violates the IMF's Article IV, section 1(ii), which states that each member of the IMF shall "(ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions." China's policy of maintaining an undervalued exchange-rate system is creating financial instability that will eventually disrupt global financial markets unless China appreciates its currency in line with underlying economic fundamentals. The threat to the international financial system is exacerbated by the size of China's economy and by China's volume of global trade and foreign-direct investment in China. China's accelerating accumulation of foreign-exchange reserves is generating disequilibrium in the international financial system, will tend to create inflation and over-investment in China, and will lead to the conditions for another international financial crisis. Rather than permit the yuan to increase in value, the Chinese government has chosen instead to offer any amount of yuan needed to absorb any supply of foreign currency. Consequently, as larger and larger foreign-currency surpluses have flowed into the Chinese market, the Chinese government has had to flood the market with more and more yuan. Thus, if China wishes to maintain exchange-rate stability in the face of such foreign-currency inflows, it does so at the cost of its control over its domestic money supply. Along with this rapid growth in the money supply, however, there is increasing evidence that the Chinese government has fostered a speculative over-investment boom and the foundation for much higher inflation in the future. If not corrected, these trends will coalesce in an unstable bubble that, due to the size of China's economy and volume of trade, will adversely affect international trade and financial markets, contrary to the obligations in the IMF's Article IV, section 1(ii).

China's policy of maintaining an undervalued exchange-rate regime also violates the IMF's Article VIII, section 3, which broadly prohibits any discriminatory currency arrangements or multiple currency practices, except as approved by the IMF or as authorized by the IMF's Articles of Agreement. As previously discussed, China's undervalued exchange-rate policy discriminates against U.S. exports of goods and services. Due to the yuan's undervaluation, prices of Chinese goods and services

in the U.S. market are lower than what would prevail under an exchange rate that reflected underlying economic fundamentals. Conversely, the prices for U.S. products in China are higher than what would prevail with an exchange rate that reflected underlying economic fundamentals. In addition, the fixed undervalued exchange rate discriminates against other IMF countries. As the U.S. dollar depreciates against other currencies, the exchange rate with China does not change, and the advantage that China has through its undervalued exchange rate remains the same. Other currencies adjust simultaneously to the yuan and the U.S. dollar because the exchange rate is fixed, but those currency adjustments must be greater than what would be required under market conditions, because the yuan is undervalued and unable to appreciate against the dollar.

The clear discrimination of China's undervalued exchange-rate regime has not been authorized by the IMF and has come under increasingly negative criticism in the reports of the IMF's recent Article IV consultations over the last few years. With reference to the latest report from November 2004, the assessment of the IMF's Executive Directors is diplomatically couched with certain qualifications about the advisability of China proceeding from a position of strength in a phased fashion with the exact timing left to China's authorities, but at the same time is quite emphatic in urging China to adopt greater flexibility in its exchange-rate regime for the sake of China and resolution of global imbalances. In an excerpt from page 3 of a press release by the IMF accompanying the report and dated August 25, 2004, it is stated that "{m}any directors therefore considered that, in view of the present favorable circumstances, it would be advantageous for China to make an initial move toward greater exchange rate flexibility without undue delay, with some Directors preferring that this move be made soon."

In short, the outcome of each of the IMF's Article IV consultations since 2000 has been that the Executive Directors have recommended that China introduce greater flexibility into its exchange-rate regime. All Directors have believed that China's undervalued exchange-rate regime imposes significant costs on China's economy, particularly greater risks associated with monetary expansion, and on the global system, and thus have urged greater flexibility by China. That China has shown no flexibility indicates that China has continued to be in violation of its obligations to the IMF under Article VIII of the IMF's Articles of Agreement.

In summary, China's undervaluation of the yuan vis-à-vis the U.S. dollar violates basic and essential principles and provisions of the WTO and its agreements as well as vital obligations of China under the IMF's Articles of Agreement. China's manipulation of its currency is undermining the rules-based international trading and monetary structure, and the magnitude of the adverse consequences flowing from China's behavior for the United States and the global economy are far-reaching and taking a severe toll.

Possible Strategy in the Time Ahead

Any decision on how best to grapple with the yuan's undervaluation should begin with an articulation of where the interests of the United States lie in this matter and how those interests can most effectively be realized. Whatever approach is adopted should also rest on the most solid factual evidence available and be informed by as detached and objective an evaluation of China's outlook and purpose for itself as history permits. Within these guidelines, several observations seem appropriate and worthy of some consideration.

First, as remarked at the outset of this statement, it is in the interests of everyone, including the United States and China, that "beggar-thy-neighbor" practices not mar the twenty-first century and that China's integration into the global economy be constructive and mutually beneficial insofar as is feasible. Defining the goal in this expansive and abstract manner presumably is unobjectionable to most nations. Whether China agrees as a practical matter in relation to its undervalued yuan is an open question with different opinions.

Second, the more sharply defined interest of the United States should be to maintain a healthy and vibrantly balanced economy that encompasses not only high-technological production and services but also basic manufacturing, which is integral to our national strength. In this last regard, the United States ultimately is no differently situated today than it was in December 1791 when Alexander Hamilton as Secretary of the Treasury advocated development of manufacturing in his "Report on the Subject of Manufactures." For our political and military security and standing in the world, we need—but are allowing to be lost—our expertise, knowledge, and industrial base built up over generations. We cannot afford to be complacent in this respect, as Dr. Scott's recent study for the Commission, entitled "U.S.-China Trade, 1989–2003: Impact on Jobs and Industries," capably illustrates.

Third, in our judgment, China's deliberate actions in tightly controlling its currency's exchange rate over the last twenty-five years or so manifest an entrenched belief by China's leadership that China will be better served if its exchange rate is set by the government rather than by the market. There is no indication that China truly intends to change this pattern anytime soon unless it decides that its self-interest warrants a shift. Such a change of heart by China seems unlikely, because, as described in the section above on the historical perspective of China's foreign-exchange regime, the undervalued yuan has brought to China jobs, huge annual trade surpluses, foreign-direct investment, and extraordinary foreign-currency reserves. Nor is it apparent that China will have the self-discipline and ability to curb itself in time before uncontrollable imbalances wreak havoc. In the IMF"s Article IV consultations with China during 2004, it is evident from comments made by the Chinese authorities and noted at pages 3 and 12–14 of the IMF's report, for example, that China is extremely reluctant to wean itself from the yuan's undervaluation. The concerns cited by the Chinese authorities center on (a) the impact of a potential appreciation and large change in the value of the yuan on China's domestic economy, especially as to growth in employment, given that China must generate 20–25 million new jobs every year, and (b) risks for China's banks if the yuan is revalued. As the IMF remarked in its report on China's 2004 Article IV consultations, greater exchange-rate flexibility should not be damaging from these standpoints, and yet China remains adamant in its undervaluation of the yuan.

Fourth, on the subject of whether the yuan truly is undervalued and, if so, by how much, it is important to recall that the trade data reported by China are seriously inconsistent with—and show a very different picture than—the trade data reported by China's top forty-one trading partners, including the United States. Much of the defense for the position that the yuan is not undervalued depends upon the trade data reported by China that show comparatively modest trade surpluses with the United States each year and somewhat small but still significant and growing annual trade deficits with the rest of the world. Logic dictates that the data of China's top forty-one trading partners are not skewed, and these data reveal sizeable and increasing trade surpluses by China each year—both with the United States and also with China's top forty trading partners other than the United States. These last data reinforce the general consensus by economists that the yuan is undervalued. By how much the yuan is undervalued is, not surprisingly, also a subject for debate. Here, too, however, there is something of a critical mass that indicates the yuan is undervalued somewhere in the range of forty percent. Indeed, this view is reinforced by comments of the Chinese authorities themselves, who, as just noted above, in the IMF's 2004 Article IV consultations expressed concern that a potential appreciation and large change in the yuan's value would be problematic for China's domestic economy and jobs. A proper quantification of China's trade surpluses also detracts from the argument that the problem lies with a low savings rate by the United States, not any undervaluation of the yuan. While the U.S. economy would surely stand to gain from more savings and investment, a realistically valued yuan would do far more to bring global trends into balance even while likely causing U.S. importers to curtail their spending.

Fifth, and lastly, by means of the yuan's severe undervaluation, the Chinese government at one fell swoop is doing great harm to the rules-based system of the WTO and the IMF. On the one hand, the yuan's undervaluation comprehensively subsidizes all of China's exports. On the other hand, the yuan's undervaluation—as a practical matter—variously acts as a discriminatory tax, an added import duty, and a quantitative restriction on imports into China. These far-reaching effects of the yuan's undervaluation frustrate the GATT's basic intention of opening markets. Indeed, China's utter refusal to eliminate this undervaluation immediately is causing large-scale and adverse consequences for the United States and the global economy. If China's accession to the WTO in December 2001 is to be a constructive step, it is imperative that China—as the major trading country that it is—honor its obligations. Absent any indication that China will act promptly and of its own volition to revalue the yuan, the commencement of negotiations under the auspices of the WTO's Dispute Settlement Understanding is justified in the China Currency Coalition's judgment. This step is warranted in order to buttress respect for the rule of law and in light of the pressing need to stem and reverse the weakening of the U.S. economy and the global imbalances attributable to China's manipulation of the yuan.

Finally, especially if China continues to delay a meaningful revaluation of the yuan, but even if the yuan's undervaluation is corrected, there are several other steps that the Administration and Congress can take to underscore China's accountability for upholding the obligations it assumed upon joining the WTO.

1. First, countervailing duty proceedings should be conducted against subsidized imports into the United States from China. The WTO's Agreement on Subsidies and Countervailing Measures ("SCM Agreement") provides for countervail cases against non-market-economy ("NME") countries. In our judgment, the U.S. countervail statute as it stands authorizes the U.S. Commerce Department and U.S. International Trade Commission ("ITC") to go forward with countervail cases against Chinese products. Any doubt in this respect, however, can be removed by legislative amendment. The undervalued yuan is a prohibited export subsidy, the most egregious form of trade-distorting subsidy under the WTO's rules.

2. Second, the Administration should not eliminate application to China of the NME provisions of the U.S. antidumping law. Per China's Accession Agreement with the WTO, this applicability is in effect for fifteen years and should not be diminished.

3. Third, the Administration must make clear that it is prepared to implement section 421 of the U.S. trade laws (19 U.S.C. § 2451) and to apply restrictions against imports from China when the ITC determines that market disruption has occurred. Thus far, the Administration has not granted any relief in the several cases in which the ITC has found market disruption by imports from China.

4. The Administration should urge the IMF to convene a special meeting of the finance ministers and central banking authorities of the major countries for the purpose of developing a financial accord that will ease the pending financial crisis.

Thank you for inviting me to appear before you today.

TABLE 1: CHINA'S BALANCE OF TRADE WITH THE UNITED STATES
Annual 1995-2003, 2004 YTD
All Commodities
FOB Values in US Dollars

TABLE 1A: AS REPORTED BY CHINA

CHINA DATA:	1995	1996	1997	1998	1999	2000	2001	2002	2003	2003 (Jan-June)	2004 (Jan-June)
Chinese Imports*	15,312,376,604	15,347,132,849	15,473,368,013	16,147,097,632	18,513,316,722	21,246,377,160	24,893,412,619	25,866,505,421	32,188,814,081	15,652,601,850	21,648,659,850
Chinese Exports	24,713,497,878	26,683,100,907	32,702,663,287	37,964,973,088	42,015,984,348	52,142,000,913	54,318,910,896	69,959,401,299	92,510,148,387	39,934,724,000	54,146,814,000
Chinese Surplus:	**9,401,121,274**	**11,335,968,058**	**17,229,295,274**	**21,817,875,456**	**23,502,667,626**	**30,895,623,753**	**29,425,498,278**	**44,092,895,878**	**60,321,334,306**	**24,282,122,150**	**32,498,154,150**

Source: GTIS Global Trade Atlas--Data Reported by China
** Imports valued at CIF less 5% to approximate FOB values.*

TABLE 1B: AS REPORTED BY THE UNITED STATES

US DATA:	1995	1996	1997	1998	1999	2000	2001	2002	2003	2003 (Jan-June)	2004 (Jan-June)
Chinese Imports	11,612,547,215	11,801,242,997	12,533,478,742	13,908,495,969	12,584,898,241	15,335,341,048	17,959,041,258	20,552,991,012	26,706,938,428	11,902,428,000	16,388,710,000
Chinese Exports	45,369,985,492	51,209,375,856	61,995,926,355	70,815,035,767	81,522,281,394	99,580,514,118	102,069,326,282	124,795,665,331	151,620,143,845	66,236,406,000	85,504,766,000
Chinese Surplus:	**33,757,438,277**	**39,408,132,859**	**49,462,447,613**	**56,906,539,798**	**68,937,383,153**	**84,245,173,070**	**84,110,285,024**	**104,242,674,319**	**124,913,205,417**	**54,333,978,000**	**69,116,056,000**

Source: Official Statistics of the U.S. Department of Commerce

Prepared by Georgetown Economic Services

TABLE 2: CHINA'S BALANCE OF TRADE FROM VARIOUS SOURCES USING 5% CIF/FOB DEFLATOR
Annual 1995-2003, 2004 YTD
All Commodities
FOB Values in US Dollars

TABLE 2A: AS REPORTED BY CHINA FOR ALL TRADING PARTNERS

CHINA DATA (ALL):

	1999	2000	2001	2002	2003	2003 (Jan-June)	2004 (Jan-June)
Chinese Imports*	157,490,138,667	213,840,385,165	231,388,697,168	280,537,760,042	392,440,834,852	176,591,967,967	251,698,756,780
Chinese Exports	195,176,530,901	249,239,664,195	266,661,113,296	325,642,067,334	438,472,556,679	190,257,810,346	258,206,196,076
Chinese Surplus:	**37,686,392,234**	**35,399,279,030**	**35,272,416,128**	**45,104,307,292**	**46,031,721,827**	**13,665,842,380**	**6,507,439,296**

Source: GTIS Global Trade Atlas--Data Reported by China Customs.
** Imports valued at CIF less 5% to approximate FOB values.*

TABLE 2B: AS REPORTED BY CHINA FOR 41 PARTNER COUNTRIES

CHINA DATA (41 PARTNERS):

	1999	2000	2001	2002	2003	2003 (Jan-June)	2004 (Jan-June)
Chinese Imports*	148,921,348,973	194,321,026,883	212,535,105,664	258,798,638,193	358,718,978,703	160,579,309,761	226,391,733,032
Chinese Exports	176,871,447,627	224,977,241,973	238,687,112,727	290,559,091,078	388,626,842,357	168,850,005,908	228,906,763,493
Chinese Surplus:	**27,950,098,654**	**30,656,215,090**	**26,152,007,063**	**31,760,452,885**	**29,907,863,655**	**8,270,696,147**	**2,515,030,461**

Source: GTIS Global Trade Atlas--Data Reported by China Customs.
** Imports valued at CIF less 5% to approximate FOB values.*

TABLE 2C: AS REPORTED BY 41 PARTNER COUNTRIES

41 PARTNER DATA:

	1999	2000	2001	2002	2003	2003 (Jan-June)	2004 (Jan-June)
Chinese Imports*	153,009,172,819	191,945,577,057	203,345,941,904	249,027,337,825	342,450,741,264	153,370,090,040	210,081,759,793
Chinese Exports	292,673,201,238	362,625,500,841	372,600,502,777	437,673,684,993	552,364,057,768	245,614,129,463	322,674,763,140
Chinese Surplus:	**139,664,028,419**	**170,679,923,784**	**169,254,560,873**	**188,646,347,168**	**209,913,316,504**	**92,244,039,423**	**112,593,003,347**

Source: GTIS Global Trade Atlas--Data Reported by Partner Countries
** Exports (Partner-reported imports) valued at CIF less 5% to approximate FOB values.*

Prepared by Georgetown Economic Services

TABLE 3: CHINA'S BALANCE OF TRADE EXCLUDING TRADE WITH THE UNITED STATES
Annual 1995-2003, 2004 YTD
All Commodities
FOB Values in US Dollars

TABLE 3A: CHINA'S BALANCE OF TRADE WITH AND WITHOUT THE U.S.

		1999	2000	2001	2002	2003	2003 (Jan-June)	2004 (Jan-June)
CHINA DATA:	Surplus with 41 Partners*	27,950,098,654	30,656,215,090	26,152,007,063	31,760,452,885	29,907,863,655	8,270,696,147	2,515,030,461
	Surplus with the U.S.*	23,502,667,626	30,895,623,753	29,425,498,278	44,092,895,878	60,321,334,306	24,282,122,150	32,498,154,150
	Surplus (Deficit) w/o U.S.	**4,447,431,028**	**(239,408,663)**	**(3,273,491,215)**	**(12,332,442,993)**	**(30,413,470,651)**	**(16,011,426,003)**	**(29,983,123,689)**
PARTNER DATA:	Surplus with 41 Partners**	139,664,028,419	170,679,923,784	169,254,560,873	188,646,347,168	209,913,316,504	92,244,039,423	112,593,003,347
	Surplus with the U.S.***	68,937,383,153	84,245,173,070	84,110,285,024	104,242,674,319	124,913,205,417	54,333,978,000	69,116,056,000
	Surplus (Deficit) w/o U.S.	**70,726,645,266**	**86,434,750,714**	**85,144,275,849**	**84,403,672,849**	**85,000,111,087**	**37,910,061,423**	**43,476,947,347**

**Source: GTIS Global Trade Atlas--Data Reported by China Customs*
***Source: GTIS Global Trade Atlas--Data Reported by Partner Countries*
****Source: Official Statistics of the U.S. Department of Commerce*

TABLE 3B: DISCREPANCY IN CHINA'S BALANCE OF TRADE

		1999	2000	2001	2002	2003	2003 (Jan-June)	2004 (Jan-June)
CHINA DATA:	Surplus (Deficit) w/o U.S.	4,447,431,028	(239,408,663)	(3,273,491,215)	(12,332,442,993)	(30,413,470,651)	(16,011,426,003)	(29,983,123,689)
PARTNER DATA:	Surplus (Deficit) w/o U.S.	70,726,645,266	86,434,750,714	85,144,275,849	84,403,672,849	85,000,111,087	37,910,061,423	43,476,947,347
	DISCREPANCY w/o U.S	***66,279,214,238***	***86,674,159,377***	***88,417,767,064***	***96,736,115,842***	***115,413,581,738***	***53,921,487,426***	***73,460,071,036***

Prepared by Georgetown Economic Services

TABLE 4: LIST OF 41 PARTNER COUNTRIES

1. **Argentina**
2. **Australia**
3. **Austria**
4. **Belgium**
5. **Brazil**
6. **Canada**
7. **Chile**
8. **Colombia**
9. **Denmark**
10. **Finland**
11. **France**
12. **Germany**
13. **Greece**
14. **Hong Kong**
15. **Iceland**
16. **Indonesia**
17. **Ireland**
18. **Italy**
19. **Japan**
20. **Luxembourg**
21. **Malaysia**
22. **Mexico**
23. **Netherlands**
24. **New Zealand**
25. **Norway**
26. **Peru**
27. **Philippines**
28. **Portugal**
29. **Russia**
30. **Singapore**
31. **South Africa**
32. **South Korea**
33. **Spain**
34. **Sweden**
35. **Switzerland**
36. **Taiwan**
37. **Thailand**
38. **Turkey**
39. **United Kingdom**
40. **United States**
41. **Venezuela**

Panel III: Discussion, Questions and Answers

Cochair MULLOY. Thank you all three for your enlightened testimony.

I just want to, before turning to our first questions by Commissioner Wessel, I want you to know that we did have the administration in here this morning, the Commerce Department and the State Department. We had invited the Treasury; this was probably the third time we've invited the Treasury, and they could not show up, because we think their reports to the Congress saying that China is not a currency manipulator while they're out there trying to get China to move their currency just doesn't make any sense.

And so, we wanted to have them here to ask them some questions about that, but they have failed to appear.

So we now want to turn to Commissioner Wessel.

Commissioner WESSEL. I thank each of the panelists for all they do not only on this issue but also on many others. You are leading in your fields, and you make a huge difference here in Washington to the policy debate and the level of knowledge on these issues.

I want to ask a couple of questions, and maybe, Fred, some of these are directed to you early about what all of this means, not just vis-à-vis China in terms of the currency manipulation and our competitiveness, but we saw some time in the fall that no foreign interests participated in one of the auctions of our Treasury bonds.

We're seeing increasing denomination of debt in the world markets in euros. There have been some discussions lately of some of the international resources potentially being valued in euros.

With the level of debt that we face here in the U.S., both our budget deficit and our trade deficit, similar to the situation we were in the eighties but with much higher percentages of our GDP, do you see a weakening of confidence in the dollar? Do you see the impact of this potentially, if we don't right it in some way, as increasing the prominence of the euro and potentially other currencies on the world market?

Mr. BERGSTEN. Well, there is no doubt that there is a big decline in international confidence in the dollar. It's come down by a trade-weighted average of 15 percent over the last three years. It has come down 65 percent against the euro and a lot against all of the currencies that are truly floating.

The problem, as we're saying here, is that Asians have blocked their piece of it. But for the currencies that are determined by market forces, the dollar has come down much more than the trade-weighted average of 15 percent. I was at Davos last week, World Economic Forum; it's hard to say there's ever a consensus there on anything, but the closest to a consensus I've ever seen is on this issue. Even Bill Gates said it's time for the dollar to come down a lot. He's a latecomer on these kinds of things normally.

So I think it is axiomatic: the dollar is going to come down a lot more. The only issues are, one, how much? I would say another 15 or 20 percent average; in other words, we're about halfway through the correction. Two, against which currencies, and certainly, as we're saying here, the Asians must be the centerpiece of the next wave of dollar correction, as the Europeans were the first wave. And third, crucially, will it be orderly as the first three years of

dollar decline were, or will it be disorderly? Will it turn into a free fall, a hard landing, a crash?

And I think it's very possible that this will happen if the U.S. does not develop a credible budget position here over the next few weeks and show that we are getting our own house in order but also if the other countries don't play their role, permit their currencies to go up in an orderly way.

Commissioner WESSEL. Do you see, though, are there implications, do you see a trend towards, again, let us take oil for an example, the potential that that would be denominated in some other currency?

Mr. BERGSTEN. Yes.

Commissioner WESSEL. And what are the implications for us policy wise?

Mr. BERGSTEN. Yes, and let me give you two major implications of that. If you ask why the dollar has been the dominant currency over the last 100 years and why it's been easy for us to finance trade deficits, the simple answer is the absence of competition. Even when U.S. economic performance was terrible, like in the seventies, even when our economic policy was awful, the dollar remained the world's dominant currency. The only competition was the deutschemark, and as Helmut Schmidt always said, West Germany was about the size of Oregon. The West German economy never got more than one-fourth our size, and the deutschemark never took more than about one-fourth of the world currency market.

Now, it's all different. There's an economy that is actually bigger than ours, a financial market that in terms of bonds is already bigger than ours, and so, yes, now there is competition. Of course, the last thing the Europeans want now is diversification out of dollars into euros, because they don't want the euro to go up more.

So whenever the Chinese hint that they might buy euros, the Europeans leap up and say no, no, no, not now. I always kind of kid them about that, since three years ago, they were seeking conversion.

But here's the other point, and it goes to your first question also about lack of foreign participation in Treasury auctions and all of that: remember, you cannot have it both ways. What we want is orderly correction of the exchange rates, meaning, in this case, a stronger renminbi in order to reduce China's current account surplus, in order to reduce their buildup of foreign exchange reserves, and therefore, we want them to buy fewer Treasuries.

So keep that in mind. There's no free lunch in this business any more than in the rest of economics; the adjustment has two sides. We want—I think we all want—real adjustment, meaning bring our trade deficit down, Chinese surplus down, all of that. But if their surplus goes down, their buildup of currency reserves is less; therefore, the money going into Treasuries is less.

What all that does say is that an inevitable part of the adjustment is higher U.S. interest rates. The question is whether this happens in a relatively orderly way, so that the Fed's "measured tightening" can go on more or less as they hope, or whether we get a crash landing.

We ran one of the macro models: Martin Bailey, who was chairman of the Council of Economic Advisors under President Clinton, ran a macro model that asked what would happen if the dollar dropped sharply, 25 percent in six months at a time when we're close to full employment, as we will be in a year? The answer is U.S. interest rates at double digits.

So there could be a very big unanticipated shock to the economy if this problem is not headed off; if, as has been the case so far, despite Frank's nice words about the administration, I don't think they've done much, and what they've done is wrong, so I'm not impressed.

If they continue on that path, and nothing happens to prevent the problem, inevitably, when the deficit gets to 8 percent or so of GDP or somewhere fairly soon, there's going to be a very sharp fall in the dollar and that will mean interest rates up, inflation goes up, and the economy literally could tank. That is the big risk that needs to be anticipated.

If you want the horror precedent, it's the 1970s—that is when we had sharp declines of the dollar coupled with sharp rises in the price of oil. Need I remind you that in the late seventies, the United States experienced double digit inflation, 20 percent interest rates, the worst recession since the 1930s. I don't think it will get that bad, but it could go if it is not handled preemptively, including via Chinese participation in the adjustment process.

Commissioner WESSEL. Thank you.

Cochair MULLOY. Commissioner Reinsch.

Commissioner REINSCH. Thank you.

I've got three or four questions, so I'm going to hope for short answers, so I can squeeze them all in.

Fred, you make a compelling case, one I agree with. And the most important part of your case, I think, is that it's good for them. Revaluation is good for them just as it is for us. If it's so obvious and so strong, why don't they do it?

Mr. BERGSTEN. I think they have a couple of hang-ups. They have what I think of as money illusion. They continue to say they must maintain stability in their exchange rate by preserving their peg to the dollar. I tell them until they're blue in the face that pegging to the dollar ensures them of instability in their exchange rates because the dollar fluctuates so wildly against the euro, the yen and everything else, but they have a kind of fixation that a dollar peg is stabilizing, when, in fact, it's destabilizing.

Second, more simply, they just don't want to rock the boat. The policy has worked, as has been mentioned; it's a huge, off balance-sheet, off budget unrecorded export subsidy, part of their development strategy. They have gotten away with it so far under the international rules, and it's been an integral part of their development program. From their standpoint if it ain't broke, don't fix it.

I also honestly think they've got some blind spots on the payoff to their domestic economy. The Chinese have been very sophisticated on some of these issues, but on the relationship between the exchange rate and their domestic monetary and economic conditions, I think they've just got a blind spot.

The People's Bank of China, the central bank, understands it very well, but the political people do not. A lot of them still go back

to the closed economy, pre-Deng Xiao Ping reforms, and it may just be that they don't quite understand how all this works.

Commissioner REINSCH. Okay. Let me pursue the scenario a little bit, because I think one of the things you implied, and if you add together what the other two witnesses said might cause you some concern, is it seems to me you're projecting scenarios here in which the only outcome is a variety of protectionist actions.

I mean, what you said is, if nothing happens, what you're likely to see is action against shrimp, action against steel, action against whatever it is, which we're beginning to see. It seems to me what we heard this morning from Senator Schumer and others is that at a macro level, if nothing happens, what you're going to see is the Schumer Amendment, which is likewise protectionist from your point of view.

Is there any happy scenario here? Any happy ending?

Mr. BERGSTEN. Only if the Chinese get religion and show up at breakfast tomorrow morning with a 25 percent revaluation, which I don't think is too likely.

No, I think it's headed toward a bust-up, and it is very reminiscent of our pattern with Japan back in the seventies and eighties. It is exactly the same dynamic: the Japanese would resist an obvious need for revaluation of their currency. They would get trade barrier after trade barrier after trade barrier. They would get foreign policy opprobrium. The exchange rate would go up anyway, and they'd wind up with the worst of all worlds, and the thing would ratchet and escalate.

I think the same thing is happening. I'm no fan of trade protection as you know, but if you're going to get it anyway, maybe it makes sense to be very explicit and threaten it, whether it's a Schumer Amendment or the administration's invoking the IEEPA, the International Economic Emergency Powers Act, and simply saying fellows, we say this more in sorrow than in anger, but if you continue to distort the system, we are just going to have to tell you, a 50 percent import surcharge would be about the equivalent of a 25 percent revaluation, and we're going to have to do it.

That should be, incidentally, multilateral, and the Europeans, Canadians, and the rest of the G–7 should go along, because as I said, they are now being hit even worse than the U.S. by the Chinese undervaluation.

Commissioner REINSCH. Just a quick sort of economic question: if they revalued by, say, 25 percent tomorrow, how long would it take to see an effect on our economy?

Mr. BERGSTEN. You would start to get a competitive effect in terms of orders and all that pretty quickly. The models show you that it takes two to three years for the full effect to play through into the trade numbers, but they start to show up in the first couple of quarters. You can see the trend.

I think when the dollar came down 50 percent in the mid-eighties, you didn't really stop the deterioration of the nominal numbers until 1987, but already, after the Plaza [Agreement] began to drive the dollar down, you saw a big swing in order books, political attitudes and the politics of domestic trade policy. So I think you would begin to see it pretty early.

Commissioner REINSCH. Early. That's helpful.

Frank, let me just ask you one question in closing: even if they revalued by 25 percent tomorrow, and the effects unroll the way Fred just described, that is not sufficient, I assume, to rebuild our manufacturing base, is it? Or is it?

Mr. VARGO. Well, China, again, is not the principal reason why we have lost almost 3 million manufacturing jobs, but China is a growing factor. Were China to revalue 25 percent tomorrow, for the industry sectors that are really impacted by China, yes, it would begin to make a pretty quick difference.

Commissioner REINSCH. What is the principal reason we've lost 3 million jobs if it's not China?

Mr. VARGO. We see the largest reason as the drop in our exports; you know, our exports dropped almost $100 billion after the year 2000; second largest reason was the decline in the—well, the bursting of the high tech bubble in the United States. Probably the third was a very, very unusually rapid productivity growth, way above trend. And then, I would put China as probably fourth.

Commissioner REINSCH. Thank you, Mr. Chairman.

Cochair MULLOY. Commissioner Dreyer.

Cochair DREYER. I was very interested in what Mr. Hartquist said about China being an extreme case of currency manipulation that is undermining the rules-based basis of WTO and also the IMF's Articles of Agreement. And if I understand you correctly, you suggested that if these negotiations don't work that we take this case to the WTO.

Could you walk us through, or could any of you walk us through, what happens when you take this case? We have had people testify before that yes, you can take this to the WTO, but it takes X number of years, and heaven knows what amount of resources, and in the end, you can win the case but lose the issue. Meanwhile, your company may have gone bankrupt.

Do you think that this would be addressed properly by the WTO, or as some of our other people who testified, these are faceless bureaucrats who don't really care about consequences and will just come to some kind of bland, unhelpful conclusion?

Mr. HARTQUIST. Well, that's a very good start for my answer. Simply put, the way it works is that the complaint would be lodged by the United States with the World Trade Organization seeking dispute settlement. And then, there would be a period of consultations between the governments. If there is no resolution, then, it goes into formal dispute settlement in the WTO.

And the job of the WTO then is to investigate the allegations and determine their merit. This whole process can take a year or longer depending on whether certain deadlines are met or extended.

Frankly, the Bush administration has been unwilling to take this case to the WTO, I think, for a number of reasons, one, because it is an uncertain process, and the United States and other trade authorities have been disappointed in the results in the WTO in a number of cases. In fact, we took a look at that a year or so ago, and I used to say that, whenever the United States took a case to the WTO or a case was lodged against the United States and our trade law enforcement in the WTO, we lost. We lost every one but one, something like a year ago.

And then, we took a broader look at it, and we discovered that everybody loses in the WTO. The WTO generally finds against the trade authorities of whatever country has enforced its trade laws.

So here, we have a novel theory, that currency manipulation has trade effects and can be dealt with by trade agreements as opposed simply to the IMF Articles of Agreement. Our view is it will scare the Chinese to death to have this case taken to the WTO. They don't know how it's going to come out, but the consequences for them if we were to succeed are enormous, and we felt when we filed this petition last fall that the Chinese were right on the brink of revaluing. There was a lot of talk about 5 percent, 7 percent, too small, we felt, but a step, a first step to tell the markets, to tell the world that they were going to start to move.

We also felt that if the United States accepted this petition and began this process it would add leverage to our discussions with the Chinese, because they would have this uncertain future facing them that the World Trade Organization may find against them on this issue, with all the consequences that would flow from there.

So our view has been to take it to the WTO. It probably would never reach a final decision, because the incentives to the Chinese to make adjustments to what they're doing would be very substantial, and we felt that nothing ventured, nothing gained; we're not making any progress now just talking with these folks and sending technical teams over there, so let's try this route, and we have faith that the arguments that we're making are justified under WTO rules.

Cochair DREYER. I would really like to hope that you're right. What worries me is that the Chinese tend to be much better negotiators than we are and to have much more patience, historically, than we do, so they agree to negotiate, and they talk, and they talk, and they talk, and they talk, and meanwhile, the dire consequences that you have predicted, all of you, that this is unsustainable, happen.

Anybody want to chew on that one?

Mr. HARTQUIST. I'll comment briefly on that, Commissioner.

I'm not sure I would agree that we're outgunned by the Chinese negotiators. The problem is the Chinese make agreements and then don't keep them, and this is a great example of it. But one of the members of my firm, Bob Cassidy, who came out of USTR, negotiated many of those agreements with the Chinese prior to WTO accession, and Bob will tell you ad infinitum about the agreements that the Chinese have made that they simply have not kept.

So the problem is not the agreement itself. The problem is getting them to do what they say they're going to do, and that's where some kind of an enforcement mechanism is necessary.

Mr. BERGSTEN. Let me give three or four observations. I don't worry too much about this last point that you made, because the dispute settlement mechanism in the WTO is not a negotiation; it's a legal process. It has time deadlines. Some deadlines are fairly far out for my sense of urgency, but the Chinese couldn't stall that by negotiating. So once the process got going, it would, in fact, run through; there would be timetables, and so, that would play out. So I don't worry too much about that.

On the initial suggestion of having the U.S. lodge this case, I'll repeat what I said in a different context a minute ago: I think it would be far better and quite doable for the case to be lodged not just by the U.S. but by a whole panoply of China's trading partners. I don't think you'd object to that.

Mr. HARTQUIST. Not at all.

Mr. BERGSTEN. It's the EU, it's the British, it's the Swiss who are being killed by the fact that the dollar decline goes against their currencies because the Chinese block a rise in the renminbi. So if one could develop a credible case here, and if the U.S. Government would decide to take a lead in propagating it, I think we could get some competitioners pretty quickly, which would help enormously in both the substance of the WTO itself and in the broader negotiating and psychological strategy that you have in mind here.

You were saying how the Chinese would be scared to death; well, more so if the bulk of the world trading system was taking them to court rather than just the U.S., so I would put some effort into multilateralizing the process.

The case itself, Mr. Hartquist acknowledged is uncertain. This is an unprecedented area of WTO or GATT law. Provisions have been in there from the start about the relationships, with balances of payments and currencies which have never been pursued. I've written on it for 30 years, and it's been a dead letter, much to my dismay.

Therefore, I have felt all along that whether you did the WTO case or not, you should move with equal force in parallel in the IMF. Because the IMF rules are very clear: the rules say manipulation of currencies is not permitted, and it defines manipulation very clearly: very large intervention in one direction for prolonged periods of time.

It's not only China, incidentally; Japan fits that bill, and you could argue some of the other Asians also do, but China clearly fits that bill. So our administration has been derelict not only in the respects mentioned to date but also in failing to go to the IMF with the case.

Now, again, the IMF has been derelict. It has not really implemented that provision over the 25 years it's been in the books. The IMF has taken a couple of small countries, Sweden and Korea, I believe, into the docket on exchange rate manipulation; but no big ones. Why not start here, when you've got a systemic disruption like this?

So as I say, whether or not you did the WTO case, I would certainly move in parallel in the IMF, and you might even get faster progress there.

Mr. VARGO. I think that it's more extreme than that, because there's cross-references between the WTO and the IMF. And if you had a WTO panel convened on this, first thing they'd do is pick up the phone and call the IMF and say is there currency manipulation? And if the IMF said no, we've looked, and there's none, case closed. Panel has lunch and goes home.

So you've got to go through the IMF. And the IMF is not going to say yes, there's currency manipulation if the Treasury is telling the Congress no, there's not, so that's why the emphasis has to go all the way back to the beginning as to the next step.

Cochair MULLOY. So you say the beginning is our own Treasury Department?

Mr. VARGO. Treasury, I think, has to make a finding. If Treasury—Treasury has believed that, since this is in the interest of the Chinese as we all believe, and it's got to happen, that by working with the Chinese, they can get it to happen; you know, that's certainly the best course. But I think we're running out of time on that one.

Cochair MULLOY. Yes.

Mr. VARGO. So the next step would have to be, in my view, making a finding to Congress—I forget the section number——

Cochair DREYER. I'm sorry; who is making this finding? Because Treasury already decided in early December that the Chinese currency was not undervalued.

Mr. VARGO. Right, and they've done that for a long time.

Mr. BERGSTEN. They didn't say that. They said they're not manipulating the rate. They did not say it was not undervalued.

Mr. VARGO. That's true; that's true, but still, that's the next step.

Cochair MULLOY. What they've done is—I worked on the statute that put that in the law in 1988; we had a two-point test, I think, one, that you had to have a large bilateral surplus intervening, and two, that you had to have a global surplus. I think the Treasury hid behind the fact that at least some time ago, maybe the Chinese, at least on the books, weren't running a global surplus.

So the way they couch it within the terms of the statute, I think they always say that they're not manipulating their currency within the terms of the statute, and that's the way I think they hide behind it. But with Dr. Bergsten now telling us the size of their global surplus, I don't think in their next report, which I think is due in April, I don't think they can hid behind that provision anymore.

One last thing: on the semiconductor case, once we filed, we did find a number of people joining us, and then, the Chinese settled very quickly, so we take your point there on that, Dr. Bergsten.

Dr. Wortzel.

Commissioner WORTZEL. Thank you.

I think this is directed to you, Dr. Bergsten, because you argued that a revaluation of the renminbi is better than letting it float, as I understand it, for one reason, you're afraid of this big outflow of renminbi. If you look at their banking system, if you look at the way they're using bonds to state-owned enterprises, if you look at the way folks aren't getting paid, if you look at the nonperforming loan rate of banks there, it seems to me that the greater concern for them, maybe not for the United States, but for the Chinese, wouldn't be the outflow; it would be when people wanted to make an outflow of renminbi, there's only half of what they think they have to outflow.

The money's not there. It's a hollow currency. So, which is the case? Are you able to shed any light on that?

Mr. BERGSTEN. I can't give you the precise numbers. You're probably right. There would be some missing assets in the banking system, given its weakness. I was just observing that China has had 25 years of economic growth at 10 percent. In the course of that, an enormous amount of wealth has been generated, and because of

the exchange controls, 99.9 percent of that wealth is held in renminbi terms.

Therefore, the capital export controls are lifted or even liberalized somewhat, an outflow of substantial magnitude is bound to take place simply for portfolio diversification reasons. This is exactly what happened in Japan: in 1980—as late as 1980—Japan liberalized its capital outflow controls. They had them until 1980. During the previous 20 years, they have had 10 or 12 percent growth, and massive wealth buildup, all in yen.

When the controls were relaxed, there was a massive outflow from Japan. The yen dropped like a stone despite the fact that Japan was running the biggest trade surpluses in human history to that time. And it exacerbated the big increase in our deficits during the early 1980s, and I think the same thing would happen. In short, it would make the trade situation worse, and I cannot for the life of me explain why the U.S. Treasury, in addition to pursuing something that is impractical to happen, pursues something that would make the problem worse.

Cochair MULLOY. Thank you.

In other words, a free-floating currency is not the answer, because it could make their currency collapse as the money flowed out of it.

Mr. BERGSTEN. I wouldn't say collapse, but it could depreciate further.

Cochair MULLOY. Yes.

Mr. BERGSTEN. Let me be clear: as a long run proposition China is going to be a bigger and bigger player in the world economy. It will get rid of its capital controls. It should have a more or less floating exchange rate over the long run, and the Chinese say once a day and twice on Sundays that's where they're headed, but it's at least 5 to 10 years out if not longer.

So even if you thought it was going to go in the right direction, there's no possibility that it would be a remedy to the immediate problem, even over the medium term.

Cochair MULLOY. I note that this Commission recommended a repegging and not a floating of the currency

Commissioner D'Amato.

Chairman D'AMATO. Thank you, Mr. Chairman.

That repegging recommendation came directly from the testimony by somebody named Fred Bergsten I think a while ago.

Mr. BERGSTEN. The Commission displayed its wisdom acting in that respect.

Chairman D'AMATO. I'm going to have two questions for Mr. Bergsten, and you all can chime in. First, I guess my feeling is that the Chinese think that if they were to go and repeg their currency 40 percent that it would affect their growth rate, and they would be afraid that it would have a downward dampening effect on their growth rate, which might put some instability into their economy. My guess is they might think that.

Do you think that is true, A, and secondly, what would your guess be about how the competitiveness of China would be affected if you took away that 40 percent tip that they get on everything?

Mr. BERGSTEN. Well, clearly, the Chinese worry about exactly what you say, but I think the worry is excessive. Keep in mind that

from 1994 until the early part of 2002, the Chinese actually rode the dollar up. To defend China for a minute, they can hardly be accused of long-term manipulation. If so, they were very stupid, because they pegged their currency to the dollar just before the dollar hit its all-time record low in early 1995.

So they rode the dollar up 40 percent until the early part of 2001. I did not note any substantial decline in their competitiveness. They continued to grow at 10 percent; their trade surpluses expanded; their foreign exchange reserves built up. So they were quite able to weather a 40 percent—a number the same as you just mentioned—rise in their currency over a seven-year period.

Now, they might say doing it all at once would make it worse, but remember, they've gone down 10 to 15 percent over the last three years; the first 10 to 15 percent would just offset the further improvement that they've gotten in their competitiveness. So it wouldn't be all that big a deal.

But again, there is no free lunch. The objective of the exercise is to reduce their trade surplus, in part, to help us reduce our trade deficit. So yes, there would be some decline in their trade surplus. We don't think it would be huge—$30 billion to $40 billion over a couple of years, but there would be some hit.

Now, the Chinese would say that's going to create unemployment. But that depends on what they do with the rest of their economy and the rest of their policy. The classic textbook case for any country whose trade surplus goes down is to increase domestic demand, and heaven knows there's enormous scope for increased domestic consumer demand in China; indeed, that's what the population wants.

The Chinese government, in response to this overheating over the last couple of years has publicly said they want a lower growth rate in order to dampen the expansion of the economy, dampen inflation pressures, and all I've said before is that this is a ready way to do so and to kill simultaneously three birds they want to: somewhat lower growth, less inflation, and less inflow of speculative capital that's ballooning their money supply. And so, it would be a three-for that they would be able to achieve with one policy tool.

But again, not to gild the lily, there would be a diminution in their trade competitiveness. It would obviously not decimate them. It would, by design, reduce their trade competitiveness to some extent. They would have to compensate that on the domestic demand side. They don't want to do it, because it would require yet another complication in their economic management scheme, but if the alternative is more trade controls and something of the extreme type we're talking about, I just hope they'll do it sooner rather than later.

Chairman D'AMATO. Yes, go ahead, Mr. Vargo.

Mr. VARGO. There's an interesting wrinkle, if I could add, Mr. Chairman, in that a substantial portion of China's exports are really just assembly exports. And if the yuan were to move up, say, 40 percent, then, these components that are assembled basically into electronic products would become less expensive in China. The only increase in the export cost of these assembly electronic products would be the domestic value added portion in China, which would be relatively small. So I don't think China would see a great dis-

ruption in that part of its trade, nor would we see a huge increase in the prices of electronic consumer goods.

Where it would affect China, I think, is exactly in some of the areas where we hear the most from our companies, and that is where the bulk of the cost is of domestic Chinese origin. But even so, given China's other advantages, I do not believe that even a 40 percent revaluation would cause a collapse in China's exports.

It would slow them down. It would make a difference to the rate of growth of our imports from China, but not a reversal, and Fred has made exactly the right point: China has got to move to domestic-led growth. You could extrapolate this export-led growth out for a number of years, and pretty soon, you'd find there's not enough demand in the world to keep fueling that.

Chairman D'AMATO. Let me just say that the pressure here is because the impression is growing that this 40 percent differential is just plain unfair to the American economy, and the sense of unfairness is a reaction—you may have known that this morning, we had testimony, it is clear there is a reaction growing here in the Congress; very severe; we're going to have legislation in this area.

It seems to me the only way we're going to solve this is to convince the Chinese that they're going to have to do it either through a WTO case or through passage of a Schumer-type tariff bill. And those two things may go on parallel tracks, but it seems to us that the question here is what kind of pressure is necessary to move this back into an area where the perception is that the Chinese are being fair with the Americans.

Mr. BERGSTEN. Could I add just one point to that? I think it's very important in the political dynamic of this. You've characterized the Schumer amendment, Congressional action as designed to get the Chinese to move. I think it would more likely get the administration to move.

Chairman D'AMATO. Well, either way.

Mr. BERGSTEN. And if you look at the two historical cases where this has happened, the Connelly surcharge in 1971 and the Baker Plaza Agreement in 1985, in both cases—and Mike remembers this well—the administrations acted to keep control of the policy issues and avoid losing control to the Congress. It was the domestic pressure for trade restrictions that caused both Republican administrations to do 180-degree policy reversals.

People say to me, there's no way the Bush administration would do this. I say, that's the same thing we said about the Reagan administration. But they moved from pure benign neglect of the currency in their first term to Baker's Plaza Agreement which drove the dollar down 50 percent in their second term. It was a 180.

The Nixon administration ignored these issues for the first two years; then suddenly went out and put on a 15 percent import surcharge and negotiated a big devaluation of the dollar, again, because in that case, the Burke-Hartke bill, Congressional legislative pressure, the administration didn't want to lose control.

So the real world dynamic is that if you get sufficient Congressional agitation and pressure, the administration, largely for turf reasons, wanting to keep control of the issue will be galvanized to act. And then, something like I mentioned earlier might be quite feasible.

Chairman D'AMATO. We may see history repeating itself in that respect here.

Commissioner THOMPSON. Mr. Chairman, could I ask one question?

Cochair MULLOY. Commissioner Thompson.

Commissioner THOMPSON. Yes, how would the increased inflow of foreign direct investment into China from all over the world affect their willingness or ability to devalue?

Mr. BERGSTEN. The increase of foreign capital coming into China is, of course, pressing in the direction of a revaluation. If market forces were permitted to play out, the huge capital inflow they're getting would have long since pushed the currency way up. As I said before, they get more direct investment inflow in a year, $50 billion to $60 billion, than India has gotten in its entire history since independence in 1947. They're the world's leading attractor of foreign direct investment.

On top of that comes a huge amount of liquid portfolio capital. Even with the exchange controls, $10 billion, $12 billion, $15 billion a month is coming in. If there were no exchange controls, who knows how huge that amount would be? And if market forces were permitted to play, the renminbi would already be much, much higher in value than it is.

Thus the manipulation; they're blocking that and therefore blocking the play of market forces. But it's exactly that mechanism, Senator. It's the inflow of foreign capital that should be pushing the exchange rate to a level that would then lead to a better balancing of the trade——

Commissioner THOMPSON. And that doesn't present any particular difficulty for them to keep the lid on the way they have?

Mr. BERGSTEN. Well, it does cause difficulties. Capital controls, like anywhere, are leaky, so a fair amount of money does come in. The amount that comes in then adds to the growth of their domestic money supply, which adds inflation pressure. The Central Bank tries to sterilize that but by its own testimony is unable to do so totally, and that's one reason that their inflation rate has gone up.

Two years ago, we were talking about deflation in China. Now, their best indicator of inflation is showing 8 to 9 percent price rise. That's pretty sharp inflation in the current world. And a lot of it is driven by this capital inflow, which goes back to my suggestion earlier: it's in their own interest to take action to head this off.

Commissioner THOMPSON. Thank you, Mr. Chairman.

Cochair MULLOY. Thank you, thank you, Senator; thank you, Dr. Bergsten.

Commissioner Becker.

Commissioner BECKER. Thank you, Mr. Chairman.

I wanted to be the last one, because I want to shift a little bit on what we're talking about. I want to talk about trade policy. China seems to have a very effective nationalistic trade policy, one that's guided for future development and long-term growth in China. They direct-guide the foreign direct investment, they decide what technologies they want, and they search those out in foreign direct investment. They locate them; they even locate them in the areas to where they can be suppliers and users.

They have quite a plan. They coerce, persuade research and development to be constructed by companies that want to come in. China, their leaders, have a heavy hand on this. And this is consistent.

And I guess my question is how can the United States deal with that when essentially, the trade policies of this country are decided by the multinationals and by manufacturers in this country with a profit motive before a nationalistic motive? And what's your take on that? I'd like to get a feel from you.

Mr. VARGO. Commissioner, let me begin by answering that.

First of all, you say our trade policies set by multinationals kind of in, if you will permit me, in a pejorative way that they don't have an interest in the United States. But our multinationals, 70 percent of all their global production is here in the United States, and we in the NAM just went through an exercise of putting through a trade policy, and I've given the Commission a copy of our China trade policy.

We had full participation of our small companies as well, and we looked at the trade policy, and we concluded that, you know, it's not right for the United States to be so open and other countries not. You know, today, Commissioners, 70 percent of all imports into the United States come into the United States duty free, totally duty free. We face high duties in other countries. So one thing I hope everybody agrees, we've got to get them down to our level. So we're pushing a trade policy that does that.

But the second thing is that we have to use our trade policy, to use the existing rules, not to upset the rules, but to use the rules to our advantage. And we seek to do that. Getting China into the WTO, some of the provisions of the WTO are aimed exactly at getting countries like China to have less of an ability to do some of the things that you've been saying, and we need to press them on that.

And I would like also to note that we need a trade policy that works for us. Part of that is the exchange rate. It's a very large part of our trade deficit. In our analysis, and I think in Fred's and others, the vast bulk of the trade deficit that we have stems because we allowed our currencies to get too much out of line, and the biggest thing we can do with China is to get their currency in line so that we can have more of an underlying competitiveness.

We worry about the things that you mention, with China looking to become a center for research. Part of that, though, Commissioner, is that we can't let our leadership go. We have to also, in addition to worrying about trade policy, we have to worry about our basic science policy, about whether we're graduating enough engineers. China is graduating five engineers to our every one, so we have to look a little further down the road as well.

Commissioner BECKER. I have a problem with deciding who is we when we say we have to look at this. When you take—without mentioning any names—a company that would relocate into China and call all their suppliers together, and say if you're going to continue to supply for this company, you're going to have to relocate into China, or you're going to have to meet the China price here in the United States, which is impossible to do.

And they don't do it. So they either relocate into China, or they go out of business. And this isn't just one multinational; this is many of them. All of them have a profit line, not nationalistic line, and I'm not saying that's wrong. I'm just saying China has a national policy, trade policy, that's driven to advance the interest of China.

We don't have that in the United States. Our government is not driving these relocations or the shifts in all of this. These are individual companies that are leaving, and there's a profit motive behind it. Can we deal with it, this is what I'm saying? When you say we, how do we match that?

Mr. BERGSTEN. I'd like to just make two points. One is that the famous China price is importantly affected by the exchange rate, as Frank Vargo just said. That price would be 40 percent different if there were a 40 percent revaluation of the renminbi, and at least there would be a better shot for some of the things that you want.

But the other and broader point I'd kind of like to leave the Commission with is that I've been very critical of China here and will continue to be so, but I want to defend them on one point. When you look at China's participation in the world economy, I would not characterize them as a closed, protectionist country. I would characterize them as a very open economy.

That may shock you. Why do I say that? If you look at the share of trade in the Chinese economy, it's more than double the share of trade in ours; and more than triple the share of trade in Japan. Its trade barriers are by far the lowest of any significant developing country in the world. It has liberalized those barriers at a dramatic pace over the last two or three decades. It has been the engine of growth of over 20 percent of world trade on the import as well as export side over the last three years. It has become the leading importer from every country from—Japan, Korea, Southeast Asia through Canada to Brazil.

It is a big player on both sides of the world-trading scene. Sure, it still has lots of barriers; it does a lot of industrial policy and direction of the type you mentioned. But the aggregate picture for a country that 25 years ago wasn't even in the world economy is actually quite stunning.

The reason China is such a big player in the world economy is threefold: (a) it's very big; (b) it's grown very fast; but (c) it's very open in the sense that trade is a very big and rapidly growing share of its total economy. It is not the picture of a protectionist nation.

Again, to be clear: lots of things have to be done for them to come into full compliance with the WTO. Lots of problems of the type you mentioned are absolutely correct and legitimate, and we need to hit them. But the aggregate picture—and I think that's very important for the Commission to have in mind—is not a Japan of 30 years ago; it is very, very different.

Today China is incredibly more open to the world than Japan today, let alone Japan 40 years ago when it was at somewhat the same stage of development as China now.

Mr. HARTQUIST. Mr. Chairman, may I comment briefly on this as well?

Cochair MULLOY. Yes, Mr. Hartquist.

Mr. HARTQUIST. Mr. Becker, I would like to take kind of a broad look at this, as you did in your question, and look at what China is doing beyond simply the currency issue. From my vantage, you see China doing several things. One, they're buying resources around the world. They're buying a Canadian nickel company. They're buying oil around the world. They're buying raw materials from around the world.

They have a plan. They have policies very clearly defined, I think, economic policies, political policies and military policies that they're following. You know this: if you want to invest in China, you have to give them your technology. You cannot invest in China without turning your technology over to them.

Why? Because they want to leapfrog in a very short period of time over what other countries have taken decades to achieve. So you want to go in there like GE did with gas turbines? You give them your latest gas turbine technology, or you don't invest. They control investment in your former industry, the steel industry. They turn on and off the spigot. They've decided now there's too much steel capacity in China, so when you apply to expand your facility in China, they say no, we're not in the steel expansion business today; check with us tomorrow.

The currency issue: there's an interesting article in the Financial Times this morning about the European Union loosening the embargo on selling weapons to China. And the point that was made in the FT article was Europeans are talking trade. They want to make money; they want to sell to the Chinese. We have an embargo on selling arms to China for military reasons.

I've made this observation before, and it's simply a personal observation, but I think if you were preparing a country for war, whether it's economic and commercial war or the real fighting kind of war, you wouldn't do anything different from what the Chinese are doing now.

So in the narrow sense, the bottom line is, in answer to your question, I think our first step is to enforce the laws that already apply through the World Trade Organization, through the IMF, and our own statutes to deal with the economic issues, and the geopolitical issues are a broader matter, of course.

Commissioner BECKER. I thank you very much for that, because I agree with a lot of what you said. But what I'm afraid of is not what China is doing but step-by-step, we're stripping our manufacturing base in the United States. We're cutting out national interest industries in the United States. When they start moving hand tools, for example, to China, all of them had to go, because they couldn't compete, then, with the American industries that went over there and are exporting back to the United States.

We face this with textiles. We faced it with shoes. There are a lot of industries that are at risk, and they target an industry, and it's gone. They have a trade policy. We don't. And when a manufacturer wants to move to China, he moves to China. He sets the trade policy. And we've got to live with what's left.

That's what I'm concerned about: how do we deal with that here in this nation?

Mr. BERGSTEN. If I could just add one sentence——

Mr. VARGO. I'd also like to add something.

Mr. BERGSTEN. If I were a country planning for war, I would not have 60 percent of my economy tied up in international trade. It would be hard to go to war, jeopardize more than half my economy. I don't think that really suggests a preparation for military activity.

Chairman D'AMATO. If you were going to war in 20 years, you might be doing that.

Cochair MULLOY. Mr. Vargo.

Mr. BERGSTEN. Watch the ratio.

Mr. VARGO. I don't propose to engage in debate, but I would just like to make one point so it is understood, and that is U.S. manufacturing output today is higher than it ever has been. Our manufacturing industry has problems. We've got a lot of challenges. We've got an enormous set of domestic costs that we have to worry about. But a view that American manufacturing has become a weakling or has been hollowed out at this point is incorrect, and American manufacturing is still so large, if it were an economy in its own, it would be the eighth-largest economy in the world.

Now, we want to keep it that way or move it up the ladder, but part of the answer also lies in how we, how the United States Government views manufacturing, and is it going to worry about it and foster its growth more than it has?

Cochair MULLOY. Thank you.

Vice Chairman Robinson.

Vice Chairman ROBINSON. Back to the IMF.

A logical place to go, I think we agree.

They define, as we well know, currency manipulation as protracted, one-sided intervention. China's massive, rapid accumulation of foreign reserves would tend to fit that definition, and serves as evidence that this is the case. So how does one explain why the IMF would endorse the Treasury's view in its last report of December 2004 the claim that it's not manipulating its currency? We are curious also as to the criteria that the Treasury is using to make that determination. We are having a hard time finding that laid out somewhere in clear, layman's terms as to what it is they're looking at precisely in making that judgment.

Finally, what would a country have to do to get a determination of currency manipulation from Treasury at this juncture?

Thank you.

Mr. HARTQUIST. We certainly agree with your observations. There is no good definition. And I don't think you'll find either a layman's explanation or a technician's explanation for the IMF position. So, you know, our view is this is really being driven by political considerations, not by any rational definition of what currency manipulation is.

Mr. BERGSTEN. The IMF is a large, conservative international bureaucracy made up of its member countries, and at the end of the day, its policies are driven by those of its major member countries, of which the United States is the single biggest one.

So you don't find too many initiatives on any issues in the history of the IMF that have not been driven or at least significantly supported by the U.S. and/or the rest of the G–7 countries. We've talked about that. The U.S. is on the wrong track. It is, in fact, not

pushing the issue hard at all, so that explains a lot of the IMF ennui on the issue.

Now, some people will tell you that the IMF has done more behind the scenes than you see publicly. They have certainly had an ongoing dialogue with the Chinese. They have carefully said to the Chinese that they should have greater flexibility as opposed to floating exchange rates.

The IMF tries to be careful to differentiate itself from the U.S. and the G–7 in terms of what it has sought, and I think that's to the IMF's credit, but the bottom line is that the IMF could only take a strong position with China or any other country and really haul them into the international court of appeal here with very strong support from its major member countries.

So as Frank said earlier, I think it goes back to the U.S. Government, the Treasury in particular.

Mr. VARGO. Can I just add a thought to that? Because it's only recently that we've seen the European Central Bank express concern, the Canadian bank, the Japanese, and unless their level of concern is elevated to the point where they are also willing to press in the IMF, I doubt we'll see IMF action.

Cochair MULLOY. Thank you.

Commissioner Bartholomew?

Commissioner BARTHOLOMEW. Thanks very much, and thank you to our panelists. Your testimony has been very interesting.

I am going to modify my question, which is following up on Vice Chairman Robinson's, but first, I just wanted to make a reflection. Dr. Bergsten, I thought your comments about the Chinese government's rigidity acting against its interests to be very interesting. It's clear, of course, that it's not just in this area. Most recently, we've seen the absurdity that the rigidity can put it in with the disrespect to the memory of Zhao Jiang and its unwillingness to reconsider Tiananmen Square. So I think there is a characterization of the Chinese government and the way that it behaves that crosses a lot of different areas.

Mr. Hartquist, you identified a very important point, that the Chinese government makes agreements but doesn't comply with them. Again, I feel like I'm always saying the same thing, but it's true in trade, it's true in proliferation, and it's true in the area of human rights. We had a discussion with an earlier panel of administration witnesses that negotiations are not in and of themselves progress; that talk is not resulting in results, and what is happening on the ground in this country has very serious consequences.

It seems to me that the emperor has no clothes on a lot of these issues, and this administration continues to insist that it does. Frankly, the previous administration did, too, though not on this issue; it was on other issues. My question is why is it that the administration won't admit that there's currency manipulation going on? Why isn't it willing to pull some of these triggers?

In the anticipation that your answers are going to be it's political considerations, I would just like your thoughts on what are those political considerations, and what are they getting in return that they're so willing to essentially ignore the decimation of our manufacturing base and serious harm to our economy?

Mr. HARTQUIST. This is just a personal observation, but I think that in Treasury's view, they're willing to give up some American manufacturing jobs in order not to rock the boat on the currency issue. Second, I think that they are simply unwilling to allow the currency issue, which has been a matter debated among the pinstripers of the IMF, a gentleman's club essentially, to get into the rough and tumble of the trade arena of the WTO.

They have more certainty in terms of what is going to happen in the IMF and more control over that process than they would in the WTO. In part, it's a turf battle, but in part it's because at least that part of the administration that really controls the currency issue, simply does not want the currency issue to be considered a trade issue, despite the trade effects. They want to have control of it; they want to be able to negotiate it.

Also, thirdly, there is a certain fear, which I think everybody shares, including the Chinese, about the consequences of a significant revaluation. They have all of these nonperforming loans that have been referred to. They are frightened that their banking system will just fall like a house of cards. It appears to be very fragile indeed.

So there is a reluctance to act aggressively to deal with this problem, and that's why I think they were talking about a 5 percent, 7 percent revaluation, taking baby steps. Now, they've even moved away from that.

And lastly, the point that Mr. Bergsten has mentioned as well as many others, which is hey, they're doing fine. They're building those reserves; their trade surplus is fantastic. We haven't talked about their real numbers compared to the numbers that the Chinese put out, but in fact, their real trade surplus is tremendous, and it's benefiting them at this point.

Mr. VARGO. I'd like to offer another view having worked with the Treasury somewhat and other parts of the administration.

When you look at the various ways that this job can be done, you know, going to the WTO, a two, three-year process, and if the IMF hasn't found manipulation, you're very unlikely to come out with a positive result. Looking at other avenues, these take time also.

I think there has been a feeling that since this is in the interests of the Chinese, that this is the best solution all around, that the best and fastest way to get the job done is to get the Chinese to understand they should do it now, and I think the Treasury has been pushing for that. And what we need to see is either a result or the Treasury getting frustrated with the present course before they shift to a different one.

I don't think that the national security—well, this is my personal view—I don't think that national security has been the overwhelming factor.

Mr. BERGSTEN. Let me give you two other answers. As you said, part of it is political. The administration has been counting on the Chinese to help with North Korea, on the war on terror. You're probably more expert than I on whether there's been much payoff to that, but that's been a very conscious tradeoff. I actually did an op-ed in the Post about 18 months ago about how our international economic negotiators, whether on finance or trade, were required to

pull their punches in favor of these broader foreign policy objectives. That's part of it.

But there's a second and more fundamental problem: the Treasury is in denial on the basic issues we're talking about here. The Treasury continues to say that the current account deficit is not a problem, that it reflects the strength of the American economy, that the world loves to put this $5 billion a day in here and buy all these wonderful American assets, and that it is a reflection of our strength and not our weakness, so we should all relax about it.

So if they were to really go after China or anybody else, then, they would, in a way, be self-contradictory. This sounds bizarre, but it is true: the reason that the Treasury asks the Chinese to float is so they can say they are not asking them to revalue and therefore reduce the value of the dollar. With a straight face, high-level Treasury officials say that we have not asked them to raise the value of their currency. We have asked them to let market forces determine its value, to which I have said in debates: nobody really thinks you're asking them to weaken the renminbi.

But that is bizarrely what they say in public discourse on this issue. So they are in denial on the broader question. They want to maintain a sort of ideologically pure view that we're for markets to set everything in the face of blatant manipulation that is blocking markets from setting it.

The administration is wholly inconsistent within its own terms. It says let the market do it, but here are countries massively blocking the ability of the market to do it. So on those grounds, they're totally inconsistent as well.

But the basic point on the economics of it is the fundamental denial of the problem, which stems from the fact—as we all know from dealing in government—they don't have a remedy, and if you don't have a remedy, then, you deny there's a problem. And then, that circles back to an inability and an unwillingness to pursue a remedy.

So it's even more complicated than my colleagues suggested, but I think those two fundamentals are blocking any kind of constructive action. It's the equivalent of fiddling while Rome, if not burning is certainly getting——

Commissioner BARTHOLOMEW. Sinking quickly?

Mr. BERGSTEN. —heated up, and one of these days is, in fact, going to singe a few people.

Commissioner BARTHOLOMEW. Thank you.

Cochair MULLOY. Thank you, Commissioner Bartholomew.

I'm the last questioner on this panel, unless anyone has some other comment, and then, we'll move on to our textile panel, but let me ask one thing related to Commissioner Bartholomew's question: could it also be in the Treasury's thinking that they're responsible for financing the U.S. Government debt; they unload an awful lot of it into China.

If the Chinese got unhappy, and they didn't purchase, would that impact interest rates, which would then further blow up the U.S. budget deficit, because it would increase the cost of financing that?

Mr. BERGSTEN. Yes, you're absolutely right, Mr. Chairman. I should have said that.

The Treasury is in the business, among other things, of selling Treasury paper. And they've got a happy buyer here, and Japanese and other happy buyers out there. So there is bound to be some internal tension within the Treasury. The domestic finance guys love it. Here, you've got some ready buyers.

As I said before, there is a tradeoff, and if the Chinese let the exchange rate go up, and they buy fewer Treasuries, then, there will be higher U.S. interest rates. That is part of the adjustment process. And surely a part of the Treasury and the government as a whole and the American public as a whole says we like that, and if it could go on forever, like if nobody ever called your credit card debt then, you'd be very happy with that.

But we're getting to a point where some calls, I think, are going to begin to come in. In the meanwhile, it's fun, and particularly, if you're trying to get into a reelection campaign, you don't want it to happen before that. I would have hoped that now, since November 2, things would have changed, but we haven't seen it yet.

Cochair MULLOY. Now, I have for Mr. Vargo and Mr. Hartquist, I was reading, Mr. Vargo, your testimony, and you have a really good trade agenda for NAM spelled out in here. Among the issues that we talked about today are the change in the Chinese currency, but secondly, which we talked about, keeping China designated as a nonmarket economy, which you endorse, and I think the other people endorsed that.

Three, you want to have our countervailing duty laws, our subsidy laws be able to apply to China, which was also discussed here earlier today; four, you want to apply the China safeguard. And that was also discussed here. And let me ask you and Mr. Hartquist a question on that particular issue.

That provision of law, the ITC makes a recommendation to the President, and then, there are interagency meetings, and then, the President makes his decision. So far, even though the ITC has found injury to domestic companies to something that the Congress fully intended to be used on a regular basis, and the President has decided not to use it, and we have testimony that there has been a lot of Chinese lobbying to keep him from using that provision; there was a recommendation that we change the law to just make it actionable on an ITC recommendation rather than going into this interagency process.

Do you think that's a wise amendment to make to Section 421?

Mr. VARGO. Well, we first want to really test the use of 421 by getting some good cases from our members, Mr. Commissioner. That's what we're doing now.

Cochair MULLOY. Mr. Hartquist, do you have a view on that?

Mr. VARGO. Could I, before we get to Skip——

Cochair MULLOY. Yes.

Mr. VARGO. —just mention one point on the countervailing duties, which is an area where we think we have to move, because so many of our companies tell us that the Chinese products are being offered for sale for less than the cost of the raw materials, and even with a currency undervaluation to the degree that China has, that still doesn't get them below the cost of raw materials.

So while a lot of companies suspect that there are subsidies going on, and to the extent that there are, then, these should be

countervailable regardless of whether it is a market or nonmarket economy.

Cochair MULLOY. Now, my understanding is that our Commerce Department takes the view that they don't apply our anti-subsidy laws, countervailing duty laws against China because it's a nonmarket economy.

Mr. VARGO. That is correct.

Cochair MULLOY. But they have discretion under the law to change that without further legislation; is that your understanding?

Mr. VARGO. Well, since Commerce put that ruling in itself, it can take it off itself.

Cochair MULLOY. That is correct.

Mr. VARGO. However, then, that might leave the situation very open to court challenge, since this has been, since 1984, U.S. practice.

Legislation was introduced in the Congress the last year to clarify the intent of Congress being this should be applied regardless of whether it's a market or a nonmarket economy, and we have supported that legislation.

Cochair MULLOY. Mr. Hartquist, do you have anything?

Mr. HARTQUIST. Mr. Chairman, your question really is close to home as far as I am concerned, because we filed one of those 421 cases. We waited until there were a number of cases that had been filed until we thought we had just a great case on the facts. It was a ductile iron pipe case.

And it sailed through the ITC, a unanimous, 6–0 decision. We went through the interagency process, and everybody we met said this is a great case. This is a very strong case. And until the final decision came out, we thought the President was going to grant relief. And ultimately, he didn't.

So we have been thinking a lot about whether that section of the law ought to be amended in some way to reduce the discretion that the President has. The idea of letting the ITC decision take effect is another approach. I think either the administration has to show that it's serious about using these provisions and giving the relief that was contemplated, or I think the law is going to have to be amended to reduce the amount of discretion that the administration has.

Cochair MULLOY. Well, I think we will then close this panel. I want to thank you all, each of you, very much for the testimony that you have given. I want to salute Frank for the prepared testimony, and Mr. Hartquist, your testimony has given us a guide or a map for how to bring a WTO case is invaluable.

Mr. HARTQUIST. Thank you.

Cochair MULLOY. So we thank you, and Dr. Bergsten, we always appreciate your testimony. We're going to take a five-minute break, and then, we'll start our next panel.

Chairman D'AMATO. And I have an announcement for Commissioners. Please stay around between this and the next panel. We're going to take a group picture.

[Recess.]

PANEL IV: STRATEGIES FOR ENFORCEMENT—TEXTILES

Cochair MULLOY. We're going to convene our final panel of the day, but I do want to remind anyone who may be interested that we are continuing this two-day hearing tomorrow, and we're going to have panels on intellectual property rights and agriculture, and we're also having a witness from GAO. They've done a study on the whole China implementation issue, and we'll have them testify as well tomorrow. So I think we start that at what time? 9:00? Yes, 9:00 tomorrow.

This panel today, we're lucky. We have on this panel, I think, the key interests all involved in a most important issue, and that is the phase-out of the global textile quotas, which happened on January 1, and the implications of all of that for the U.S. textile industry and the global textile industry. And so, I want to thank each of the witnesses for being here with us today.

And we will go in the order just across the panel, if that's all right with you, and is it all right? We're going to limit to six minute opening statements, and then, we'll go through: Mr. Cass Johnson, who is the President of the National Council of Textile Organizations; Mr. Auggie Tantillo, the Executive Director of the American Manufacturing Trade Action Coalition; Mr. Harris Raynor, the Vice President of UNITE HERE, which you represent the workers in the textile industry.

Mr. RAYNOR. What's left of them.

Cochair MULLOY. Yes.

And then, we have Mr. Erik Autor, who used to work up here in the Senate Finance Committee, an old colleague who is now the Vice President and International Trade Counsel for the National Retail Federation. And finally, we have Julia Hughes, the Vice President for International Trade and Government Relations for the U.S. Association of Importers of Textiles and Apparel.

Why don't we then just start with you, Mr. Johnson, and we'll go right across? And after—we'll open it up for each Commissioner to have no more than five minutes to ask questions.

STATEMENT OF CASS JOHNSON, PRESIDENT NATIONAL COUNCIL OF TEXTILE ORGANIZATIONS

Mr. JOHNSON. Thank you very much. Again, my name is Cass Johnson, and I'm the President of the National Council of Textile Organizations.

Before I talk, my colleagues and I from AMTAC and UNITE decided how to approach these statements was that each of us would take two of the questions that you asked and concentrate on those, so that we wouldn't be duplicating or saying the same thing over and over again. So I'm going to be looking at the threat that China poses and the data that the industry has collected on the threat that China poses to the U.S. textile industry, and I'll also include some information from overseas sources about the threat that China poses to textile and apparel sectors around the world.

Before I start, I would like to thank the Commission for its hard work over the last three years. Your work has really shown a beacon onto a very dark and murky area, and that is U.S.-China relations. And our industry certainly and sincerely appreciates what you do. The intense public outreach, the strong research bent; your

strong intention to reveal what exactly is happening between the U.S. and China on trade relations is of intense importance to our industry and to our workers, and I, frankly, cannot think of a commission or a body in Washington that is doing more important work, especially as it regards the textile and apparel industries, so thank you very much for that.

I would like to begin by stating what I think is obvious to many of us within the industry, and that is that the U.S. textile and apparel industry is on the edge of a precipice, and that is not a precipice that is caused by the removal of quotas on countries around the world; it's a precipice caused by the removal of quotas on one country, and that is China.

As the detailed testimony will show, China has spent 15 years preparing for the day when quotas would be removed. We are at the end of China's third five-year plan on textiles and apparel. China has declared textiles and apparel a pillar industry of the nation. It is an immense industry, certainly beyond my easy comprehension.

Here are some figures about what China has created: it is by far the largest textile apparel producing country in the world. Ninety million people are directly or indirectly employed in China in textiles and apparel. It is China's largest earner of foreign exchange, and I think that gives you an idea of how important it is to the government.

It has, incredibly, entire cities named after the production of one or another types of textile products. There are cities in China that are devoted exclusively to the production of sweaters, of underwear, to sportswear, to pants; entire cities. I think that also gives you an idea of how managed this economy still is.

Today, one month after quotas were removed, China has 3,784 textile plants that are currently under construction. It has increased its garment production by 50 percent in the last four years and increased its garment production by an astonishing 27 percent over the last year. And this is coming from a country, which is already the largest producer of textiles and apparel in the world.

And amazingly, China reported last year that its garment sector produced 20 billion garments. As they said in an announcement, we can now clothe every person on Earth with four garments made in China. So this is an astonishingly big, astonishingly dangerous player to suddenly arrive on the world stage in the textile and apparel sector without restraint, without anything to prevent it from doing whatever it pleases.

One thing I'd like to go over are some charts that the U.S. textile industry has been putting together to look at how China can impact the U.S. sector specifically, and what we have done to analyze the threat is to look at what China has done in quota categories that were removed in 2002. This was a preliminary and a rather small removal of quotas in preparation for the major removal, which occurred on January 1.

By tracking what China has done in these categories, we believe this will give us and the government a sense of what China will do or will now do now that the rest of the quota categories have been removed. Again, this was a small but a varied group of textile

and apparel categories. It includes everything from knits to wovens to man-made fiber to silk to cotton products.

And if I could make this slide show work, and I've got to tell you, we were aware that China was going to be pretty spectacular when China was given the ability to join in the quota phase-out. I don't think anyone thought in three years' time, China would do this to the U.S. apparel market. China went from a 10 percent share while it was under quota to a 73 percent share of the U.S. apparel market. It basically wiped everyone else out that was competing.

And I will read to you China's competition. As you can see, in 2001, China was pretty much on par with Mexico, the Philippines, Bangladesh, the CBI, Hong Kong, South Korea and Taiwan. Quotas go off, and you can see that it doesn't matter if you have a free trade agreement; Mexico has one. It doesn't matter if you have a trade preference program; the CBI has one. It doesn't matter if you have lower wage rates, which Bangladesh does. Everyone fell to the wayside, and China took the market, took the market in these products. This is a chilling picture or a prophecy of what may happen now that China's remaining quotas have been removed.

We also looked at what China has done in other markets, and we did this by taking UN trade data and excluding the U.S. from it. So this is a chart of what worldwide trade in textile and apparel looks like today from non-quota restrained countries, so countries that did not use quotas, this is how the trade looks now, and actually, when I say now, I mean 2003, which is the most recent year that data is available.

China has 62 percent of worldwide trade in and apparel. As to China's competition, on the chart, the 6 percent is Italy; the 3 percent is the United States; the 3 percent is Hong Kong; 2 percent is Turkey; 2 percent is Germany; 2 percent is France; 1 percent is Bangladesh.

Cochair DREYER. Can't you really add Hong Kong and China together?

Mr. JOHNSON. I would. They are essentially the same thing. So I would say, you know, if I was going to do as I want, I would say 68 percent, 69 percent, 68 percent is China. The rest is just small shares for everyone else.

We looked in particular at the Japanese and Australian apparel markets. These were particularly interesting to us because they mirror the U.S. market: developed countries, highly developed consumer markets, similar buying patterns. Japan and Australia have never had quotas. Today, China controls 83 percent of the Japanese and Australian garment markets, apparel markets. Again, we see a number of countries with very small shares as number two being Italy with 5 percent, South Korea with 3 percent, Thailand with 3 percent, France with 2 percent, the United States with 1 percent, Indonesia and India with 1 percent.

This is chilling data for the industry and what it looks to in terms of its ability to compete on a fair playing field with China. We also looked at categories that the industry has filed safeguard petitions on, and we looked at the prices China charges in the world market for these categories. And these categories, trousers, woven shirts, knit shirts and underwear, this is the stuff that our industry makes all day, every day. These are our bread and butter

items. These are where we will go head to head with China in a quota free world.

The blue bar is the Chinese price; the gray bar is the rest of the world price, and keep in mind when I say the rest of the world, I don't mean the United States price. I mean the Bangladesh price, the Indonesian price, the Turkish price, the Mexican price, the Caribbean price. All the big competitors, this is their average price.

And it is just incredible to us that China can do these things and is doing these things. The Chinese price is 58 percent below the average rest of the world price. As you can see, from trousers to woven shirts to knit shirts to underwear, there is no way that any of our sectors around the world that any sector around the world can make up these kinds of price differences.

The last thing I would like to say is that, and this slide is—I put this up not so that you could read it but so that you could be impressed by the number of names that are on this list: the United States industry is obviously not in this alone. The fact that quotas have phased out affects every country, every exporting country on Earth. This is a list of 96 trade associations from 54 countries with $150 billion in textile and apparel exports that have banded together; an unusual alliance.

We now sit down with, and we did just two weeks ago, with Bangladesh, with Indonesia, with Nepal, with Turkey, with Mexico, countries that we used to and companies we used to fight head to head with, and we plan strategy for trying to save ourselves from what we call the China price, which no one can beat. We have, over the last year, created this coalition. We have gotten governments active in the WTO, and I think it's an expression of the danger of an unrestrained China on world markets.

If all of these countries and all of these groups are worried that they cannot compete, then, there is something there. And I think that is my buzz, so I'll move on. But thank you very much for your time.

Cochair MULLOY. Yes, Mr. Johnson, we permitted you to go a little further, because that was rather interesting material you were putting up and helping us get the context in which the discussion will take place.

Mr. JOHNSON. Thank you.

[The statement follows:]

Prepared Statement of Cass Johnson, President
National Council of Textile Organizations

My name is Cass Johnson and I am the President of the National Council of Textile Organizations, which is the national trade association for the domestic textile industry.

Before I get to the topic of discussion, I would like to say how appreciative our industry is of the important work the Commission has been doing. From our perspective, there is probably no more important work being done in Washington today. This Commission, through its strong research and intensive public outreach, provides the only comprehensive vehicle for examining this country's complex relationship with China. You have shown a bright light on an area that has been neglected for far too long and you lay an essential foundation for real progress in meeting the many challenges that China poses.

Today, I would like to address specifically the threat from China and how the removal of quotas on imports from China is likely to impact the U.S. textile and apparel sector. My colleagues from AMTAC and UNITE will, in turn, examine the other questions the Commission has asked the panel to review.

Summary of Data

A summary of the available data, studies and importer insights on the impact of the quota phase-out is relatively simple—if governments do not act and act quickly, the U.S. textile and apparel sector—along with much of the world's textile and apparel production—is today on the cusp of a unprecedented disaster. For the last 15 years, the Chinese government has been aggressively implementing an ambitious plan to make their textile and apparel sector the dominant player in world trade. In pursuit of this goal, the Chinese government has poured tens of billions of dollars into its textile and apparel sector in the form of free capital, direct and indirect subsidies and a host of other "incentives" to create an environment where no one, including the lowest cost-producing countries in the world, can compete with them in world markets.

In this effort, China has largely succeeded. As United Nations trade figures clearly demonstrate, there is essentially no doubt that China is substantially underpricing its textile and apparel exports compared with every other producer in the world. The United Nations COMTRADE database [1] shows that producers in China charge on average 58 percent less for apparel products than do producers in the rest of the world.

Past experience has shown us that in virtually every case where China has gone head to head with other producers, China has captured the market. Typically, China has ended up with a 75 percent share of the market with the next largest supplier getting five percent. The trade figures show that whenever China enters the picture, the free market fundamentals that should drive trade and competition get thrown out the window. Literally, no country is spared. It has not mattered whether you have the benefits of lower labor costs (Bangladesh, Indonesia), duty-free access to a particular market (the Caribbean Basin, Sub-Saharan Africa) or proximity to the U.S. market (U.S. producers, Mexico and the Caribbean). These factors simply do not make a difference when China is part of the equation.

We have seen the same thing happen in the U.S. market. When quotas were removed on a limited number of apparel categories in 2002, Chinese share of market went from 10 percent to 73 percent in less than three years. Chinese exports rose 1,100 percent. As the Commission's own research study has shown, U.S. textile and apparel companies that produced the yarns and fabrics for these products were put out of business as almost 50,000 U.S. textile and apparel workers lost their jobs to surging Chinese imports.[2]

The reason for this is the pervasive intervention of the Chinese government throughout its textile and apparel sector. Because the Chinese government essentially finances the sector—through currency manipulation, central bank loans, subsidies to state-owned enterprises, exports subsidies, tax incentives, reduced electrical costs (among many others)—Chinese exporters are free to drop prices to whatever levels are necessary to get the sale.

This means that as hard as U.S. textile mills or Bangladeshi knitters or Turkish yarn spinners or Mexican trousermakers or African shirt manufacturers improve their businesses, when put head to head with China, they will lose the sale. This fact has proven out time and again in world markets where quotas have not been in place. In Japan, for instance, China has taken 83 percent of the Japanese apparel market. The next largest supplier is Italy with 5 percent.

Producers around the world have tried to compete. U.S. textile mills have one of the highest capital reinvestment rates of any industrial sector. Since the quota phase-out was agreed to in 1994, U.S. Government statistics show that U.S. textile mills have invested more than $34 billion in new plants and equipment. As a result, U.S. textile output per worker has increased by 37 percent over the last ten years, from $44.50 per worker hour to $63.54 per worker hour.

The industry has done what it was supposed to do in order to prepare for the quota phase-out. It has re-invested in its plants and equipment and become even more productive than ever before. In fact, productivity increases in the U.S. textile sector are among the highest of any industrial sectors over the last ten years.

But the textile industry, or any industry, cannot compete against entire governments. We cannot compete against a Chinese government that gives its exporters a 40 percent price advantage because of a rigged currency. We cannot compete against Chinese government banks that provide essentially free cash for plants and

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[1] The United Nations COMTRADE database collects export and import trade data from government around the world: *http://unstats.un.org/unsd/comtrade*.

[2] "U.S.-China Trade, 1989–2003—Impact on jobs and industries, nationally and state-by-state," Economic Policy Institute, January 2005, p. 29. Research commissioned by the U.S.-China Commission.

equipment. We cannot compete against state-owned textile mills that get billions of dollars in government hand-outs each year and never have to show a profit.

And, as mentioned earlier, we are not alone. All across the globe, textile and apparel sectors that provide millions of jobs, mostly in developing and least developed countries, are at risk. A clear recognition of this is that 28 countries stood up at the WTO's Council on Trade in Goods last October and demanded that the WTO take up the issue. Another is the creation of an international coalition of textile and apparel groups—the Global Alliance for Fair Trade in Textiles—which was formed just last March and now includes 96 textile and apparel trade groups from 54 countries representing $150 billion a year in textile and apparel trade. At GAFTT's most recent meeting last week in Washington, the group called for immediate use of the China textile safeguard in order to prevent a China takeover of world trade in these sectors. (See Attachment's 1 and 2.)

When the Chinese government breaks the rules, our government can and should act on behalf of U.S. industry and U.S. workers. The safeguard measures in the WTO were directed specifically towards China because negotiators realized that China in particular did not play by the rules and, as a result, it posed a real threat to textile and apparel sectors around the world.

Finally, before reviewing the data on the threat from China, I would like to suggest some courses of action by the U.S. Government.

First, the safeguards petitions must move ahead quickly or the U.S. Government must self-initiate safeguard actions on its own. Hundreds of thousands of U.S. textile and apparel jobs and millions of workers around the globe cannot be put into jeopardy because a judge in New York has decided to hijack the legitimate relief that was promised to this industry.

Second, the U.S. Government must push for a permanent safeguard mechanism in the Doha Round of trade talks. The most serious flaw in the existing safeguard is that it is currently scheduled to expire in 2008 regardless of whether China ends the unfair trade practices that make the safeguard necessary in the first place. A permanent safeguard must be part of the Doha Round of trade talks.

Third, the U.S. Government must stop talking about taking on China's unfair trade practices—and actually do something to begin addressing this problem. It must impose punitive sanctions of Chinese imports if China does not move quickly to float its currency. It must initiate WTO subsidy cases against China's use of government banks to finance its export machine. It must crack down on continuing massive transshipment and illegal smuggling of Chinese textile and apparel products. It must reverse the Commerce Department position against allowing industry to attack China's subsidy schemes using countervailing duty laws.

Finally, I would like to quote from a perhaps unlikely source, Joe Dixon, the Vice President of production for Brooks Brothers, the major clothing retailer. In a recent article by Apparel Magazine,[3] Mr. Dixon acknowledges that Brooks Brothers sources from all over the world but "as a concerned citizen, [he] says he worries the U.S. manufacturing structure will be forced to dismantle and believes the United States and Europe 'are being very foolish to walk away from our manufacturing base and give up:'"

> We've lost sight of the fact if you outsource everything, you will find it difficult to keep people employed . . . service industries throughout history have been established to support the needs of those employed in manufacturing and other non-service industries.
>
> Dixon points to statistics that show that two-thirds of the U.S. gross domestic product is driven by consumer spending, and questions: What are we going to do when they stop spending? Without jobs, without manufacturing, you've lost the thing that's feeding the engine. What worries me most is that when you put something like this in reverse, it goes into reverse awfully fast.
>
> If the exportation of the textile and apparel industry is the start of a process that leads to the exportation of other U.S. industries, there 'could be a very quick domino effect with disastrous consequences.' If you let market forces dictate where you will source products, you will always find a good reason to import from the lowest cost provider, Dixon says. It will always be the most economically sound option, but in some ways this logic is desperately wrong, he notes, comparing the U.S. economy to a castle built of sand, or a wooden house with termites eating away the foundation. 'Everything looks OK, but its about to fall apart.'

[3] Apparel Magazine, 2/1/05: "China Safeguard Issue Ignites Industry."

The next sections of this testimony will present data evaluating the threat that China poses: (1) the size of China's textile and apparel sector; (2) the government support that China gives to this sector, and (3) China's ability to underprice and overwhelm its competitors, including the U.S. textile industry.

Size and Capacity of China's Textile and Apparel Sector

It is no exaggeration to say that China's textile and apparel sector exists on a scale unimagined in other countries. This sector alone employs tens of millions of workers and supports, directly or indirectly, as many as ninety million workers.[4] Entire cities in China are dedicated to the production of specific types of textile or apparel products. And the textiles and apparel sector, targeted by the Chinese government as a "pillar of the economy," is China's largest earner of foreign exchange of any sector, garnering $65 billion in foreign exchange earnings in 2003.

Today, according to Chinese government reports, China produces more than 20 billion garments a year, enabling China "to offer four pieces of clothing to every person on earth."[5] Its production base has increased by 50 percent in just the last four years. And the Chinese government reports investments of $21 billion in its textile and apparel sector in just the last three years.

The International Trade Commission reports that, in 2001, "China alone accounted for 29 percent (34.7 billion pounds) of the world's total textile fiber production." Keep in mind that China reports that its textile and apparel output has increased by between 40 and 50 percent since that time.[6]

Other Chinese government statistics show that last year there were 3,784 textile plants under construction in China, with $180 billion in outstanding planned investment and $78 billion poured into new production in 2003.[7]

In order to fill these plants with machinery, China has been on a buying spree during the past four years, in some cases consuming up to two-thirds of world production of textile machinery (i.e. broadwoven fabric looms).

Recent information on China's garment industry indicates that China has maintained its enormous pace of expansion through September 2004. Already the world's largest exporter of textiles and apparel, China is reporting a 27 percent increase in production thus far this year.[8]

Chinese Textile and Apparel—Updated Figures through Sept. 04

	Amount	Increase over YTD September 2003
Textile and Apparel production	1,081 billion Yuan	27%
Exports of textiles and apparel	$83.17 billion	20%
—Garments	$44.69 billion	19%
—Textiles	$26.01 billion	27%

Source: CNTC

A new survey of China's apparel manufacturers by Global Sources, a large broker for many of China's exports, found that 89 percent of them were planning to expand output after the global end of apparel quotas. Half of the 215 companies surveyed planned to increase production capacity by 20 to 50 percent, and several other companies indicated intentions to expand capacity by more than 50 percent.[9] The survey found manufacturers were either building new factories or moving to new factories and extending existing factory space or upgrading equipment. All of them said they would be hiring more staff.

An even more recent study of a garment supplier in China found that "over 91 percent of mainland China's garment suppliers are planning to increase their production capacity following the end of quotas next year, according to new research."[10] The 'China Supplier Survey: Summer Garments 2005 Buying Season' interviewed

[4] *China: Stick to WTO Rules, Commerce Minister Urges*, just-style.com, September 20, 2004.
[5] XINHUA news agency (April 14, 2003) "China's garment industry makes important strides."
[6] *Id. See*, ITC discussion of Yarn and Fabric production Capacity, pp. 1-19–1-22 of the ITC Report.
[7] *China Surge Big Topic at Cotton Meet*, Women's Wear Daily, March 3, 2004.
[8] *See table*, "Chinese Textile and Apparel—Updated Figures through Sept. 04," provided by CNTC.
[9] *U.S. Weighs Import Limits on China*, The New York Times, September 11, 2004.
[10] "China: Suppliers to Expand Capacity Post-2005: Survey" Just-style.com, 11/29/04. Petitioners are attempting to secure a copy of this survey, but could not obtain the survey prior to the close of the comment period.

garment manufacturers in China and found that two-thirds expect their capacity to expand by over 20 percent when clothing and textile trade is liberalized at the start of 2005.

According to reports, the survey indicated that 92 percent of suppliers in China expect higher sales for the summer 2005 season. Over half of the respondents plan to expand capacity by 20 to 50 percent by taking on more employees and developing their factories and/or buying extra machinery. The survey also found that one-third of the suppliers surveyed are planning to create, or are already building, new garment manufacturing plants.

The capability for further apparel production increases unnerves even some of China's own operators, such as Wang Hequing, owner of Ningbo Hongli, who jokes that China's ability is "scary." "We could make 100 million t-shirts for $1 each—half the U.S. population could have one of our t-shirts. And how many factories are there in China like us? Thousands!" [11]

China's Government Support of its Textile and Apparel Industry

As the Commission has already noted, the Chinese government engages in a variety of unfair and anti-competitive trade practices that make it difficult, if not impossible, for either U.S. manufacturers or other manufacturers, to compete.

In textiles and apparel, government involvement is pervasive in China. China has declared textiles and apparel to be a "pillar industry of the nation" and China's textile and apparel output is actively managed through Five-Year Plans going back almost 50 years, and the Tenth Five-Year Plan concludes in 2005.[12] In its most recent five-year plan, China establishes government objectives for virtually every segment of the industry.[13]

According to the most recent Textile Five-Year Plan, 46 percent of textile assets are state-owned, and 31 percent of all state-owned enterprises are operated at a loss.

For its part, the U.S. Government has long acknowledged that China does not play fair in textiles and apparel. In a recent WTO submission, the U.S. Government noted that China provides assistance to its textile sector in numerous ways, including "the manufacturing of raw materials, the financing of mill establishments and the purchase and selling of raw materials." [14]

China's other unfair trade practices affecting textiles and apparel include currency manipulation, forgiveness of loans from state-owned banks, favorable bank terms for "honourable enterprises" which target export industries, export-contingent tax incentives for foreign-invested enterprises (FIEs), income tax refunds for foreign investors in export-oriented businesses, income tax reductions equal to 50 percent for FIE's in export-oriented businesses, VAT refunds for imported capital equipment used for export-oriented businesses, grants by individual provinces for export-oriented industries and continued subsidies for state-owned enterprises which are running at a loss [15] and subsidies for coal and oil supplied to Special Industrial Sectors (such as textiles and apparel).

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[11] Asia Pulse, 5/1/2003.

[12] "Industry Overview: The Tenth Five-Year Plan of the Textile Industry and its Development," BizChina, 11/18/2004.

[13] The Tenth Five-Year Plan contains objectives for all aspects of the textile and apparel sector. These include:

1. Annual growth rate
2. Industrial value growth rate
3. Growth rate for foreign exchange to be earned
4. Proportionate growth for different textile and apparel sectors
5. Labor productivity growth
6. Energy consumption
7. Water consumption
8. Renovation and upgrade of the cotton spinning sector
9. Renovation and upgrade of the wool yarn and weaving sector
10. Renovation and upgrade of the silk and linen sector
11. Renovation and upgrade of the knitted textile sector
12. Renovation and upgrade of the chemical fibers sector
13. Renovation and upgrade of the industrial textile sector
14. Renovation and upgrade of the industrial textile machinery sector
15. Renovation and upgrade of the dyeing and finishing sector
16. Renovation and upgrade of the apparel sector, including the expansion of exports and development of branded and children's apparel.

[14] Ibid.

[15] China committed to end these subsidies as part of its accession agreement and reported that all had been terminated as of 2002. However, recent Chinese government reports indicate that these subsidies are still in place and that money-losing enterprises continue to be sup-

Continued

China's Ability to Underprice and Overwhelm Its Competitors, Including the U.S. Textile Industry

The threat that China poses to U.S. textile and apparel companies and their workers can be assessed in a number of ways. These include a review of: (A) China's prior behavior in textile and apparel categories removed from quota control in 2002; (B) China's penetration of textile markets outside of the United States; (C) China's pricing on the worldwide market for textile and apparel products; (D) analyses and studies by international groups on China's domination in a post-quota world; (E) statements by importers and retailers about their sourcing intentions once quotas are removed.

It is significant that all of these perspectives come to the same conclusion—China will dominate trade in textiles and apparel in a quota-free world. Estimates for the size of that domination begin at around 50 percent and increase upwards to between 70 and 75 percent. Correspondingly, the impact on the U.S. textile and apparel sector from such a scenario is severe, with U.S. production plunging by two-thirds and job losses of 500,000 workers or more. The United States is not the only victim—job losses worldwide may be as large as 30 million with developing and least-developed countries bearing most of the cost.

China's Prior Behavior in Textile and Apparel Categories Removed From Quota Control in 2002

In 2002, as part of the phase-out of worldwide quotas, a relatively small number of textile and apparel categories were removed from quota control. The bulk of textile and apparel categories—80 percent of trade—remained under quota restraint until January 1, 2005.

In particular, 25 apparel categories and 115 home furnishing and made-up[16] tariff lines saw quota protection removed. This early quota phase-out provides a preview of how the rest of the world—including U.S. textile and apparel manufacturers—might fare now that all quotas have been removed.

The result in 2002 was a quick and devastating flood of apparel imports from China in quota-free products. According to Department of Commerce figures, in less than three years, China's exports took a 73 percent share of the U.S. apparel market in the quota-free categories, with exports from China rising more than 1,100 percent (see Attachment 3).

On the home furnishing and made-up product lines, China took a 60 percent share of the U.S. market as exports from China increased more than 900 percent. China's share in these textile and apparel products is continuing to increase today.

In volume terms, China's export increases were unprecedented, with China's total increases into the U.S. market in just three years totaling nearly 4 billion square meters.[17] In comparison, China's increase in this relatively small number of categories was as large as the entire exports of the second largest supplier to the U.S. market, Mexico, which shipped 4.1 billion square meters in 2004. China's increase was larger than the total textile and apparel export from every other country in the world.

The flood of apparel exports from China was driven by a sudden, drastic decline in China's prices for these goods once quotas were removed. In apparel categories, China dropped prices by an average of 53 percent while for "made up" products, Chinese price declines averaged almost 60 percent.

As China's exports soared, every other major supplier saw its market share drop sharply, falling by half or two-thirds. Countries such as Mexico, Honduras and Lesotho with free trade area and tariff preference benefits saw their exports in these products fall as dramatically as non-preference countries. This clearly demonstrates that China will take markets regardless of whether countries are beneficiaries of duty-free access to the U.S. market.

China's Penetration of Textile and Apparel Markets Outside of the United States

With quotas in place, China's penetration of the U.S. (and European) markets has remained relatively low. In U.S. textile and apparel categories which have had quotas in place, China's market share has generally been below ten percent.

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ported. This includes one report that up to 47 percent of state-owned enterprises in the textile sector are running at a loss.

[16] Includes curtains, napery, tenting, bags, sailcloth, cordage, ropes, twine and bags, among other items.

[17] China increased its exports of apparel products by 1.3 billion square meters and its exports of home furnishing products by 2.6 billion square meters.

However, United Nations trade figures show that in countries where China has not been restrained, China has achieved a virtual monopoly of textile and apparel trade. Of particular interest to U.S. textile and apparel manufacturers is Japan and Australia. These are highly developed countries with strong consumer markets similar to those in the United States. The U.N. database shows China's share of these markets at 83 percent with China's textile and apparel exports totaling $16.5 billion in 2003 (See Attachment 4). The next largest supplier is Italy with a five percent market share and $1 billion in exports. Following Italy is Korea with a 1.5 percent market share.

U.N. figures show that China has repeated this domination around the world. China's market share outside the United States and the European Union averages 63 percent with China's exports totaling $37 billion and the 100 plus countries making up the rest of the world exporting only $23 billion. The next largest competitor to China in this quota-free environment is Italy with a 6 percent share. The United States ranks third with a 3 percent market share (See Attachment 5).

China's Pricing in the Worldwide Market for Textile and Apparel Products

The following excerpts from a December 2003 study by the Jassin-O'Rourke Group [18] details how China is able to sell goods at prices often below the cost of the production:

> To date, major countries such as China . . . generally take[s] little or no profit on exported products, in order to generate hard currency and maintain capacity utilization levels; actual import statistics (average price per garment) for core products, compared to typical garment cost analysis, provide further validation of this, and in fact, suggest that some product is sold well below possible cost.
>
> Additionally, a vast majority of China's apparel manufacturers are financed by government banks, and fail to repay loans; it is a widespread and typical practice to "forgive" outstanding debts of apparel firms. *Such practice contributes to China's apparel export pricing strategies that effectively encourage sale of products at whatever value is necessary to capture and/or maintain business; in our experience, such pricing is clearly below possible manufacturing costs for given garments.* These hidden subsidies can have a significant impact on the profitability or competing opportunities of the exporting companies.

Exporters in China appear to agree that they lack a reputation for fair pricing. The China Textile News Company warns that "malicious price competition" in order to earn foreign currency could invite retaliation by trading partners.

> "Major textile companies and organizations said a mechanism to control export prices should be set up to prevent malicious prices competition after quotas are removed in 2005." . . . Export prices of clothing have dropped by about 30 percent since five years ago. Price of shuttle-woven garment fell by 27 percent and those of knitwear by 33 percent, according to Xu Xiaochuan from the Sichuan Xinlixin Textile Company.
>
> A senior official from the China Chamber of Commerce of Import and Export for Textiles echoed Xu, saying malicious price competition should be stopped because it merely invited international criticism and trade protectionism that would target the whole industry. . . . **To push exports up and pull in more foreign currency, many domestic companies run down their export business with fierce price cutting as they get more freedom with the gradual lifting of quotas.**[19]

United Nations database tends to verify the Jassin-O'Rourke conclusions and China's own acknowledgement of their pricing strategies. COMTRADE shows that China charged, on average, 58 percent less for exports of trousers, shirts and underwear than did all other suppliers (See attachment 8). These trouser, shirt and underwear product groupings represent the bulk of apparel production worldwide.

According to the U.N. data, China's prices averaged $1.84 per garment compared to an average "rest of world" price of $4.42 per garment. China's disparity with U.S. producer prices was even greater, with China's prices averaging 76 percent lower than U.S. producer prices ($1.84 per garment vs. $7.63 per garment) (See Attachment 6).

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[18] "Merits of A Free Trade Area Of The Americas," December 2003. The Jassin-O'Rourke Group has been providing consulting advice in textile and apparel sourcing to leading retailers, manufacturers and sources for more than twenty years.

[19] *Textiles Warn of Price War Damage*, China Textile Network Company, 8/23/04.

The U.N. data also showed that China's market share for these product categories in non-quota countries averaged 58 percent, with China's share in Japan and Australia averaging 88 percent. China's worldwide market share has been increasing rapidly over the past five years as China has ramped up production and increased exports by 76 percent.

The actual size of China's worldwide exports of these products is simply astounding. According to the U.N., China exported 2.9 billion shirts, 2.5 billion trousers and 3.6 billion pieces of underwear in 2003, the latest year that information is available.

Economic Analyses and Studies by Institutional Groups on China's Domination in a Post-Quota World

Virtually every study produced by private consulting groups, governments and international agencies has concluded that once quotas are removed, China will rapidly increase its share of world trade in apparel, and the U.S. market will be the largest recipient of these exports. These studies include:

Goldman Sachs: "China's Textile/Apparel Manufacturing: The Big Bang in 2005," June 2004.

Goldman Sachs concludes that "without quotas, China's exports are set to expand immediately" and that "China has the ability to grow its textile and apparel exports rapidly once trade barriers are removed."

The Sachs study cites China's domination of similar sectors "such as footwear or toys or sporting goods—equally labor-intensive and low-value added" with China's market shares of 66 and 67 percent as an example of the kind of market control China can assert. The study also cites the development of a "complete food chain in textile and apparel manufacturing" in China and the likelihood that "once quotas are removed, wholesalers and retailers are likely to immediately consolidate their orders."

The study concludes that "we expect a rapid increase in textile and apparel manufacturing" from China and warns that "China is likely to have rapid market dominance in certain products, and exert tremendous price pressure and destructive power on other exporters as well as domestic manufacturers in the importing countries once quotas are removed."

The study also concludes that safeguard measures *based on market disruption* are not likely to be successful because of China's ability to rapidly capture market share. Sachs says that such safeguards may be approved but because "there is likely a lead time for China's exports to prove to be market disruptive, and by which time, China's exports in these product may already be very substantial."

World Trade Organization, Hilegunn Nordds: "The Global Textile and Clothing Industry Post the Agreement on Textiles and Clothing," 2004.

Nordds concludes "the predicted changes (from quota elimination) are a substantial increase in market shares for China and India, while previously unrestricted (no quota or non-binding quotas) countries will lose market share as well as *local producers in North America* and the European Union." [emphasis supplied]

Using a GTAP general equilibrium model, Nordds predicts that China (including Hong Kong) "triples its share" and takes a 56 percent share of the U.S. import market for apparel while Mexico and the rest of Latin America loses 70 percent, with the Mexican share falling to 3 percent (from 10 percent) and the South and Central American share falling to 5 percent (from 16 percent).

Nordds also notes the consensus view among researchers: "Most analyses of the phasing out of impact of the ATC conclude that China and India will come to dominate world trade in textiles and clothing, with post-ATC share of China alone estimated at more than 50 percent or more. This study replicates those predictions."

United States International Trade Commission, Publication 3671: "Assessment of the Competitiveness of Certain Foreign Suppliers to the U.S. Market."

The United States International Trade Commission study of the impact of the quota phase-out concluded that "China is expected to become the 'supplier of choice' for most importers because of its large ability to make almost any type of textile and apparel product at any quality at a competitive price." The Commission cited importers who said "there is no garment that they would not make in China."

The Commission also concluded a primary reason that importers were unlikely to concentrate sourcing entirely in China was "because of uncertainty over the use by the United States of the textile-specific safeguard provision."

The Commission reviewed a number of recent studies concerning the quota phase-out, all of which predicted a large increase in Asian market share (China share was not generally extrapolated). One study by Avisse and Fouquin (2001) extrapolates China's apparel exports, predicting that it would jump 87 percent once quotas are removed.

The Commission noted many reasons for China's predicted dominant position, including that "China is the world's largest producer and exporter of textiles and apparel and it has invested more in spinning and weaving equipment than any other country during the last five years. Moreover, China's huge supply of inexpensive labor and skilled sewers, coupled with access to indigenous raw materials, has enabled China's textile and apparel industries to remain highly price competitive and attract foreign direct investment in facilities and technologies."

The World Bank, Elena Ianchovichina and Will Martin: "Trade Liberalization in China's Accession to the World Trade Organization," 2001.

The World Bank study concludes that China will gain a 47 percent share of the world's export market in apparel once quotas are removed. While the study does not break out the U.S. import market, most studies and commentators agree that the U.S. import market is more susceptible to import penetration by China than others because of its "big box" retail concentration, intense price competition and long standing ties that U.S. importers and retailers have already developed with China.

The World Bank concludes that "the most important impact of [WTO accession] is on China's output of apparel" and predicts that production of apparel in China, which is already by far the largest producer in the world, will increase by 57 percent once quotas are removed.

McKinsey & Company—DHL: "DHL-McKinsey Apparel and Textile Trade Report," March 2004.

The McKinsey study concluded that China will account for 50 percent of world apparel exports once quotas are removed, noting that "many commentators have expressed concern that China will wipe out less competitive exporting countries." McKinsey concludes that China's apparel export market share will grow from 12 percent to 50 percent in four years time, with actual value of apparel exports from China increasing by $72 billion to $126 billion by 2008.

Statements By Importers and Retailers About Their Sourcing Intentions Once Quotas Are Removed

Executives that make the sourcing decisions regarding textile and apparel products have been virtually unanimous that imports from China into the U.S. market will dramatically increase once quotas are removed.

Of these statements perhaps most significant was a confidential survey earlier this year of top U.S. executives for major importing and retailing firms who predicted that China would dominate trade in apparel once quotas are removed. The poll, which was conducted in January at the Cotton Sourcing Summit in Miami, asked what percentage of the U.S. apparel market China would take once quotas were removed. Eighty-seven percent of the respondents said China's share would exceed 50 percent, and half of those predicted that China would gain between 75 and 90 percent.

Regarding major suppliers, 96 textile and apparel trade associations from 54 countries around the world have joined together in the Global Alliance for Fair Trade in Textiles (GAFTT) to raise concerns about China's ability to disrupt markets around the world once quotas are lifted. Citing member concerns, GAFTT recently stated: "Since China joined the WTO at the end of 2001, it has engaged in a premeditated and systematic effort to monopolize world trade in textiles and clothing by undercutting fair market prices through a complex scheme of industrial subsidization and currency manipulation" and that "China has used and continues to use the following unfair trade practices to artificially undercut the prices of every other country in the world."

Regarding sourcing agents, one leading sourcing executive recently sketched his scenario for the end of quotas and China's likely response. In a Women's Wear Daily article, Robert Zane, of Liz Claiborne, described why China would move to quickly flood the U.S. market. Zane, who is Senior Vice President of sourcing, distribution and logistics at New York-based Liz Claiborne Inc., said the likelihood of safeguards will probably prompt a flood of Chinese goods into the U.S. market starting in January.

> "We should not underestimate what many Chinese factories will do at the end of this year to prepare to ship early next year," he told the group of mill, importer and apparel manufacturer executives. "They will be looking for incentives to offer their buyers."
>
> In a later interview, Zane said price cuts of as much as 20 percent might be reasonably expected in the opening months of the year. *He added that for a brief period companies might resort to selling goods at or below cost to drive volume.*

> Chinese exporters will be looking to quickly fill their order books for a simple tactical reason, Zane said. The U.S. is allowed to impose one-year safeguard quotas that would limit Chinese exports in any given category to no more than 7.5 percent higher than the volume of goods imported over the past year. *Even a few months of sharply higher imports could lead to significantly higher safeguard quotas*.

In a complaint filed in the U.S. Court of International Trade on December 1, 2004,[20] the United States Association of Importers of Textiles and Apparel[21] (the "USA–ITA") stated to the Court that even allowing CITA to accept this petition for investigation harmed and aggrieved its members[22] because of the lead time necessary to enter into contracts to purchase textiles and apparel from China, which it indicated could be anywhere from 120 to 160 days.[23]

The USA–ITA indicated that its members had entered into contractual relationships concerning the subject products and "are now forced to modify their current sourcing plans—*i.e.* move such orders outside China. . . ."[24]

The USA–ITA also stated to the Court that its "members purchase and import into the United States textile and apparel products, and have entered into or intend to enter into contractual relationships for the purchase and import of such products. These products include goods that are the subjects of domestic petitions—filed October 13, 2004. . . ."[25] The original safeguard request concerning the subject products was filed October 13, 2004.

The USA–ITA goes further and indicates that its members have already placed orders for January delivery from China as it indicates that apparel ordered now would be for delivery in the third quarter of 2005. USA–ITA also clearly indicated its belief that imports from China of the subject products would grow dramatically as it argued to the Court that "quotas covering such products may be filled and closed by the third quarter of 2005."[26] USA–ITA believes that any safeguard limits imposed on the subject products would be filled by the third quarter of 2005, *even though those limits would necessarily be 7.5 percent greater than imports in 2004*. USA–ITA, therefore, essentially admitted to the Court of International Trade that it is convinced imports of the subject products will increase significantly once quotas are removed.

Other leading retail, importing and sourcing executives have regularly expressed their own expectations regarding how China will quickly move to dominate the U.S. market:

South China Morning Post 6/11/04—"A lot of importers in the U.S. and Europe are placing huge orders for basic items like jeans and polo shirts, in anticipation of the lifting of quotas. These importers want to grab market share. These are not normal purchases but speculative. In the end they may depress prices and prompt dumping."—Hong Kong Textile Council Vice Chairman Willy Lin Sun-mo

Bloomberg News 8/4/04—Bruce Rockowitz, an Executive Director at Hong Kong-based Li & Fung, which sources clothing worldwide for retailers including American Eagle Outfitters and Abercrombie and Fitch, estimates that 70 to 80 percent of all clothing production will move to China after January 1. Mr. Rockowitz said that the Li & Fung has seen a sharp rise in U.S. orders for Chinese clothing. "The surge probably reflects fears that the U.S. will impose anti-surge quotas on Chinese clothing," stated Rockowitz.

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[20] *U.S. Association of Importers of Textiles and Apparel v. United States*, et al., Complaint filed in the U.S. Court of International Trade, Court No. 04–00598, dated December 1, 2004.

[21] "USA–ITA is a person who has been 'adversely affected or aggrieved by agency action within the meaning of section 702 of title 5.' 28 U.S.C. § 2631(i). USA–ITA members purchase and import into the United States textile and apparel products, and have entered or intend to enter into contractual relationships for the purchase and import of such products," *supra* note 21 at paragraph 6.

[22] "USA–ITA is a non-profit industry association representing the interests of the textile and apparel importers before Congress, the Executive Branch, the judiciary, the business community, and the public." *U.S. Association of Importers of Textiles and Apparel v. United States, supra* note 21, paragraph 5.

[23] "The nature of the business is such that importers typically need lead times of 120 to 160 days to place and receive orders," *supra* note 21, paragraph 41.

[24] *U.S. Association of Importers of Textiles and Apparel v. United States, supra* note 21, paragraph 42.

[25] *U.S. Association of Importers of Textiles and Apparel v. United States, supra* note 21, paragraph 6.

[26] *U.S. Association of Importers of Textiles and Apparel v. United States, supra* note 21, paragraph 41.

Financial Times 7/20/04—Bob Zane, head of global sourcing and manufacturing for Liz Claiborne, told the Financial Times that he expects Liz Claiborne to halve the number of countries from which it sources clothes in the next three to four years. In the process, China's share of company direct overseas sourcing will go from about 15 percent to about half, a ratio that Zane expects other big U.S. purchasers will match. He sees China becoming "the factory of the world."

Textile Asia, June 2004—Alex To Man-yau, head of Chinese operations for Hong Kong trade facilitator, Trade Easy, said: "We are seeing a lot of inquiries and orders for Chinese garments from the U.S., Europe and Canada." Mr. To said that the average value of orders placed through his firm for Chinese garments by U.S., Canadian and European buyers has increased fivefold this year over last year."

Textile Asia, June 2004—Mr. Neeraj Sawhney, a Director for the Hong Kong textile trade, Topnet International, said: "There are many more queries for orders and shipments of Chinese garments from the U.S. for 2005 and beyond."

Textile Asia, July 2004—Steven Feninger, Chief Executive of Linmark Group, a trading firm, said: "Garment orders are rushing to the Mainland from Southeast Asia and Central America in anticipation of the lifting of global textile quotas next January. The scale of the move to China is going to affect national economies." Linmark notes that "once textile quotas are eliminated under World Trade Organization rules, buyers are expected to shift en masse to cheaper Chinese goods." Linmark estimated "that the proportion of its sourcing from Mainland, Hong Kong and Taiwan will rise to 70 percent in two years."

Attachment 1

GLOBAL ALLIANCE FOR FAIR TEXTILE TRADE (GAFTT)

96 Trade Groups from 54 Countries Supporting Fair Trade for a Safer World

GAFTT Urges United States to Approve
Textile and Clothing Safeguard Petitions Filed by U.S. Industry

October 12, 2004

The Global Alliance for Fair Textile Trade (GAFTT), a coalition of 96 textile and clothing manufacturing trade associations from 54 countries, urged the U.S. Government to approve the threat-based textile China safeguard petition filings announced by the U.S. textile and clothing industry on October 12, 2004. GAFTT, a coalition that counts amongst its members textile and apparel producers from some of the poorest developing countries in the world, stated:

The U.S. Government must approve the petitions if millions of textile and clothing manufacturing workers from around the globe are not to see their jobs destroyed and moved to China. If approved, these safeguard petitions will prevent China from taking more than $37 billion in textile and apparel exports in these items which are currently being supplied by dozens of other countries. If the U.S. does not act, China will use currency manipulation and other unfair trade practices to quickly dominate these markets. China already has taken more than 70 percent of the U.S. clothing and textile home furnishings import market in the categories that were removed from quota control just two and a half years ago. China accomplished this by dropping its prices by an average of 53 percent, far below the cost of other suppliers.

The prospect of catastrophic job losses in exporting countries around the world represents a crisis of global proportion. Many of the countries at risk of losing textile and clothing exports have no other viable economic sectors into which they can transition ten of thousands—in some cases, hundreds of thousands—of unemployed manufacturing workers. That is why nearly 30 countries stood up at the WTO Council on Trade in Goods meeting on October 1 and expressed support for governments to take special measures to prevent job losses, particularly those in least developed countries, caused by the near-certainty of China flooding world markets after quotas expire on January 1st, 2005.

The United States represents by far the largest market for imported textile and apparel products, and, as a consequence, the U.S. Government bears a special responsibility to prevent China from hurting the export sectors from dozens of countries from around the world. Textile and clothing manufacturing industries in truly developing countries will be severely damaged or destroyed unless the U.S. Government acts to approve these safeguard measures.

Moreover, China is also expected to surge into the European Union, Canadian and other developed and developing world markets, causing additional substantial job losses worldwide. GAFTT also calls on these countries to use their special textile China safeguards too.

Statements by GAFTT Members from Turkey, Mexico, Bangladesh, Peru and Swaziland follow:

"The need for a comprehensive and immediate WTO solution to the international crisis in textile and clothing trade is well understood by much of the world. The quota system has worked precisely as intended, encouraging the development of private-sector textile and clothing manufacturing industries in all corners of the globe. Now much of that development stands at the brink of destruction unless the U.S. Government uses its safeguards in a timely and effective manner. The relief provided by the safeguards will help give the WTO the time necessary to address the negative impact of the worldwide expiration of quotas on textile and clothing products" said Ziya Sukun, Executive Director of ITKIB Association of New York, a trade association representing Turkish textile and clothing manufacturing interests.

"The Mexican textile industry supports the imposition of safeguards on imports from China in the product categories identified by the U.S. industry on October 12. These products represent more than 80 percent of Mexican exports of apparel to the United States. If these safeguards are not approved, the market disruptions associated with a surge in imports from China will clearly have a serious impact on the textile and apparel industry in Mexico. At the same time, however, we also can anticipate significant adverse impacts on the production of fiber, yarn, and fabrics in the United Sates as well, because the Mexican textile industry is one of the prin-

cipal export destinations for these U.S. products," stated Nora Ambriz Garcia, Director General of the Camera Nacional de la Industria Textil (CANAINTEX). Continued Ambriz, "The Governments of the United States and Mexico have recently renewed their mutual commitment to the NAFTA integration process, with specific reference to the textile industry in the hemisphere. CANAINTEX joins with our colleagues in the U.S. textile industry in asserting that the vigorous use of safeguard actions to combat unfair Chinese competition is essential to preserving a competitive textile and apparel industry in the U.S. and in Mexico."

"These safeguard actions are the only effective way to stop China from flooding markets around the world. In Peru, Chinese imports threatened the economic survival of our industry and we were forced to take similar measures. We strongly support the U.S. industry in its effort to obtain safeguards and also urge other countries around the world to apply them as well," said Jorge Mufarech Babin, Presidente of the Comite Textil de la Sociedad Nacional de Industries del Peru.

"BKMEA strongly supports the use of safeguards by the U.S. Government. They are critical to preventing massive job losses in the Bangladesh apparel sector once quotas are removed. Unless the U.S. industry's petitions are granted, much of our workforce could lose their jobs as orders are shifted quickly to China. These safeguards will stop such a disaster from happening and we urge the U.S. Government to approve them," stressed Fazlul Hoque, Chairman of Bangladesh Knitwear Manufacturers & Exporters Association (BKMEA).

"Swaziland's clothing industry is almost entirely dependent on apparel exports to the United States. If these safeguards are not used, the damage will be extreme and thousands will lose their jobs. Swaziland's clothing industry was established only four years ago with the introduction of the African Growth and Opportunity Act (AGOA), a free-trade agreement between the United States and developing countries in Sub-Saharan Africa. We are a fledgling industry employing close to 30,000 workers, most of whom are young females that had no previous work experience or job opportunities before the clothing industry came along. We have been able to compete and grow with AGOA, but stand no competitive chance against a Chinese government so willing to subsidize industry so massively. We ask that the U.S. Government save AGOA and our jobs by approving the U.S. industry's safeguard requests," pleaded Robert Maxwell of the Swaziland Textile Exporters Association (STEA).

"Just this past month three factories in Swaziland have closed due to lack of orders and all but four out of 25 factories have given their employees reduced hours or have shut down production for short periods of time during the past eight weeks. The second largest factory in the country, a facility that employs over 2,000 workers under a single roof, recently informed me that this week they will close for two weeks minimum, as they have no work. The clothing manufacturing industry in Swaziland is on a knife's edge," continued Maxwell.

Textile and Clothing Trade Associations
Endorsing the Istanbul Declaration as of September 1, 2004

Argentina—Federacion Argentina de Industrias Textiles (FADIT–FITA)
Austria—Association of the Austrian Clothing Industry
Austria—Fachverband der Textilindustrie Osterreichs (Die Textilindustrie)
Austria—Eurocoton
Austria—Vereinigung Textilindustrie
Austria—Joint Committee of the Textile Finishing Industry in the EU (CRIET)
Bangladesh—Bangladesh Textile Mills Association (BTMA)
Bangladesh—Bangladesh Knitwear Manufacturers & Exporters Association (BKMEA)
Bangladesh—The Federation of Bangladesh Chambers of Commerce and Industry
Bangladesh—Bangladesh Terry Towel & Linen Manufacturers and Exporters Assoc.
Belgium—Federation Belge de L'Industrie Textile (FEBELTEX)
Belgium—Eurocoton
Belgium—Joint Committee of the Textile Finishing Industry in the EU (CRIET)
Belgium—International Association of Users of Artificial and Synthetic Filament Yarns and of Natural Silk (AIUFFAS)
Bolivia—Asociacion Nacional de Textileros de Bolivia
Bolivia—Federacion Textil Andina
Botswana—Botswana Export Development and Investment Authority (BEDIA)
Bulgaria—Association of Apparel and Textile Exporters in Bulgaria

Bulgaria—Bulgarian Association of Textile and Clothing
Bulgaria—Bulgarian Industrial Chamber
Bulgaria—Bulgarian Chamber of Commerce and Industry
Chile—Instituto Textil de Chile—Asociacion Gremial
Colombia—Asociacion Colombiana de Productores Textiles (ASCOLTEX)
Colombia—Federacion Textil Andina
Costa Rica—Costa Rica Textile Chamber
Costa Rica—Textile Quota Council
Czech Republic—Association of Textile-Clothing-Leather Industries
Dominican Republic—Dominican Free Zones Association (ADZONA)
Denmark—Joint Committee of the Textile Finishing Industry in the EU (CRIET)
Ecuador—Asociacion Textil del Ecuador (AITE)
Ecuador—Federacion Textil Andina
El Salavador—Union de Industrias Textiles
France—Eurocoton
France—Federation Francaise des Industries Lainiere et Cotonniere (FFILC)
France—Union Francaise des Industries de l'Habillement (UFIH)
France—Union des Industries Textiles (UIT)
France—Joint Committee of the Textile Finishing Industry in the EU (CRIET)
France—International Association of Users of Artificial and Synthetic Filament Yarns and of Natural Silk (AIUFFAS)
Germany—Eurocoton
Germany—Industrievereinigung Garne—Gewebe Technische Textilen
Germany—Joint Committee of the Textile Finishing Industry in the EU (CRIET)
Ghana—Gold Coast of Ghana
Greece—Association des Industries Cotonnieres de Grece
Greece—Hellenic Fashion Industry Association
Greece—Eurocoton
Greece—Panhellenic Union of Cotton Ginners and Exporters
Indonesia—Himpunan Pengusaha Kecil & Koperasi—Tekstil and Produk Tekstil (HPKK–TPT)
Indonesia—Asosiasi Industri Rakyat (AIR)
Indonesia—API DKI JAYA—Indonesian Textile Association of Greater Jakarta
Israel—The Manufactures' Association of Israel, Fashion & Textile Industries Assoc.
Italy—Associazione Italiana Industrie della Filliera Tessile Abbigliamento (AIIFTA)
Italy—Associazione Tessile Italiana (ATI)
Italy—Eurocoton
Italy—Joint Committee of the Textile Finishing Industry in the EU (CRIET)
Italy—International Association of Users of Artificial and Synthetic Filament Yarns and of Natural Silk (AIUFFAS)
Ivory Coast—Agency for the Promotion of Exports (APEX–CI)
Jordan—Jordan Garments, Accessories & Textile Exporters Association (JGATE)
Kenya—Kenya Apparel Manufacturers Exporters Association
Kenya—Kenya Association of Manufacturers—Textile Sector (KAM)
Latvia—Association of Textile and Clothing Industry
Lesotho—Lesotho Textile Exporters Association
Lithuania—Lithuanian Apparel and Textile Industry Association
Madagascar—Madagascar Export Promotion Association (GEFP)
Mauritius—Mauritius Export Processing Zone Association (MEPZA)
Mauritius—Mauritius-U.S. Business Association (MUSBA)
Mexico—Camera Nacional de la Industria Textil (CANAINTEX)
Mexico—Cámara Nacional de la Industria del Vestido (CNIV)
Mexico—Cámara Mexicana de la Industria Textil Central
Mexico—Cámara Textil de Occidente
Namibia—Namibian Investment Authority
Nepal—Garment Association of Nepal (GAN)
Netherlands—Joint Committee of the Textile Finishing Industry in the EU (CRIET)
Norway—Joint Committee of the Textile Finishing Industry in the EU (CRIET)
Paraguay—Cámara Textil Paraguaya
Peru—Comité de Confecciones de la Sociedad Nacional de Industrias del Perú
Peru—Comite Textil de la Sociedad Nacional de Industries del Peru
Peru—Federacion Textil Andina
Philippines—Confederation of Garments Exporters of the Philippines
Poland—The Gdynia Cotton Association
Poland—Polish Textile and Clothing Chamber
Poland—Polish Chamber of Textile Industry
Poland—Union of Employers of Textile Industry
Portugal—Federation of Portuguese Textile and Clothing Industry (FITVEP)

Portugal—Textile and Apparel Association of Portugal (ATP)
Senegal—Agency for the Promotion of Investments and Exports (APIX)
Slovenia—Chamber of Commerce and Industry of Slovenia, Textiles, Clothing and Leather Processing Association
South Africa—Clothing Trade Council of South Africa (CloTrade)
South Africa—Export Council for the Clothing Industry in South Africa
South Africa—South African Textile Industry Export Council (SATIEC)
South Africa—Textile Federation of South Africa (TEXFED)
Spain—Agrupacion Espanola de Desmotadores de Algodon (AEDA)
Spain—Asociacion Industrial de Proceso Algodonero (AITPA)
Spain—Consejo Intertextil Espanol
Spain—Eurocoton
Spain—International Association of Users of Artificial and Synthetic Filament Yarns and of Natural Silk (AIUFFAS)
Sri Lanka—Joint Apparel Association Forum
Sri Lanka—National Apparel Exporters Association
Swaziland—Swaziland Investment Promotion Authority (SIPA)
Swaziland—Swaziland Textile Exporters Association (STEA)
Switzerland—Eurocoton
Switzerland—Swiss Spinning Committee
Switzerland—Joint Committee of the Textile Finishing Industry in the EU (CRIET)
Switzerland—International Association of Users of Artificial and Synthetic Filament Yarns and of Natural Silk (AIUFFAS)
Tanzania—Tanzania Investment Center (TIC)
Tunisia—Federation Nationale de Textile (FENATEX)
Turkey—Turkish Textile and Raw Materials Exporters Association (ITKIB Textiles)
Turkey—Turkish Ready Wear and Garments Exporters Association (ITKIB Apparel)
Turkey—Turkish Clothing Manufacturers Association (TGSD)
Turkey—Turkish Textile Employers Association (TUTSIS)
Turkey—Eurocoton
Turkey—Joint Committee of the Textile Finishing Industry in the EU (CRIET)
Turkey—International Association of Users of Artificial and Synthetic Filament Yarns and of Natural Silk (AIUFFAS)
United Kingdom—Joint Comte. of the Textile Finishing Industry in the EU (CRIET)
United Kingdom—International Association of Users of Artificial and Synthetic Filament Yarns and of Natural Silk (AIUFFAS)
United States—American Manufacturing Trade Action Coalition (AMTAC)
United States—American Yarn Spinners Association (AYSA)
United States—National Cotton Council (NCC)
United States—National Council of Textile Organizations (NCTO)
United States—National Textile Association (NTA)
Uruguay—Asociacion de Industrias Textiles del Uruguay
Venezuela—Asociacion Textil Venezolana (ATV)
Venezuela—Federacion Textil Andina
Zambia—Export Board of Zambia
Zambia—Textile Producers Association of Zambia

Attachment 2

GLOBAL ALLIANCE FOR FAIR TEXTILE TRADE (GAFTT)

96 Trade Groups from 54 Countries Supporting Fair Trade for a Safer World

Global Alliance Presses Governments and WTO to Halt Chinese Monopolization of Global Trade in Textiles and Clothing

3rd International Summit—Washington D.C.—January 26, 2005

WASHINGTON, D.C.—Representatives from the Global Alliance for Fair Trade in Textiles (GAFTT) and government officials from 25 countries met on Wednesday, January 26 in Washington, D.C. to discuss a coordinated international response to the crisis associated with the worldwide expiration of quotas on textiles and clothing. Private briefings for U.S. Government officials and the U.S. Congress are planned for later on Wednesday and on Thursday morning.

GAFTT represents 96 trade groups from 54 countries that exported over $170 billion in textile and apparel products in 2003. It issued the following communiqué from the 3rd International Textile Summit:

By allowing worldwide quotas on textiles and clothing to expire without adequate measures in place to prevent the rapid monopolization of the market by a small number of countries through the use of unfair trade practices, the World Trade Organization (WTO) has allowed global trade in textiles and clothing to become severely disrupted. Absent immediate and responsible action by individual governments, up to 30 million jobs around the world will be lost to China and the continued development of a fair and beneficial trading system for this vital sector will be strangled.

Because of the extraordinary threat that world trade in textiles and apparel faces today, the Global Alliance for Fair Trade in Textiles (GAFTT) calls for the following actions:

(1) Governments, especially those of the United States, European Union and Canada, should immediately and effectively implement the WTO special China textile safeguards to prevent China from monopolizing worldwide textile and apparel trade;
(2) The WTO must undertake an urgent review of the impact of the quota phaseout and of how market distorting trade practices threaten to monopolize trade in this vital sector in the hands of one or two countries;
(3) The WTO must develop new permanent instruments[27] as part of the Doha Round to prevent the textile and clothing sector from being monopolized in the future;
(4) As a part of the development of new permanent WTO instruments to prevent a small number of countries from monopolizing global trade in textiles and clothing, GAFTT urges other governments to support WTO paper 496 submitted by several developing countries that calls for the WTO to actively monitor and address the economic impact of the quota phaseout and to support WTO paper 497 submitted by the Republic of Turkey that calls for a permanent, global safeguard mechanism. GAFTT believes it is critical that the WTO Council on Trade in Goods CTG give fair and extensive consideration to these papers during Formal Meetings in 2005.
(5) Governments whose textile and clothing industrial sectors export to the United States, European Union, Canada and other countries must let those countries know that they support immediate and effective use of the China textile safeguard. This means that safeguards should be invoked on threat of market disruption rather than waiting for actual market disruption to occur;
(6) Governments must move aggressively at the WTO and within their own trade regimes to attack unfair trade practices employed by countries that seek to dominate world trade in textiles and apparel. These practices, which are illegal under the WTO, include currency manipulation, industrial subsidization of state-owned companies, the extension of "free" capital by central banks and illegal export tax rebates; and,
(7) GAFTT recognizes the importance of an active policy of access to markets, especially on the part of countries that are the major beneficiaries of the quota phaseout, such as India, by achieving acceptable levels of tariffs together with the elimination of non-tariff barriers.

[27] The China textile safeguard mechanism expires at the end of 2008.

(8) GAFTT also notes that Vietnam has applied to become a WTO member and that as a non-market economy, it has been able and willing to mirror many of the unfair practices used by China to monopolize key sectors of the global textile and clothing market. Consequently, GAFTT calls for the WTO to include safeguards or other specific provisions that would prevent Vietnam from using unfair trade practices to monopolize segments of global trade in textiles and clothing, such as the $82 billion U.S. import market, as a part of any accession agreement allowing Vietnam to become a member of the WTO.

GAFTT announced that its efforts over the next twelve months would be focused on ensuring that safeguard actions are implemented in key markets and that unfair monopolistic trade practices are attacked. GAFTT will also focus on persuading the WTO to introduce new permanent safeguards for textile and apparel products into the current round of worldwide trade talks.

GAFTT Review of the Textile and Apparel Trading System

The now expired worldwide quota system for textiles and clothing was arguably one of the most successful economic aid packages for developing countries in history. The system allowed virtually every developing country access to key global markets by preventing any single country from monopolizing the market. In 2003, 41 countries exported more than $1 billion USD in textile and clothing products annually, creating desperately needed jobs and generating invaluable foreign earnings for some of the poorest countries on earth.

However, since China joined the WTO at the end of 2001, it has engaged in a highly damaging and systematic effort to monopolize world trade in textiles and clothing by undercutting free market prices through a complex scheme of industrial subsidization and currency manipulation.

In the clothing categories removed from quota in 2002, China dropped its prices by an average of 53 percent in a successful effort to dominate world trade in the U.S. market in these product areas. Not a single competitor was able to match China's artificially low prices. By November 2004, the next largest supplier of these products to the U.S. market was Thailand, with 3 percent.[28] Also, GAFTT notes that China's average export prices for trousers, underwear, and woven and knit shirts are 58 percent below the average prices charged by other countries.[29]

Moreover, China already controls a combined 40 percent share of world exports for cotton and man-made fiber trousers, men's woven shirts, cotton and man-made fiber knit shirts, and underwear. When one excludes U.S. and EU exports in these categories, China's world export market share rises to an astounding 57 percent![30] Finally, in these same categories, China already controls an 88 percent market share of the lucrative Japanese and Australian markets.[31]

China has used and continues to use the following unfair trade practices to artificially undercut the prices of every other country in the world:

- Currency manipulation (40 percent advantage)
- Export subsidies (rebate of export taxes: 13 percent)
- Free capital (U.S. Government reports that up to 50 percent of government loans to Chinese business are never repaid)
- Direct state subsidies to textile industry (50 percent is still owned by the Chinese government)
- Plus many others. . . . include tax holidays, land giveaways, power and freight subsidization

These unfair trade practices undeniably have severely disrupted world trade in textile and clothing. In the critical $82 billion U.S. import market, China's market share in the clothing and home textile products categories removed from quota in 2002 surged from less than 10 percent in 2001 to more than 73 percent as of November 2004. Every player in the world trading community lost market share to China, even countries with geographic proximity and preferential trade agreements.

China saw substantial growth in its market share in Europe as well, capturing anywhere from 30 to more than 50 percent market share in several key categories.

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[28] U.S. Department of Commerce statistics, analyzed by NCTO.

[29] According to the UN Comtrade database, the average Chinese export price for trousers, shirts and underwear was $1.82 per item compared to an average export price charged by other suppliers of $4.42 per unit. For more information, go to *www.ncto.org*, 12/15/04 press release.

[30] Source: NCTO press release, "NCTO Analysis Shows Chinese Apparel Prices 76% Below U.S. Prices and 58% Below Rest of World's Prices," December 15, 2004, available at *www.ncto.org*.

[31] Id.

Every significant study on world textile and clothing trade predicts China to capture similar market share in the categories to be released from quota in 2005. The World Bank predicts that China will capture half the world's apparel trade once quotas are removed. A recent WTO study has predicted China and India will take a 71 percent share of the global market.[32] A study by McKinsey and Company also predicted that China's share would rise to 50 percent for both textiles and apparel.[33] The United States International Trade Commission predicted that absent safeguard actions, "China would become the supplier of choice."[34]

Perhaps most significantly, top executives for major importing and retailing firms—the firms that make the sourcing decisions—predicted earlier this year that China would dominate trade in apparel once quotas are removed. In a confidential poll, 87 percent said China's share would exceed 50 percent and half of those predicted that China would gain between 75 and 90 percent.[35]

China's strategy for world domination has been evidenced by the fact that China has dominated world sales of textile and apparel machinery for the past four years, in some cases consuming up to two-thirds of world production of textile machinery (weaving looms). Chinese government statistics reveal that China has invested $21.2 billion over the past three years in order to dramatically increase its textile and apparel production capacity.

The crisis in textile and clothing trade is a global problem requiring a global solution. That is why GAFTT is calling for timely and effective action by all countries, but especially by the European Union, United States and Canada, and the WTO to prevent further disruption of trade.

www.fairtextiletrade.org

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[32] "The Global Textile and Clothing Industry post the Agreement on Textiles and Clothing," Discussion Paper #5, WTO, 2004.

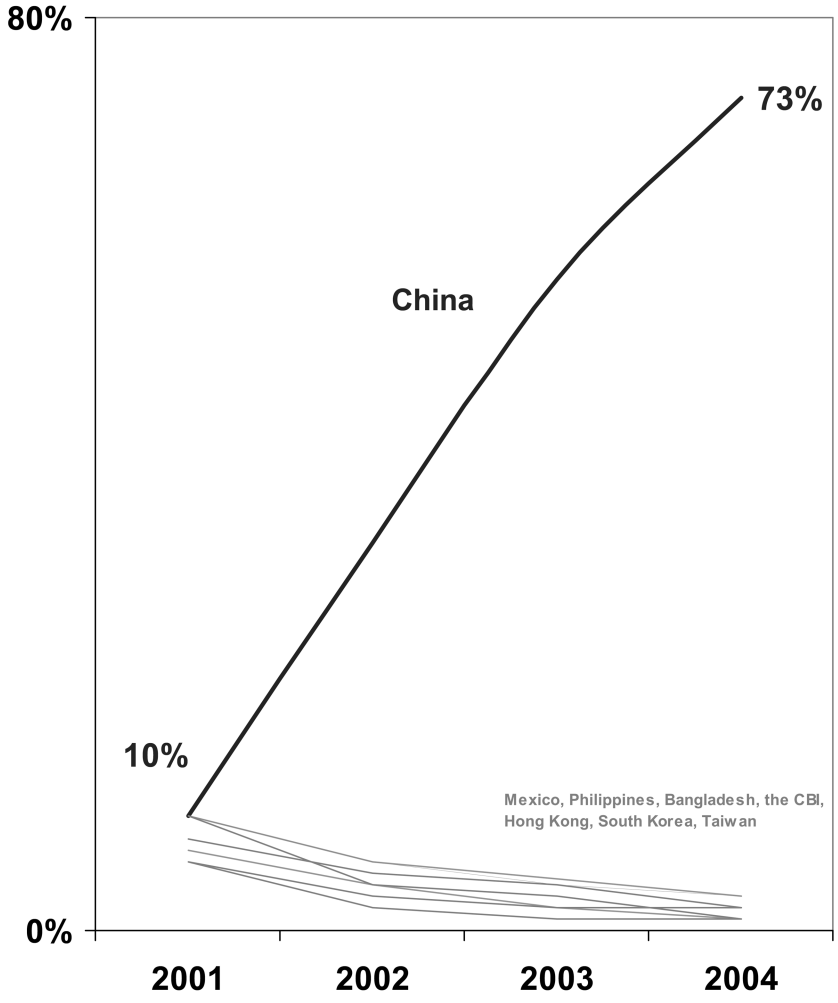
[33] "Trade Liberalization in China's Accession to the World Trade Organization," Elena Ianchovichina and Will Martin, World Bank, June 2001, p. 21. McKinsey study: *AFX News Limited*, 3/28/04.

[34] "Assessment of the Competitiveness of Certain Foreign Suppliers to the U.S. Market," Pub. 3671, U.S. International Trade Commission, Jan. 2004.

[35] "Cotton Sourcing Summit," Miami, Florida: WWD, 3/3/04.

Attachment 3

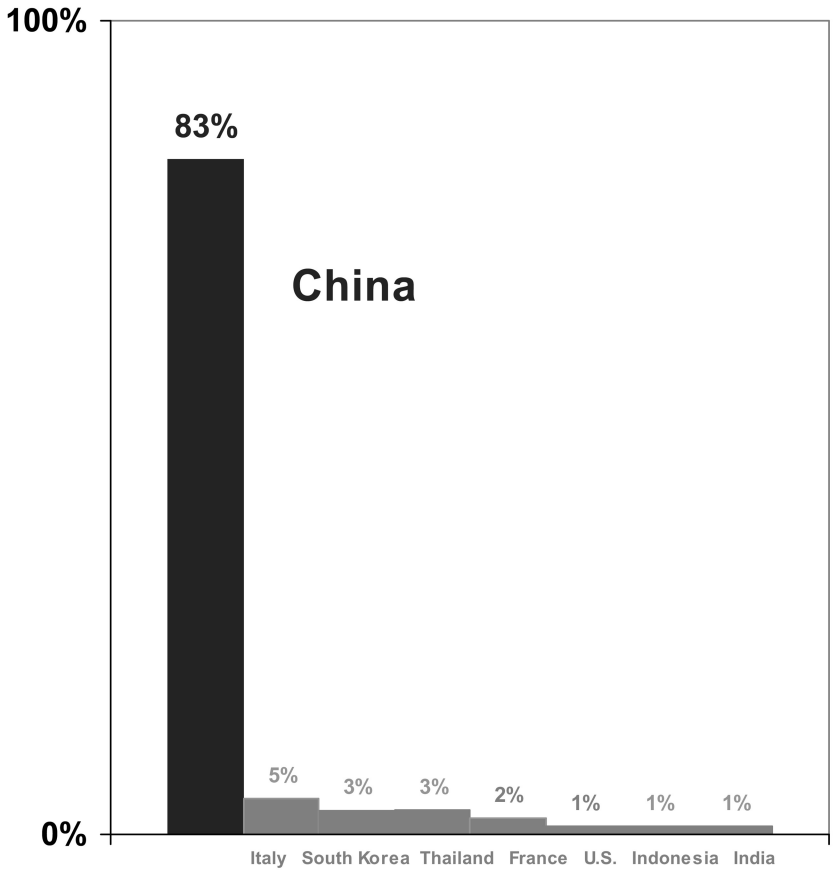
Apparel Products Removed from Quota in 2002 (top 8 suppliers)



Source: United Nations COMTRADE database, by value, 2003.

Attachment 4

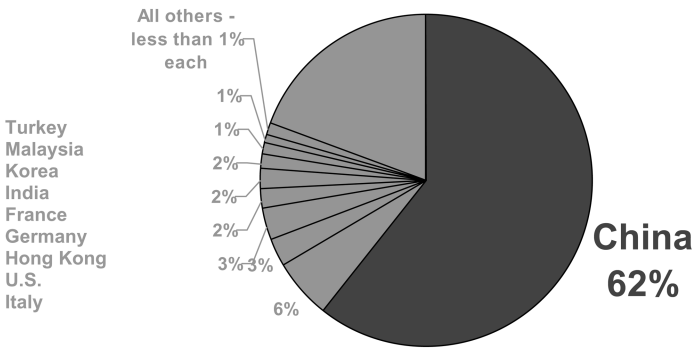
Australian and Japanese Apparel Markets (2003)



Source: United Nations COMTRADE database, by value, 2003.

Attachment 5

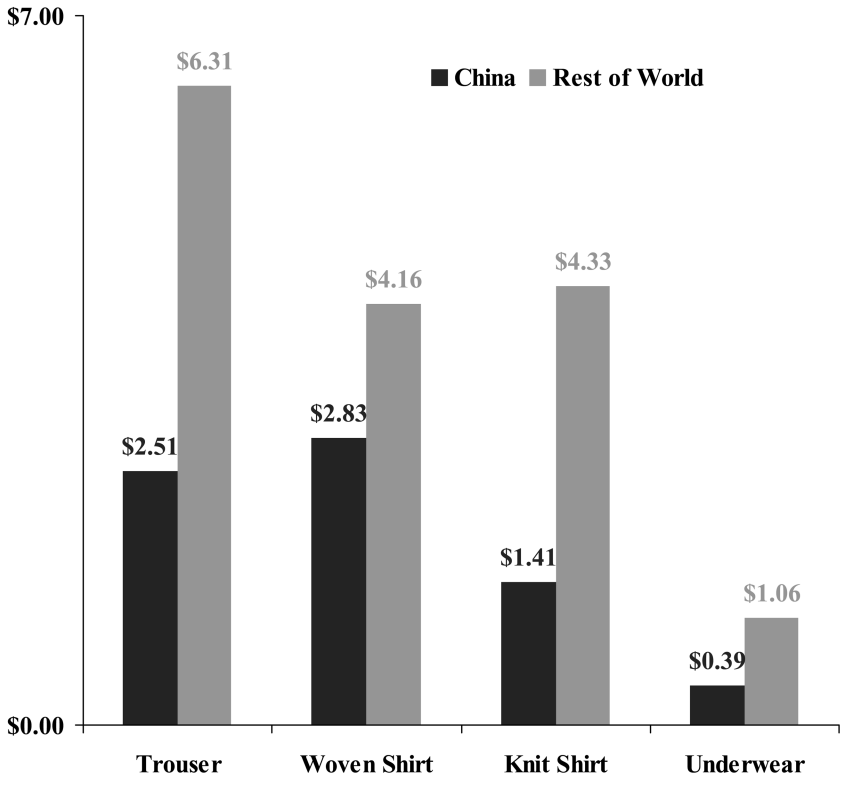
Share of Worldwide Apparel Trade Outside the U.S. / E.U. (in Non-Quota Countries)



Source: United Nations COMTRADE database, by value, 2003.

Attachment 6

China Prices Average 58% Lower than "Rest of World" for Major Apparel Products



Source: United Nations COMTRADE database, 2003.

Attachment 7

FOR IMMEDIATE RELEASE

NCTO Analysis Shows Chinese Apparel Prices 76% Below U.S. Prices and 58% Below Rest of World's Prices

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Chinese Predatory Pricing Demonstrates Need for Safeguards to Combat Chinese Currency Manipulation, Subsidies, Unfair Trade Practices

(Washington, D.C.)—The National Council of Textile Organizations (NCTO) today released statistics showing that China is exporting trousers, shirts and underwear and other apparel at 76 percent below U.S. producer prices and 58 percent below the prices of other exporting countries for the same garments.

"This data clearly demonstrates the enormously unfair trade advantages the Chinese government is employing on behalf of its textile and apparel industry, and validates our concern that China will flood the U.S. in 2005 if textile safeguards are not imposed by our government," said Cass Johnson, President of NCTO. Johnson noted that, "In twenty-nine apparel categories that were removed from quota in 2002, Chinese prices plunged by 53 percent, helping Chinese exports to the U.S. of these products to grow by more than 1,000 percent. As a result, China's share of the U.S. in these categories grew from roughly 10 percent to 72 percent—and this was in just 30 months."

These unfair advantages which the Chinese government employs include a 40 percent price advantage because of Chinese currency manipulation, billions of dollars in direct subsidization of its textile industry and government banks that are giving away money to Chinese manufacturers.

Chinese Predatory Pricing

	Average Price for Garments*	Percent Difference With China
China's Worldwide Export Price	$1.84	
Rest of World's Export Price	$4.42	58%
U.S. Producer Price	$7.63	76%

*Average of export prices for trousers, underwear, woven shirts and knit shirts. Export data is for 2003. See attachment for more details.

According to Johnson, "China engages in the worst kind of predatory pricing. When our companies are competing against the Chinese government itself, then something is very wrong and we need the U.S. Government to respond on our behalf." NCTO and other U.S. textile and apparel groups have filed for safeguards to be applied against a variety of textile and apparel exports from China in an effort to limit their growth next year to 7.5 percent. Final decisions by the U.S. Government on these petitions are expected in early February.

The NCTO analysis also showed that, where quotas do not exist, China already dominates world trade in these products. Specifically, it shows that China has captured an average 55 percent share of world trade in these products outside of trade with the United States and the EU, which have kept Chinese exports somewhat restrained by quotas.* Of particular note are figures regarding Japan and Australia, two developed country markets with similar consumer buying patterns as the United States but which have never employed quotas. In these two countries, Chinese import market share now averages 88%.

Johnson added, "China's predatory pricing figures show why 96 trade associations from 54 countries around the world have joined together to demand that governments act to prevent a brutal takeover of world trade by China once quotas are removed. When manufacturers in no other country in the world can even come close to competing against China, then it is time for governments to stand up and take China on."

***For further information on the worldwide coalition to prevent a Chinese takeover of textile and apparel trade, go to *www.fairtextiletrade.org*.**

The analysis used trade data from the United Nations COMTRADE database and Global Trade Atlas as well as U.S. producer price information. The international data is supplied by 88 exporting countries, including China. The data was included in the U.S. textile industry comments filed by NCTO and its coalition allies in support of its safeguard petitions on the cotton and man-made fiber trousers, cotton and man-made fiber men's woven shirts, cotton and man-made fiber underwear, and cotton and man-made fiber knit shirts.

(Note: The database export data does not include duties, shipping and insurance. These costs would raise Chinese export prices by approximately 20%, to $2.04/garment, and "rest of world" prices to $5.30/garment. With these costs included, Chinese prices are 73% below U.S. producer prices and 62% above "rest of world" prices.)

Comparison of Chinese Apparel Export Prices with "Rest of World" Prices and U.S. Producer Prices										
Safeguard Petitions	Chinese exports to world	Chinese average export price	U.S. producer price	Chinese price advantage over U.S. producers	Average "rest of world*" price	Chinese price advantage over "rest of world*"	Chinese share of world exports	Chinese share of world exports, not including U.S. and EU	Chinese share of Japan and Australia markets	Increase in Chinese exports in last five years (1998-2003)
Cotton Trousers (347/8)	1.5 billion trousers	$2.87	$12.79	78%	$7.73	63%	39%	56%	91%	83%
MMF Trousers (647/8)	1.0 billion trousers	$2.16	$11.39	81%	$4.90	56%	44%	64%	86%	102%
Men's Woven Shirts (340/640)	536 million shirts	$2.83	$12.05	77%	$4.16	32%	56%	61%	83%	30%
Cotton Knit Shirts (338/9)	1.7 billion shirts	$1.29	$4.55	72%	$4.29	70%	29%	56%	88%	90%
MMF Knit Shirts (638/9)	626 million shirts	$1.50	$4.09	66%	$4.37	66%	24%	45%	86%	68%
Underwear (352/652)	3.6 billion pieces of underwear	$.39	$.91	57%	$1.06	63%	46%	64%	93%	80%
Total		**$1.84**	**$7.63**	**76%**	**$4.42**	**58%**	**40%**	**55%**	**88%**	**76%**

Sources: United Nations COMTRADE database (2003), Global Trade Atlas (2003), U.S. producers (2004)
NOTE: Export data does not include duties, shipping and insurance. These costs would raise Chinese export prices by approximately 20%, to $2.04/garment, and "rest of world" prices to $5.30/garment. With these costs included, Chinese prices are 73% below U.S. producer prices and 62% below "rest of world" prices.
*Rest of world = "exporting countries" minus China.

Cochair MULLOY. So thank you.

STATEMENT OF AUGGIE TANTILLO, EXECUTIVE DIRECTOR AMERICAN MANUFACTURING TRADE ACTION COALITION

Mr. TANTILLO. Thank you. My name is Auggie Tantillo. I'm the Executive Director of the American Manufacturing Trade Action Coalition. I very much appreciate this opportunity to testify before the Commission.

AMTAC is a consortium of U.S. manufacturers from various industrial sectors: paper products, furniture, chemicals, and of course, textiles and apparel that have banded together because we believe that U.S. trade policy is critically flawed, especially as it relates to China, and we've come together because we want to remain in the United States. We want to continue to produce goods here, remain invested in our communities and continue to employ tens of thousands of workers here in the U.S.

The issue of China as it relates to textiles and apparel is, as my colleague mentioned, an extremely dramatic one. They are the single largest player on the landscape, and they have an overwhelming capability to monopolize global markets, not just the U.S. market.

In order to understand the environment in terms of trading rules as they relate to textiles and apparel today, we need to do a little bit of a recap of where we started almost 40 years ago, when the world trading community came together and adopted something known as the short-term cotton agreement, which evolved into the Multifiber Arrangement.

The MFA was constructed for the purpose of keeping two or three suppliers who had extremely low labor rates and extremely low labor standards from monopolizing global markets. In those days, it was Hong Kong, Korea and Taiwan. The concept was basically that the apparel industry for the most part is an enormously important cog in the economic development of just about every country and every region in the world.

The reason for that is that apparel is a low-capital investment industry, yet at the same time a high labor component industry. In other words, it's a developing country's dream. It takes a little bit of money to get started, but at the same time, you can employ hundreds of thousands if not millions of workers producing garments for export to the world marketplace.

The MFA was set up specifically to prevent two or three suppliers from overrunning the marketplace and therefore preventing economic development throughout the rest of the world. I know some of my colleagues in the importing community will argue that the MFA has been a travesty and a blight in terms of the free trade environment, but if you look at it from the perspective of each one of these countries that Mr. Johnson mentioned, there would not be a textile or apparel industry in the Caribbean Basin today, in Central America, in the Andean region, in Sub-Saharan Africa, in some of the poorest countries of Asia such as Indonesia, the Philippines, Bangladesh, Sri Lanka, if it were not for the Multifiber Arrangement, because it kept one or two players from monopolizing the market.

I want to note for you that the MFA was never constructed to block imports or preclude players from becoming active in the textile and apparel trading system; simply to regulate it, simply to keep growth to a moderate and reasonable level, and we believe that the MFA was a tremendous success in doing that.

To give you some specifics, last year, the United States imported textiles and apparel from 180 separate countries. That would not have been possible if China were allowed to overrun the marketplace. If you look at this from a security standpoint, you begin to understand just how vital textile and apparel production is to many of our most important allies in the war on terrorism.

Take, for example, Bangladesh: 85 percent of Bangladesh's export earnings come from apparel. The vast majority of that comes from shipments to the United States and the European Community. Bangladesh employs 8 million people producing textiles and apparel. According to their government, there are another 12 million people who are employed as a direct result of their apparel sector. That is 20 million people in a country of 120 million.

To further extrapolate, the Bangladeshi government informed us that for every person who has a job in Bangladesh, four other people eat. As a result, 60 million people eat every day in Bangladesh because of their ability to access the U.S. textile market and the European textile market. Bangladesh is an Islamic nation. If half of their population suffers a major setback because China goes from 10 percent of the U.S. market to 75 or 80 percent of the U.S. market, that's a problem.

Take Turkey: one-third of its export earnings are related to textile and apparel, over $30 billion. One-third of its industrial employment is related to textiles and apparel. Turkey is the land bridge between the Middle East and Europe. Turkey is the model of what the Bush administration is attempting to set up in Iraq: a secular Islamic nation that is stable because it has an emerging economy. What happens if Turkey loses 50 to 60 percent of its global market share because China is allowed to overrun the market?

If this were a debate about free trade and free trade principle, my arguments and concerns would be much less vociferous. But because China uses unfair trading practices, because they employ state-sponsored subsidies, because they purposely undervalue their currency, they are able to take competitors such as Bangladesh and Turkey and put them out of the market or displace them in the market.

For that reason, we are calling on the U.S. Government to take the actions that are available to them to prevent China's rapid and unfair growth in our market. There is a safeguard that is available. The safeguard mechanism was first discussed and negotiated in the late 1990s as part of a bilateral with China. It was a major, major concession on the part of the U.S. Government, and I say that in a reverse sense.

The United States should have required China to undergo a 10-year phase-out of their quota system when they joined the WTO, like all other WTO partners. The phase-out started in 1995 and ran through December 2004. China was not a member of the WTO when the Uruguay Round was completed. It would have been completely logical to ask China when they joined the WTO in 2002 to

undergo a 10-year phase-out of their quotas unlike all other players. Instead, we made an enormous concession and told them that they would enjoy quota-free access on January 1, 2005, as if they were a charter member of the WTO.

The government told us don't be concerned; don't be worried; we have a safeguard, and the safeguard will be employable if China disrupts your market here in the U.S. or threatens to disrupt your market. What happened in reality? In 2002, when 30 quotas were removed on Chinese products, the U.S. Government had not even produced the guidelines necessary to submit safeguard actions. It took them 17 months. We did not get the rules until May 2003; 17 months after China joined the WTO.

When they finally produced the rules, they were cumbersome, basically requiring us in the industry to regurgitate data that the government itself collects, requiring a four-month review process; in other words, it was a full two years after China joined the WTO before we were able to get any relief under the safeguard system. During that time, here in the United States, we lost 110,000 workers.

The safeguard system will only work if we are allowed to take a preemptive step to keep China from growing exponentially using the threat safeguard clause. It will not work if two years after the quotas are released, if we're sitting here in the late spring of 2007 and the government is still deliberating.

Cochair MULLOY. Could we ask, Mr. Tantillo——

Mr. TANTILLO. Yes.

Cochair MULLOY. I know that there's a very important case that you might want to talk about.

Mr. TANTILLO. Yes.

Cochair MULLOY. Do you mind if we wrap up your prepared testimony now, and then, there will be opportunities, I think, during the questioning period to get into some of these other issues.

Mr. TANTILLO. Absolutely; do you want me to comment on that case now or——

Cochair MULLOY. I think maybe you'll have an opportunity later.

Mr. TANTILLO. Thank you for the opportunity to testify.

[The statement follows:]

Prepared Statement of Auggie Tantillo, Executive Director
American Manufacturing Trade Action Coalition

The American Manufacturing Trade Action Coalition (AMTAC) is a trade association founded by domestic manufacturers with the mission to preserve and create American manufacturing jobs through the establishment of trade policy and other measures necessary for the U.S. manufacturing sector to stabilize and grow.

AMTAC counts a substantial number of textile companies amongst its membership. On behalf of those members, thank you for the opportunity to testify on China's compliance with its WTO obligations and on strategies that the United States Government should use to address China's shortfalls.

AMTAC's testimony today chiefly will focus on the potential and actual effectiveness of the special textile China safeguard and on the merits and ramifications of the lawsuit that is blocking the timely and effective implementation of safeguards by the U.S. Government. We will also discuss the need for the U.S. Government to unilaterally restrict China's access to our market as leverage to encourage China to make reforms that they otherwise would not undertake to level the playing field for U.S. manufacturers.

History of the Multi-Fiber Agreement (MFA)

Policymakers have long recognized that textile and apparel manufacturing holds a unique place in the global economy—the reason being that textiles and apparel are one of the few, if not only, products manufactured in every corner of the globe, regardless of the producing country's stage of economic development.

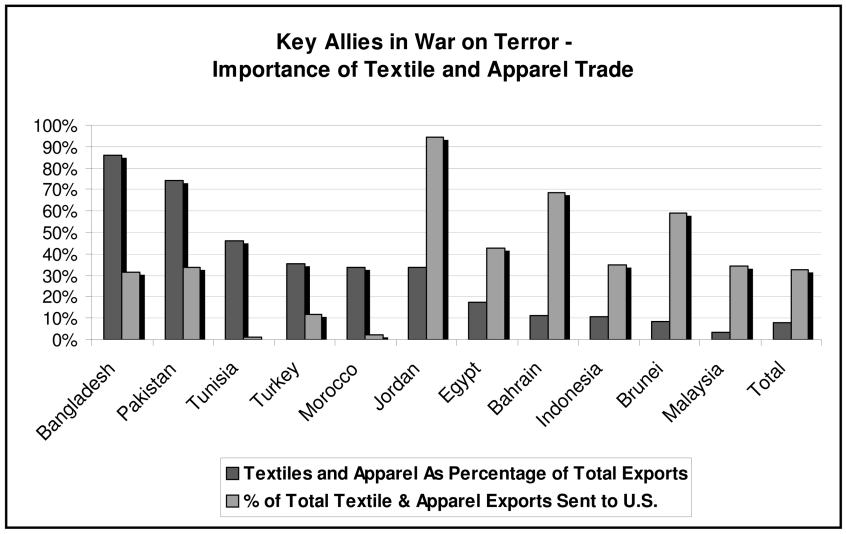
Specifically, the apparel sector is the entry-level rung for developing a manufacturing economy. Apparel manufacturing is highly attractive to developing countries because it is a sector that requires little capital investment. A country just needs sewing machines, a little bit of electrical and transportation infrastructure, imported fabric, and a large labor force to initiate production. Indeed, a human being operating a sewing machine is still the most efficient method of assembling a high-quality garment. Consequently, apparel manufacturing is a key contributor to Gross Domestic Product (GDP) and driver of export earnings in most least developed and developing countries around the world.

In contrast, textile manufacturing is a high-tech, capital-intensive industry. Millions of dollars have been poured into research and development to produce many of the fabrics in common use today. Much of the value added in this R&D comes in the dyeing and finishing sector where great expertise in chemical engineering is required. Consequently, textile manufacturing mostly has been concentrated in developed countries like the United States and Italy and large developing countries like China, India, Turkey, Taiwan and Korea.

With the demonstrated importance of the apparel sector to economic growth in the developing world evident, it was logical that the quota system of the Multi-Fiber Agreement (MFA) be constructed in a manner so that one or two large developing countries could not monopolize global trade in textiles and clothing.

In that light, the MFA has been a remarkable success. In 2003, the United States reported imports from more than 180 governmental entities. In that same year, the United Nations COMTRADE database reported that the world imported more than $392 billion worth of exported textile and apparel products in 2003. This accounted for 5.68 percent of all world imports that year. Moreover, according to the UN COMTRADE database, as reported by importing countries, textile and apparel products accounted for 25 percent or more of exports from 42 different countries and 5 dependencies and 10 percent or more of exports from another 32 countries and 4 dependencies.[1]

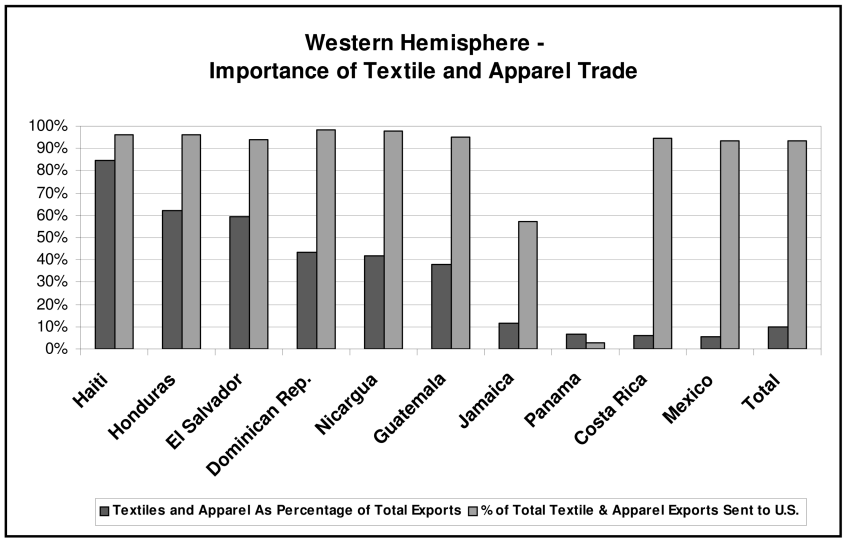
To more fully illustrate this point, as one can see in the chart below, textile and apparel trade is a key component of the economy of several important Islamic countries that are key U.S. allies in the war on terror:



[1] Data in paragraph can be found in Attachment I.

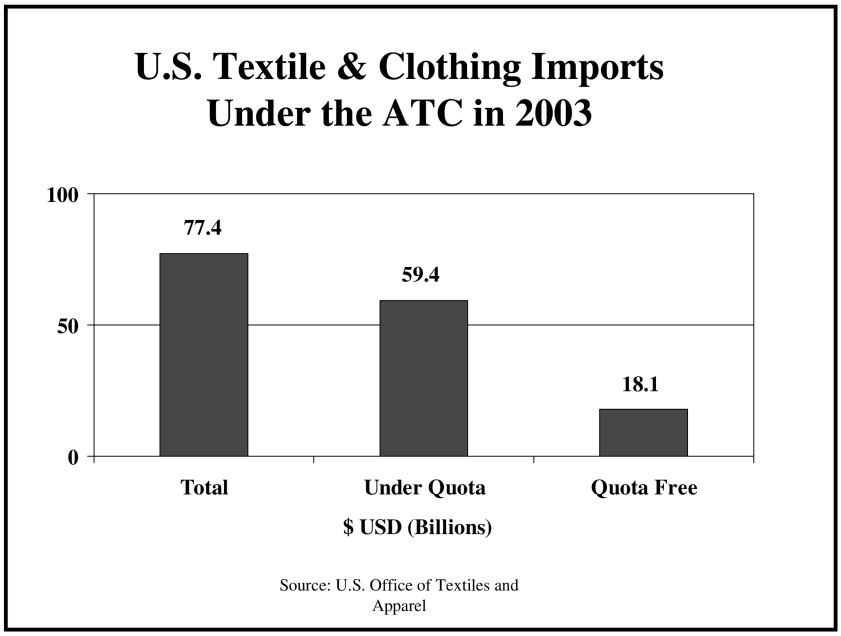
The dollar values of these exports are included in Attachment I appended to the end of this testimony. These exports support millions of jobs. For example, at the recently concluded 3rd International Textile Summit sponsored by GAFTT, the Indonesian textile and apparel manufacturing sector reported that it employed 3.6 million people alone.

The same is true with many critical U.S. trading partners in North America:

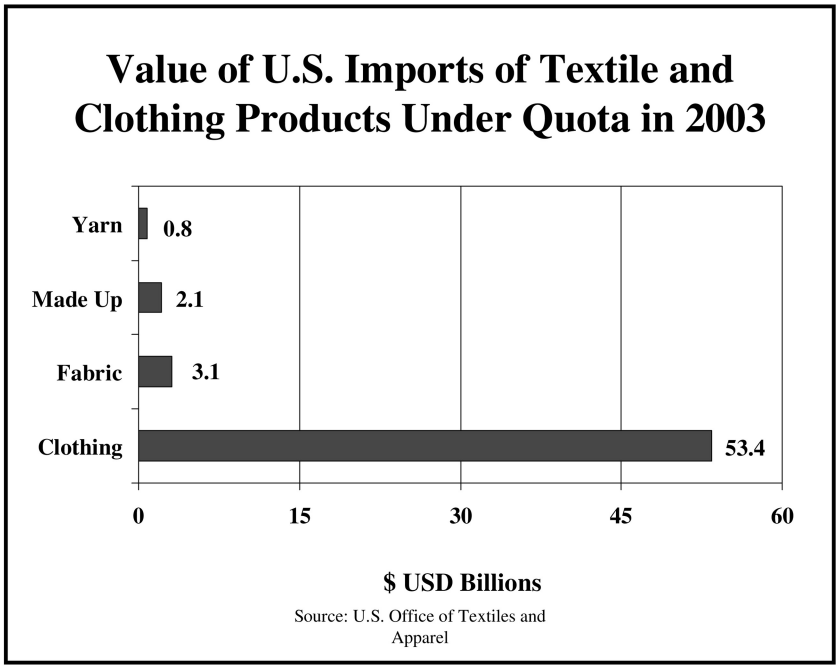


Despite the obvious success of the MFA, it was replaced in the Uruguay Round of WTO negotiations by the Agreement on Textiles and Clothing (ATC). The ATC initiated phased elimination of all quotas on textiles and clothing over a ten-year period starting in 1995. The last of these quotas were completely phased out at the beginning of 2005.

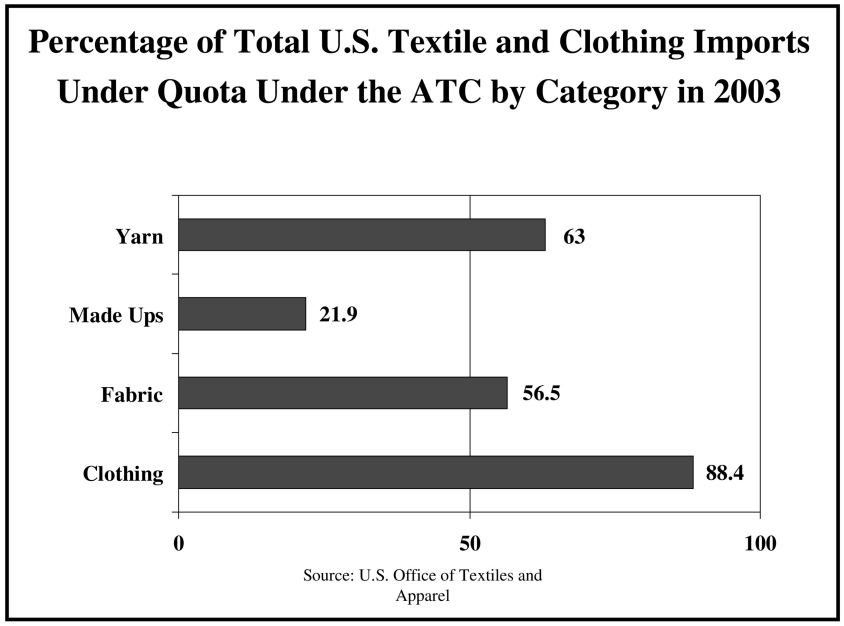
The final stage of the quota phase out will affect more than $60 billion in U.S. imports of textile and clothing products, as total imports in 2004 are up from the 2003 numbers listed in the chart on the following page:



A second chart breaks out the value of these imports by category:



The final chart shows the percentage of imports by category still under quota in 2003:



History of the Special Textile China Safeguard

No textile specific safeguard was put into place until China acceded into the WTO in late 2001. Rather than undergoing a ten-year phase out of quotas like every other country, China was granted the privilege of joining the quota phase out in lockstep. This meant that when China joined the WTO in 2002, it was given quota-free access to markets of all WTO members where quotas on textile and apparel products had been allowed to expire as of the beginning of 2002. Moreover, China subsequently received quota-free access to all WTO markets upon the expiration of all remaining quotas at the beginning of this year.

In return for receiving quota-free access in lockstep, China agreed that WTO members could impose safeguards on exports of its textile and apparel products if those exports threatened to disrupt or actually disrupted trade in those products.[2]

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[2] The authority for a country to impose a textile-specific safeguard on China is contained in Paragraph 242 of the Working Party Report to China's accession agreement to the WTO. Paragraph 242 reads as follows:

The representative of China agreed that the following provisions would apply to trade in textiles and clothing products until 31 December 2008 and be part of the terms and conditions for China's accession:

(a) In the event that a WTO Member believed that imports of Chinese origin of textiles and apparel products covered by the ATC as of the date the WTO Agreement entered into force, were, due to market disruption, threatening to impede the orderly development of trade in these products, such Member could request consultations with China with a view to easing or avoiding such market disruption. The Member requesting consultations would provide China, at the time of the request, with a detailed factual statement of reasons and justifications for its request for consultations with current data which, in the view of the requesting Member, showed: (1) the existence or threat of market disruption; and (2) the role of products of Chinese origin in that disruption;

(b) Consultations would be held within 30 days of receipt of the request. Every effort would be made to reach agreement on a mutually satisfactory solution within 90 days of the receipt of such request, unless extended by mutual agreement;

(c) Upon receipt of the request for consultations, China agreed to hold its shipments to the requesting Member of textile or textile products in the category or categories subject to these consultations to a level no greater than 7.5 percent (6 percent for wool product categories) above the amount entered during the first 12 months of the most recent 14 months preceding the month in which the request for consultations was made;

These safeguards could only be imposed for a maximum of twelve months before needing to be renewed and the ability to impose safeguards would expire at the end of 2008.

Allowing the WTO to admit China, with its large non-market economy and immense labor force, was a strategic mistake of incalculable proportions by the United States. WTO membership gave China carte blanche opportunity to use its non-market subsidy schemes to systematically undermine the U.S. manufacturing sector.

The negotiation of the China safeguard represented a further defeat for the U.S. textile industry as China was given a three-year quota phase out instead of the ten-year phase out given to all other parties. Moreover, instead of being automatically triggered, the U.S. Government was required to proactively impose safeguards—meaning that the U.S. textile industry would be reliant on U.S. Government action to prevent China from using unfair trade practices to overwhelm the U.S. market. Given the U.S. Government's general unwillingness to confront unfair Chinese trade practices, this reliance gave the U.S. textile industry ample reason to worry.

How the Safeguard Works

The decision to implement safeguards is made by the Committee for the Implementation of Textile Agreements (CITA). CITA is an interagency group comprised of one representative each from the Office of the U.S. Trade Representative and the Departments of Commerce, State, Treasury, and Labor. CITA decisions are made by majority vote.

The United States may implement the safeguard if Chinese imports of textile and clothing products are either disrupting the U.S. market or threatening to disrupt the U.S. market.

If implemented, the safeguard could limit the growth of Chinese imports of textile and apparel products to 7.5 percent (6 percent for wool products).

The safeguard review process may be self-initiated by the U.S. Government or be triggered by petition from a segment of the U.S. textile or apparel manufacturing sector. To date, the U.S. Government has not self-initiated any safeguard cases.

Because China's accession to the WTO is a trade agreement administered by CITA, the U.S. Government was not obligated to publish procedures for the private sector filing of safeguard cases. The foreign affairs exception contained in the Administrative Procedures Act gives the Executive Branch wide latitude to administer matters of foreign affairs like trade agreements.

As such, the U.S. textile industry attempted to file safeguard cases in September 2002. CITA, however, rejected these efforts with the excuse that they wanted to publish procedures for safeguard filings. Although it knew the safeguard was eligible to be used as of January 1, 2002, the U.S. Government did not publish the unneeded safeguard procedures until May 21, 2003—a delay of nearly 17 months! 110,200 U.S. textile and apparel manufacturing jobs disappeared from the time the safeguard was eligible for use until the safeguard procedures were published. To make matters worse, the unneeded safeguard filing procedures contained a four-month built-in delay from the time a petition was filed until a decision was required to be rendered.[3]

The procedures themselves do not require the U.S. textile industry to provide anything but a simple regurgitation of the import numbers and domestic production and market share figures produced by the U.S. Government itself. If the government does not collect those numbers, as is true for several critical product categories, it becomes virtually impossible for the industry to file safeguard cases because it is an almost insurmountable task to collect the necessary data required by the safeguard procedures, as producers are under no obligation to report to a private sector survey request.

(d) If no mutually satisfactory solution were reached during the 90-day consultation period, consultations would continue and the Member requesting consultations could continue the limits under subparagraph (c) for textiles or textile products in the category or categories subject to these consultations;

(e) The term of any restraint limit established under subparagraph (d) would be effective for the period beginning on the date of the request for consultations and ending on 31 December of the year in which consultations were requested, or where three or fewer months remained in the year at the time of the request for consultations, for the period ending 12 months after the request for consultations;

(f) No action taken under this provision would remain in effect beyond one year, without reapplication, unless otherwise agreed between the Member concerned and China; and

(g) Measures could not be applied to the same product at the same time under this provision and the provisions of Section 16 of the Draft Protocol.

The Working Party took note of these commitments.

[3] A copy of the safeguard procedures may be found at *http://otexa.ita.doc.gov/Safeguard__intro.htm.*

In addition, by publishing unnecessary procedures, the U.S. Government provided an opening for the U.S. Association of Importers of Textiles and Apparel to file a lawsuit that has resulted in the threat-based safeguard process being enjoined by the U.S. Court of International Trade.

Safeguards in Practice

The U.S. textile industry and the labor union UNITEHERE have filed 17 China safeguard petitions since the publication of the safeguard procedures in May 2003.[4]

In July 2003, the first four safeguard petitions were filed. Three petitions covering knit fabric, brassieres, and dressing gowns were approved four months later. A petition covering gloves was rejected for technical reasons prior to a decision on the merits. The U.S. Government formally requested consultations with China on these safeguards in late December 2003. After China refused to consult, the U.S. Government limited the growth of Chinese imports in the three categories to 7.5 percent per category.

In 2004, a safeguard petition covering socks was approved in October. Though approved, the case highlighted some of the shortcomings of the safeguard process. A few years ago, the U.S. Government stopped collecting production data on socks. Because of the complications in collecting data that the government itself should already have been collecting, the filing of the sock petition was delayed nearly a year. During that delay, China was able to increase its exports to the United States from 22.9 million dozen to 42.4 million dozen—a market share loss of 234 million pair of socks for China's competitors.

Beginning in mid-October 2004, the U.S. textile industry began the process of filing the first of nine threat-based special textile China safeguard petitions filed by year's end. Three reapplications for the safeguards on knit fabric, brassieres, and dressing gowns also were filed.

The petitions on shirts, trousers, underwear, filament fabric, and combed cotton yarn cover more than $20 billion in U.S. production and nearly $40 billion worth of U.S. imports.[5] China's share of those U.S. imports is approximately $1.9 billion.

These petitions have strong support not only within the U.S. textile community, but the global textile and apparel manufacturing community as well. The Global Alliance for Fair Textile Trade (GAFTT), a coalition of 96 trade associations representing 54 different countries,[6] has strongly supported the petition filings.[7]

All of the threat-based cases and reapplications are currently enjoined by the U.S. Court of International Trade.

Effectiveness of Safeguards

Safeguards are not effective if not implemented in a timely and effective manner. As a recent study by the National Council of Textile Organizations (NCTO) shows, by the U.S. Government not implementing the safeguard in a timely and effective manner, China's market share in apparel categories released from quota in 2002 exploded from less than 10 percent in 2001 to an average of more than 70 percent in 2004.[8]

The safeguards themselves also have problems. If a safeguard is implemented before October 1 of any calendar year, it only remains in effect until December 31. If a safeguard is implemented after October 1 of any calendar year, it remains in effect for twelve months. Because of these restraints, it is necessary to reapply for each safeguard on an annual basis. This creates tremendous uncertainty in the market.

Furthermore, simply implementing the safeguard is not enough. The government must also adequately enforce its laws against illegal transshipment.

A perfect example of this is Chinese exports of cotton, wool, and man-made fiber trousers as discussed in the threat-based safeguard petitions filed on cotton trousers.[9] Chinese exports of silk and vegetable fiber trousers were released from quota in 2002. U.S. imports of these products skyrocketed almost immediately compared to previous years, with nearly all of the increase coming from China. With little evidence of increased domestic consumption of products, there is a strong circumstantial case to be made that a substantial portion of these imports likely are illegal transshipments from China.

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[4] Copies of all safeguard petitions filed may be found at *http://otexa.ita.doc.gov/Safeguard__intro.htm.*

[5] See Attachment II.

[6] See Attachment III for a full list of GAFFT members.

[7] See GAFTT's October 12, 2004 press release on this matter at *http://www.fairtextiletrade.org/.*

[8] See September 1, 2004 press release on NCTO's website, *http://www.ncto.org/.*

[9] A copy of the cotton trouser petition filed may be found at *http://otexa.ita.doc.gov/Safeguard__intro.htm.*

Another example, also discussed in the cotton trouser petition, is the amount of textile and clothing exports emanating from Hong Kong and Macao. It is highly unlikely that the now small manufacturing sector in these special administrative regions could have assembled the volume of apparel they claim. Again, this is strong circumstantial evidence that illegal transshipping may be taking place.

Last year, Congress tried to address this problem. It authorized and appropriated funding for the U.S. Customs Bureau to hire and train 70 new agents to police illegal textile transshipments. Unfortunately, the U.S. Customs Bureau failed to hire any of these agents. With tens of thousands of jobs at stake in the United States and millions more around the world, it is unconscionable that the U.S. Government refuses to adequately enforce the law against illegal transshipping.

Finally, the safeguards only address imports from China. They do not cover import surges from any other country. Thus, if a country like India were to use unfair trade practices in an effort to monopolize the market, the U.S. Government would not have a safeguard to combat the surge.

Lawsuit Comments

The lawsuit filed by the U.S. Association of Importers and Retailers (USA–ITA) is without merit as there is no private right of action relative to the enforcement, administration, or implementation of a trade agreement. Because trade agreements are matters of foreign affairs, the Executive Branch has wide latitude to use its discretionary authority to enforce, administer and implement them. The crux of the matter in this case is whether the Executive Branch has the ability to impose threat-based safeguards as part of its responsibility to enforce, administer, and implement the accession agreement between the United States and China governing China's accession to the WTO.

The language in the Working Party Report of China's accession agreement to the WTO is clear. Governments have the right to impose threat-based safeguards.

The rationale for the threat-based provision is simple. If a government was to wait several months for actual damage figures on imports entering the country, its textile and apparel industry could be irreparably crippled or destroyed during that timeframe. Consider this apt analogy. When your house catches fire, do you call the fire department immediately, or do you wait to call them after your house has already burnt to the ground?

The lawsuit temporarily has stopped the threat-based China safeguard process—in essence it is preventing the textile industry from calling the fire department. In response to a motion by USA–ITA, the U.S. Court for International Trade (CIT) issued an injunction on December 30, 2004 prohibiting the U.S. Government from self-initiating any threat-based safeguards and from taking any action on the safeguard petitions filed by the U.S. textile industry in late 2004. The CIT also denied the U.S. Government's motion to dismiss the case.

The court injunction is causing actual damage as we speak. Heavily subsidized imports from China are surging into the U.S. market right now causing irreparable damage to the U.S. textile industry.

Every day that goes by without the imposition of safeguards, China is gobbling up more and more market share. Because its heavily subsidized prices are 76 percent below U.S. prices and 58 percent below the rest of the world's prices, once China captures market share, no one in the world has the pricing power to seize it back.[10]

The U.S. Government has given notice that it intends to appeal the injunction to the U.S. Court of Appeals for the Federal Circuit. It is imperative that the appellate court expeditiously overturns the injunction to prevent more damage from occurring.

By the extent of his actions, the judge has hijacked U.S. foreign policy and taken the safeguard process out of play. Sadly, this is indicative of the U.S. Government's inability to provide effective safeguard remedies. If it's not a 17-month delay in producing the safeguard regulations, it's a set of rules that take 120 days to adjudicate, and now there is an extra layer of complexity because a judge has brought the entire process to a complete halt.

Actions Beyond Safeguards

The U.S. Government must begin looking for a solution that more broadly addresses the negative impact of the expiration of the MFA. As previously noted, safeguards only can provide temporary relief, even if implemented in a timely and effective manner by the U.S. Government.

Absent withdrawal from the WTO and imposition of unilateral punitive measures against China in retaliation for the use of unfair trade practices, the U.S. Govern-

[10] See NCTO press release dated December 15, 2004 at *http://www.ncto.org/*.

ment must work within the structure of the WTO to fully address the economic impact of the phase out of quotas on textile and apparel products.

The best way to address the quota phase out crisis would be to have the WTO re-impose the MFA. Failing that, the United States Government should strongly support the development of new instruments as part of the Doha Round that would prevent any single country from monopolizing global trade in textiles and apparel as China is poised to do.

Proposals worthy of consideration as starting points to develop these new instruments include two papers submitted to the WTO's Council on Trade in Goods in 2004. WTO paper 496, submitted by Mauritius and several other developing countries, calls for the WTO to actively monitor and address the economic impact of the quota phase out.[11] WTO paper 497, submitted by the Republic of Turkey, calls for a permanent, global safeguard mechanism.[12]

The U.S. Government would be well advised to do everything in its power to make sure that Council on Trade in Goods gives fair and extensive consideration to these papers during formal meetings in 2005.

Conclusion—Grave Consequences for Failure to Take Decisive Policy Action

To wrap up, U.S. trade policy in relation to China has already caused an enormous amount of damage to the U.S. and global textile industry. The United States is on course to run $73 billion trade deficit in textiles and apparel. China is expected to account for $18 billion of that total and already controls a 25 percent import market share of the U.S. textile and apparel market. 371,000 U.S. textile and apparel manufacturing jobs have been lost in the last four years due to surging imports.

Unless restrained in a forceful and effective manner, it is likely that China will control 75 percent or more of the U.S. and 50 percent or more of the global textile and apparel market by the end of 2007. If that scenario occurs, 30 million jobs, including more than 500,000 from the United States, would be shifted from the rest of the world to China.

Other consequences of allowing China to monopolize global trade in textiles and clothing are equally disturbing.

As outlined in Attachment I, an inordinate number of countries are dependent on trade in textiles and clothing. If the U.S. Government concedes Chinese monopolization of the U.S. and global textile and clothing markets, it will lose enormous policy-making influence in the world. The ability to use U.S. market access for textile and clothing as a lever of influence will effectively transfer into the hands of China, an autocracy with a non-market economy and a penchant for flouting fair international trade practices.

Moreover, the sudden shift of jobs from developing countries, including numerous key allies in the war on terrorism would likely lead to widespread economic and political destabilization. If this happens, the United States is likely to bear a significant brunt of the cost as the policeman racing to address the consequences of rapid destabilization in various regions of the world.

In addition, when a country allows one of its manufacturing sectors to be destroyed, the loss of its research and development capability in that industry will soon follow. First, a significant portion of research and development occurs on the factory floor. It is one thing to invent a product, but it is another to manufacture it in a cost-effective manner. When a country loses its factories, it loses its capability to conduct research and development on the factory floor.

Second, research and development takes significant capital investment. When companies lose profitability because the U.S. Government fails to take actions against the unfair trade practices of countries like China, it becomes more and more difficult to spend the capital necessary to conduct meaningful research and development.

For decades, it has been a well-funded research and development capability that has enabled the U.S. textile industry to be a global leader in innovation. From developing spacesuits and military products to the new stain and wrinkle-resistant fabrics for everyday clothing, U.S. textile industry research and development has been the standard for the rest of the world to follow. Without decisive action by the U.S. Government, U.S. research and development capability in textiles effectively will disappear in short order.

To stop this unfolding economic and political calamity, it is imperative that the United States recognize the policy problems at hand and immediately impose safeguards in a comprehensive manner covering all sensitive categories of textile and apparel products and start work on a solution in the Doha Round to prevent China from permanently monopolizing global trade in textiles and clothing.

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[11] See Attachment IV.
[12] See Attachment V.

Attachment I

UN COMTRADE Database: Textile and Apparel Exports by Country

(as reported by importing country [World] for year 2003)

Exporter	Ranked by Percentage Textile and Apparel Exports		
	Textile & Apparel Trade Value	Total Exports	Percent Textile & Apparel Exports
Lesotho	$428,083,650	$431,798,569	99.14%
FS Micronesia	$14,680,530	$16,207,670	90.58%
Bangladesh	$6,616,629,644	$7,324,807,962	90.33%
Haiti	$316,344,364	$357,968,981	88.37%
Cambodia	$1,963,558,055	$2,258,315,947	86.95%
Maldives	$106,798,227	$128,950,318	82.82%
N. Mariana Isds	$7,455,046	$9,079,491	82.11%
China, Macao SAR	$2,189,913,388	$2,694,240,382	81.28%
Mali	$164,513,939	$204,245,175	80.55%
Western Sahara	$456,830	$575,156	79.43%
Pakistan	$6,957,559,941	$9,312,215,732	74.71%
Honduras	$2,742,124,464	$3,677,044,216	74.57%
Burkina Faso	$116,997,791	$158,599,629	73.77%
Benin	$138,047,571	$194,583,535	70.95%
El Salvador	$1,904,370,166	$2,895,211,052	65.78%
Chad	$59,084,687	$92,508,480	63.87%
Sri Lanka	$2,715,955,651	$4,298,047,374	63.19%
Madagascar	$381,350,198	$605,661,284	62.96%
Nicaragua	$509,932,978	$821,196,961	62.10%
Mauritius	$998,137,557	$1,676,764,989	59.53%
Nepal	$352,427,674	$592,668,026	59.46%
Tokelau	$12,510,929	$22,262,477	56.20%
Palau	$1,516,677	$2,708,552	56.00%
Uzbekistan	$870,761,929	$1,632,564,444	53.34%
Guatemala	$1,919,787,060	$3,642,586,566	52.70%
Mongolia	$271,028,771	$559,151,583	48.47%
Tunisia	$3,705,945,131	$7,837,834,940	47.28%
Morocco	$3,350,698,021	$8,231,017,598	40.71%
Latvia	$393,702,298	$970,624,388	40.56%
Lao People's Dem. Rep.	$146,844,479	$375,777,962	39.08%
Turks and Caicos Isds	$9,921,983	$25,532,316	38.86%
Falkland Isds (Malvinas)	$7,770,717	$20,120,607	38.62%
Dominican Rep.	$2,254,614,346	$5,873,149,611	38.39%
TFYR of Macedonia	$349,815,085	$923,970,230	37.86%
Jordan	$645,150,152	$1,723,332,459	37.44%
Turkey	$15,649,013,906	$42,369,217,919	36.93%
Tajikistan	$183,578,635	$527,982,763	34.77%
Cape Verde	$7,487,808	$22,082,653	33.91%
Turkmenistan	$225,018,694	$710,226,818	31.68%
Swaziland	$165,058,897	$522,639,943	31.58%
Fiji	$160,298,092	$524,583,579	30.56%
Togo	$48,512,581	$174,393,454	27.82%
Guinea-Bissau	$1,592,734	$5,784,572	27.53%
Albania	$124,008,669	$475,386,667	26.09%
Myanmar	$694,352,459	$2,719,201,441	25.54%
Romania	$5,188,719,354	$20,353,122,819	25.49%
Saint Lucia	$4,300,774	$16,976,972	25.33%
Kyrgyzstan	$77,651,932	$312,856,227	24.82%
Bulgaria	$1,711,516,022	$6,902,081,214	24.80%
Vietnam	$4,326,722,215	$17,800,924,875	24.31%
China, Hong Kong SAR	$13,094,388,575	$55,589,928,239	23.56%
Egypt	$1,599,567,363	$6,852,236,120	23.34%
India	$12,220,973,567	$53,424,017,238	22.88%
Kenya	$240,718,775	$1,087,459,415	22.14%
Dem. People's Rep. of Korea	$139,817,057	$642,627,661	21.76%
Rep. of Moldova	$190,655,142	$891,752,077	21.38%
Greece	$2,218,228,223	$10,983,468,054	20.20%
Niue	$102,740	$547,033	18.78%

UN COMTRADE Database: Textile and Apparel Exports by Country—Continued

(as reported by importing country [World] for year 2003)

Exporter	Ranked by Percentage Textile and Apparel Exports		
	Textile & Apparel Trade Value	Total Exports	Percent Textile & Apparel Exports
Afghanistan	$25,819,493	$143,477,452	18.00%
Portugal	$5,045,134,457	$30,580,920,847	16.50%
Lithuania	$988,472,907	$6,354,047,221	15.56%
China	$81,830,027,469	$567,099,306,010	14.43%
Tuvalu	$229,407	$1,594,370	14.39%
Samoa	$3,326,905	$24,330,382	13.67%
Uganda	$16,509,805	$123,530,610	13.36%
Norfolk Isds	$283,770	$2,134,422	13.29%
Uruguay	$242,422,626	$1,843,231,109	13.15%
Belize	$18,368,604	$141,428,558	12.99%
Jamaica	$186,710,747	$1,470,138,581	12.70%
Burundi	$930,718	$7,448,345	12.50%
Croatia	$618,255,143	$5,036,029,674	12.28%
Peru	$813,367,194	$6,780,353,455	12.00%
Bahrain	$288,058,779	$2,471,252,565	11.66%
United Republic of Tanzania	$62,496,212	$537,988,904	11.62%
Br. Indian Ocean Terr.	$299,073	$2,612,910	11.45%
Ethiopia	$21,690,099	$196,470,392	11.04%
Bosnia Herzegovina	$150,398,019	$1,362,337,234	11.04%
Malawi	$44,924,569	$413,752,557	10.86%
Namibia	$45,622,493	$421,960,808	10.81%
Indonesia	$7,126,820,534	$67,246,611,415	10.60%
Italy	$26,314,132,679	$258,625,953,757	10.17%
Syria	$544,385,636	$5,404,760,288	10.07%
Zambia	$60,854,567	$619,428,515	9.82%
US Misc. Pacific Isds	$9,332,150	$102,825,389	9.08%
Serbia and Montenegro	$203,158,663	$2,276,537,275	8.92%
Zimbabwe	$124,461,260	$1,398,057,318	8.90%
Free Zones	$2,911,382,380	$32,773,825,996	8.88%
Brunei Darussalam	$364,310,635	$4,204,321,415	8.67%
Occ. Palestinian Terr.	$1,275,249	$15,008,327	8.50%
Estonia	$484,067,473	$5,703,924,149	8.49%
Costa Rica	$645,135,996	$7,667,465,906	8.41%
Saint Pierre and Miquelon	$76,749	$932,873	8.23%
Colombia	$865,295,387	$10,616,963,813	8.15%
Andorra	$6,676,388	$82,048,195	8.14%
Panama	$125,925,288	$1,676,392,850	7.51%
Malta	$234,212,274	$3,136,214,437	7.47%
Thailand	$5,421,293,182	$73,659,641,844	7.36%
Pitcairn	$113,341	$1,552,641	7.30%
New Zealand	$766,886,957	$10,654,243,674	7.20%
Cook Isds	$393,311	$5,612,214	7.01%
Sao Tome and Principe	$737,846	$10,683,238	6.91%
Other Asia, nes	$11,321,895,809	$171,681,285,267	6.59%
Rep. of Korea	$11,703,135,243	$180,023,997,857	6.50%
Luxembourg	$596,290,339	$9,427,718,751	6.32%
Christmas Isds	$727,507	$11,700,697	6.22%
Poland	$3,028,035,202	$48,992,659,083	6.18%
Philippines	$2,851,695,176	$46,571,069,145	6.12%
Saint Helena	$605,266	$9,932,406	6.09%
Mexico	$9,494,724,507	$160,702,777,459	5.91%
Slovenia	$692,246,374	$12,197,119,362	5.68%
Paraguay	$84,462,288	$1,573,318,548	5.37%
Czech Rep.	$2,554,786,151	$48,094,956,375	5.31%
Bhutan	$3,033,626	$58,510,546	5.18%
Central African Rep.	$8,763,763	$169,878,058	5.16%
Senegal	$16,229,199	$322,759,091	5.03%
Slovakia	$1,071,852,299	$21,681,584,712	4.94%
Spain	$6,227,145,073	$126,591,175,102	4.92%

UN COMTRADE Database: Textile and Apparel Exports by Country—Continued

(as reported by importing country [World] for year 2003)

	Ranked by Percentage Textile and Apparel Exports		
Exporter	**Textile & Apparel Trade Value**	**Total Exports**	**Percent Textile & Apparel Exports**
Cyprus	$58,825,746	$1,207,049,316	4.87%
Australia	$2,853,103,661	$60,078,811,633	4.75%
Belgium	$7,769,723,194	$165,489,703,795	4.69%
Israel	$1,347,291,828	$28,865,057,875	4.67%
Lebanon	$35,666,334	$804,494,613	4.43%
Belarus	$336,120,733	$8,061,699,032	4.17%
Denmark	$1,976,857,065	$48,223,588,655	4.10%
Sierra Leone	$7,602,132	$192,542,334	3.95%
Hungary	$1,539,815,407	$39,655,873,986	3.88%
Ukraine	$730,777,879	$18,896,553,495	3.87%
Cameroon	$103,868,755	$2,707,012,323	3.84%
Armenia	$21,229,280	$557,042,849	3.81%
Mozambique	$33,196,575	$890,251,710	3.73%
Bolivia	$53,327,959	$1,438,653,686	3.71%
Timor-Leste	$109,255	$3,094,571	3.53%
Austria	$2,760,274,993	$78,316,025,789	3.52%
France	$11,407,358,540	$326,668,078,821	3.49%
Sudan	$82,108,102	$2,409,509,462	3.41%
Mayotte	$55,565	$1,767,247	3.14%
Netherlands	$6,154,073,149	$198,554,070,981	3.10%
South Africa	$898,549,548	$31,013,187,633	2.90%
Kiribati	$59,744	$2,150,089	2.78%
Rwanda	$696,898	$25,155,715	2.77%
Germany	$17,873,959,110	$663,379,469,494	2.69%
Nauru	$506,064	$19,096,857	2.65%
United Kingdom	$6,872,688,832	$265,125,614,322	2.59%
Fr. South Antarctic Terr.	$178,869	$7,051,805	2.54%
USA	$16,645,151,068	$681,156,158,578	2.44%
Niger	$2,474,549	$107,279,001	2.31%
Brazil	$1,568,974,953	$70,316,025,789	2.23%
Iran	$547,564,296	$24,589,509,837	2.23%
Malaysia	$2,638,924,461	$124,023,056,941	2.13%
United Arab Emirates	$908,117,218	$43,009,706,122	2.11%
Cote d'Ivoire	$92,273,410	$4,376,859,489	2.11%
Europe EU, nes	$95,244	$4,588,358	2.08%
Dominica	$585,905	$28,375,693	2.06%
Switzerland	$2,208,681,682	$107,582,806,562	2.05%
Anguilla	$133,817	$6,586,706	2.03%
Gambia	$364,498	$18,273,235	1.99%
Azerbaijan	$34,303,964	$1,772,732,196	1.94%
Eritrea	$263,249	$14,385,449	1.83%
Guyana	$8,799,258	$483,011,082	1.82%
Cocos Isds	$32,248	1,822,752	1.77%
Ecuador	$77,675,149	$4,405,367,412	1.76%
Mauritania	$5,186,545	$299,714,414	1.73%
Other Africa, nes	$159,045	$9,216,024	1.73%
Kazakhstan	$166,684,714	$10,044,948,219	1.66%
Montserrat	$69,259	$4,365,700	1.59%
Japan	$7,153,982,756	$456,586,654,405	1.57%
Oman	$161,027,597	$10,318,033,968	1.56%
Argentina	$413,967,598	$26,639,639,526	1.55%
Canada	$4,067,860,705	$277,253,837,838	1.47%
Comoros	$64,760	$4,571,818	1.42%
Oceania, nes	$68,814	$4,923,221	1.40%
Tonga	$119,279	$9,057,318	1.32%
Saint Kitts and Nevis	$773,698	$64,724,803	1.20%
Sweden	$1,159,166,069	$98,938,719,441	1.17%
Wallis and Futuna Is.	$3,899	$333,617	1.17%
Faeroe Isds	$1,023,422	$93,791,114	1.09%

UN COMTRADE Database: Textile and Apparel Exports by Country—Continued

(as reported by importing country [World] for year 2003)

Exporter	Ranked by Percentage Textile and Apparel Exports		
	Textile & Apparel Trade Value	Total Exports	Percent Textile & Apparel Exports
Barbados	$3,209,813	$298,924,718	1.07%
Finland	$532,044,210	$51,042,684,128	1.04%
Russian Federation	$1,263,667,489	$122,551,040,081	1.03%
Iceland	$15,409,732	$1,513,603,734	1.02%
Singapore	$917,416,180	$90,313,736,799	1.02%
Ireland	$860,676,201	$110,083,024,111	0.78%
Chile	$134,365,269	$17,775,857,931	0.76%
Qatar	$94,964,985	$13,444,890,906	0.71%
Botswana	$14,548,329	$2,112,147,985	0.69%
Western Asia, nes	$100,205	$18,036,019	0.56%
Georgia	$5,201,954	$962,575,592	0.54%
Ghana	$9,288,034	$1,731,130,489	0.54%
Neutral Zone	$4,648	$877,137	0.53%
Somalia	$180,740	$34,412,170	0.53%
Grenada	$44,038	$8,617,506	0.51%
Areas, nes	$259,279,563	$50,828,539,591	0.51%
Guinea	$3,548,767	$705,890,588	0.50%
Br. Virgin Isds	$1,784,811	$358,858,310	0.50%
Neth. Antilles	$5,793,853	$1,198,221,322	0.48%
Djibouti	$46,029	$10,558,862	0.44%
Other Eurpe, nes	$466,941	$107,894,583	0.43%
Norway	$209,360,373	$59,256,950,177	0.35%
Bunkers	$122,702	$38,756,947	0.32%
Antigua and Barbuda	$1,184,210	$402,181,844	0.29%
Bahamas	$3,300,670	$1,241,865,735	0.27%
Kuwait	$48,758,225	$18,932,253,285	0.26%
Yemen	$8,869,472	$3,488,991,500	0.25%
Suriname	$1,142,696	$470,550,312	0.24%
Gibraltar	$389,922	$169,126,565	0.23%
Vanuatu	$87,249	$38,924,000	0.22%
Venezuela	$51,246,445	$24,559,575,123	0.21%
Bermuda	$947,295	$455,694,224	0.21%
Saudi Arabia	$162,059,817	$79,780,388,210	0.20%
Special Categories	$95,629,814	$48,648,964,636	0.20%
Nigeria	$43,546,387	$22,257,923,024	0.20%
Marshall Isds	$298,486	$160,274,769	0.19%
Cuba	$1,723,975	$992,478,996	0.17%
French Polynesia	$289,770	$175,435,419	0.17%
Liberia	$1,324,334	$1,108,287,997	0.12%
New Caledonia	$640,938	$549,932,685	0.12%
Saint Vincent and the Grenadines	$47,226	$50,016,819	0.09%
Iraq	$6,149,984	$8,494,161,029	0.07%
Seychelles	$153,391	$262,764,040	0.06%
Rest of America, nes	$6,771	$11,887,530	0.06%
Solomon Isds	$74,094	$158,032,546	0.05%
Greenland	$55,852	$122,875,606	0.05%
Trinidad and Tobago	$2,258,369	$5,597,846,721	0.04%
Dem. Rep. of the Congo	$248,982	$1,150,692,630	0.02%
Aruba	$265,064	$1,234,776,941	0.02%
Libya	$2,879,495	$14,405,729,620	0.02%
Cayman Isds	$94,832	$723,836,417	0.01%
Algeria	$2,608,030	$22,347,953,356	0.01%
Papua New Guinea	$158,900	$2,276,054,601	0.01%
Gabon	$192,915	$3,842,470,124	0.01%
Angola	$197,484	$8,482,449,455	0.00%
Congo	$44,108	$2,263,761,192	0.00%
Equatorial Guinea	$27,731	$2,840,937,825	0.00%
Aggregate Total	$392,717,704,544	$6,918,366,625,987	5.68%

Attachment II
2003 U.S. Production and Import Data for China Safeguard Petition Categories

(Data in Millions $USD)

Category	#'s	Product Description	U.S. Production	World Imports	Chinese Imports
1.	347/348	M&B and W&G cotton trousers	8,221.300*	11,376.204	280.220
2.	647/648	M&B and W&G man-made fiber trousers	*	3,452.882	296.789
3.	447	M&B wool trousers	*	310.878	13.894
4.	338/339	M&B and W&G cotton knit shirts	6,325.200**	10,848.005	197.835
5.	638/639	M&B and W&G man-made fiber knit shirts	**	3,642.711	188.274
6.	340/640	Non-knit cotton and man-made fiber shirts	**	2,729.569	136.004
7.	352/652	Cotton and man-made fiber underwear	2,827.600***	3,146.099	120.126
8.	620	Other synthetic filament fabric	2,133.400	239.799	6.571
9.	301	Combed cotton yarn	218.478	162.904	4.510
	Totals		19,725.978##	35,908.772	1,244.223
1.	350/650	Cotton and man-made fiber dressing gowns	***	541.332	199.313
2.	349/649	Cotton and man-made fiber brassieres	***	1,529.692	419.702
3.	222	Knit fabric	1,391.524	784.606	42.871
	Totals		##	2,855.630	661.886
	Totals for both sets of categories		21,117.502	38,764.402	1,906.109

* $8.2213B is the U.S. production value for all M&B and W&G trousers, including production for export.
** $6.3252B is the U.S. production value for all M&B and W&G shirts, including production for export.
*** $2.827B is the U.S. production value for all underwear, brassieres, and dressing gowns, including production for export.
$19.725978 billion is the U.S. production value for all trousers, shirts, underwear, brassieres, dressing gowns, other synthetic filament fabric, and combed cotton yarn, including production for export.
Sources: OTEXA—*http://otexa.ita.doc.gov* and U.S. Census Bureau—*www.census.gov*.

Attachment III

GLOBAL ALLIANCE for FAIR TEXTILE TRADE (GAFTT)

96 Trade Groups from 54 Countries Supporting the Principles of the Istanbul Declaration—Fair Trade for a Safer World

Argentina—Federacion Argentina de Industrias Textiles (FADIT–FITA)
Austria—Association of the Austrian Clothing Industry
Austria—Fachverband der Textilindustrie Osterreichs (Die Textilindustrie)
Austria—Eurocoton
Austria—Vereinigung Textilindustrie
Austria—Joint Committee of the Textile Finishing Industry in the E.U. (CRIET)
Bangladesh—Bangladesh Textile Mills Association (BTMA)
Bangladesh—Bangladesh Knitwear Manufacturers & Exporters Association (BKMEA)
Bangladesh—The Federation of Bangladesh Chambers of Commerce and Industry
Bangladesh—Bangladesh Terry Towel & Linen Manufacturers and Exporters Assoc.
Belgium—Federation Belge de L'Industrie Textile (FEBELTEX)
Belgium—Eurocoton
Belgium—Joint Committee of the Textile Finishing Industry in the E.U. (CRIET)
Belgium—International Association of Users of Artificial and Synthetic Filament Yarns and of Natural Silk (AIUFFAS)
Bolivia—Asociacion Nacional de Textileros de Bolivia
Bolivia—Federacion Textil Andina
Botswana—Botswana Export Development and Investment Authority (BEDIA)
Bulgaria—Association of Apparel and Textile Exporters in Bulgaria
Bulgaria—Bulgarian Association of Textile and Clothing
Bulgaria—Bulgarian Industrial Chamber
Bulgaria—Bulgarian Chamber of Commerce and Industry
Chile—Instituto Textil de Chile—Asociacion Gremial
Colombia—Asociacion Colombiana de Productores Textiles (ASCOLTEX)
Colombia—Federacion Textil Andina
Costa Rica—Costa Rica Textile Chamber
Costa Rica—Textile Quota Council
Czech Republic—Association of Textile-Clothing-Leather Industries
Dominican Republic—Dominican Free Zones Association (ADZONA)
Denmark—Joint Committee of the Textile Finishing Industry in the E.U. (CRIET)
Ecuador—Asociacion Textil del Ecuador (AITE)
Ecuador—Federacion Textil Andina
El Salavador—Union de Industrias Textiles
France—Eurocoton
France—Federation Francaise des Industries Lainiere et Cotonniere (FFILC)
France—Union Francaise des Industries de l'Habillement (UFIH)
France—Union des Industries Textiles (UIT)
France—Joint Committee of the Textile Finishing Industry in the E.U. (CRIET)
France—International Association of Users of Artificial and Synthetic Filament Yarns and of Natural Silk (AIUFFAS)
Germany—Eurocoton
Germany—Industrievereinigung Garne—Gewebe Technische Textilen
Germany—Joint Committee of the Textile Finishing Industry in the E.U. (CRIET)
Ghana—Gold Coast of Ghana
Greece—Association des Industries Cotonnieres de Grece
Greece—Hellenic Fashion Industry Association
Greece—Eurocoton
Greece—Panhellenic Union of Cotton Ginners and Exporters
Indonesia—Himpunan Pengusaha Kecil & Koperasi—Tekstil and Produk Tekstil (HPKK–TPT)
Indonesia—Asosiasi Industri Rakyat (AIR)
Indonesia—API DKI JAYA—Indonesian Textile Association of Greater Jakarta
Israel—The Manufactures' Association of Israel, Fashion & Textile Industries Assoc.
Italy—Associazione Italiana Industrie della Filliera Tessile Abbigliamento (AIIFTA)
Italy—Associazione Tessile Italiana (ATI)
Italy—Eurocoton
Italy—Joint Committee of the Textile Finishing Industry in the E.U. (CRIET)
Italy—International Association of Users of Artificial and Synthetic Filament Yarns and of Natural Silk (AIUFFAS)

Ivory Coast—Agency for the Promotion of Exports (APEX–CI)
Jordan—Jordan Garments, Accessories & Textile Exporters Association (JGATE)
Kenya—Kenya Apparel Manufacturers Exporters Association
Kenya—Kenya Association of Manufacturers—Textile Sector (KAM)
Latvia—Association of Textile and Clothing Industry
Lesotho—Lesotho Textile Exporters Association
Lithuania—Lithuanian Apparel and Textile Industry Association
Madagascar—Madagascar Export Promotion Association (GEFP)
Mauritius—Mauritius Export Processing Zone Association (MEPZA)
Mauritius—Mauritius-U.S. Business Association (MUSBA)
Mexico—Camera Nacional de la Industria Textil (CANAINTEX)
Mexico—Cámara Nacional de la Industria del Vestido (CNIV)
Mexico—Cámara Mexicana de la Industria Textil Central
Mexico—Cámara Textil de Occidente
Namibia—Namibian Investment Authority
Nepal—Garment Association of Nepal (GAN)
Netherlands—Joint Committee of the Textile Finishing Industry in the E.U. (CRIET)
Norway—Joint Committee of the Textile Finishing Industry in the E.U. (CRIET)
Paraguay—Cámara Textil Paraguaya
Peru—Comité de Confecciones de la Sociedad Nacional de Industrias del Perú
Peru—Comite Textil de la Sociedad Nacional de Industries del Peru
Peru—Federacion Textil Andina
Philippines—Confederation of Garments Exporters of the Philippines
Poland—The Gdynia Cotton Association
Poland—Polish Textile and Clothing Chamber
Poland—Polish Chamber of Textile Industry
Poland—Union of Employers of Textile Industry
Portugal—Federation of Portuguese Textile and Clothing Industry (FITVEP)
Portugal—Textile and Apparel Association of Portugal (ATP)
Senegal—Agency for the Promotion of Investments and Exports (APIX)
Slovenia—Chamber of Commerce and Industry of Slovenia, Textiles, Clothing and Leather Processing Association
South Africa—Clothing Trade Council of South Africa (CloTrade)
South Africa—Export Council for the Clothing Industry in South Africa
South Africa—South African Textile Industry Export Council (SATIEC)
South Africa—Textile Federation of South Africa (TEXFED)
Spain—Agrupacion Espanola de Desmotadores de Algodon (AEDA)
Spain—Asociacion Industrial de Proceso Algodonero (AITPA)
Spain—Consejo Intertextil Espanol
Spain—Eurocoton
Spain—International Association of Users of Artificial and Synthetic Filament Yarns and of Natural Silk (AIUFFAS)
Sri Lanka—Joint Apparel Association Forum
Sri Lanka—National Apparel Exporters Association
Swaziland—Swaziland Investment Promotion Authority (SIPA)
Swaziland—Swaziland Textile Exporters Association (STEA)
Switzerland—Eurocoton
Switzerland—Swiss Spinning Committee
Switzerland—Joint Committee of the Textile Finishing Industry in the E.U. (CRIET)
Switzerland—International Association of Users of Artificial and Synthetic Filament Yarns and of Natural Silk (AIUFFAS)
Tanzania—Tanzania Investment Center (TIC)
Tunisia—Federation Nationale de Textile (FENATEX)
Turkey—Turkish Textile and Raw Materials Exporters Association (ITKIB Textiles)
Turkey—Turkish Ready Wear and Garments Exporters Association (ITKIB Apparel)
Turkey—Turkish Clothing Manufacturers Association (TGSD)
Turkey—Turkish Textile Employers Association (TUTSIS)
Turkey—Eurocoton
Turkey—Joint Committee of the Textile Finishing Industry in the E.U. (CRIET)
Turkey—International Association of Users of Artificial and Synthetic Filament Yarns and of Natural Silk (AIUFFAS)
United Kingdom—Joint Comte. of the Textile Finishing Industry in the E.U. (CRIET)
United Kingdom—International Association of Users of Artificial and Synthetic Filament Yarns and of Natural Silk (AIUFFAS)
United States—American Manufacturing Trade Action Coalition (AMTAC)

United States—American Yarn Spinners Association (AYSA)
United States—National Cotton Council (NCC)
United States—National Council of Textile Organizations (NCTO)
United States—National Textile Association (NTA)
Uruguay—Asociacion de Industrias Textiles del Uruguay
Venezuela—Asociacion Textil Venezolana (ATV)
Venezuela—Federacion Textil Andina
Zambia—Export Board of Zambia
Zambia—Textile Producers Association of Zambia

Attachment IV

WORLD TRADE ORGANIZATION

Council for Trade in Goods

POST-ATC ADJUSTMENT-RELATED ISSUES

Initial Submission on Post-ATC Adjustment-related Issues from Bangladesh, Dominican Republic, Fiji, ***Jamaica****, Madagascar, Mauritius* ***Mongolia****,* ***Nepal****, Sri Lanka and Uganda*

Revision

The following communication, dated 29 September, is being circulated at the request of the above-mentioned Delegations.

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1. The textile and clothing industry is of vital importance for the economy of many developing countries due to its contribution to GDP, incomes, employment and exports. The Agreement on Textiles and Clothing (ATC) adopted during the Uruguay Round constituted an important step in the process of integrating this sector within the multilateral trading system.

2. The ATC was devised to ensure the smooth integration of the textiles and clothing sector in the multilateral trading system by addressing the restrictions on trade in textiles and clothing, and to ensure that developing countries benefited from an increased participation in the system. During these ten years of the implementation of the ATC, there have been mixed results for producers of textiles and clothing throughout the developing countries.

3. There is a number of documents in available literature on the impact of the elimination of the quota system and further liberalisation of the sector. While, overall the studies suggest that the elimination of quotas and further liberalisation of the sector may be beneficial for developing countries as a whole and for the global economy in terms of efficiency gains and consumer welfare, they also indicate that there will be winners and losers. However, available information already indicates that the predicament of the LDCs and other small and vulnerable economies are already very serious. The textiles and clothing industry in these countries will have to undergo major restructuring to meet the challenges for surviving in a fiercely competitive environment. The attendant adjustment costs will be enormous with staggering implications for the LDCs and other small and vulnerable economies having significant impacts in terms of economic and social disruptions. This calls for concerted efforts by the international community and the development as well as trading partners to identify and implement relevant measures with a view to solving the problems of those countries.

4. It should be pointed out that all the analytical work done so far has focused mainly on the global effects of the liberalisation of trade in the textiles and clothing sector. There is now more than ever before a need for a more focused and disaggregated analysis at country level in order to assess the magnitude of the adjustment process in the affected developing countries. Indications are clear that the prospects of the LDCs and other small and vulnerable economies in particular, will worsen by the end of the phase-out in the coming months. Therefore, urgent measures should be put in place to address the concerns of the losers in the system and ensure smooth transition in order to avoid the disastrous economic and social conditions in these countries upon the expiry of the ATC agreement.

5. Assumptions and estimates made in one of the studies place the loss of jobs worldwide around 27 million. In the same breath, it is now known that job loses especially for women will be highest. The textiles and clothing sector has been predominantly the sector offering the largest job opportunities for female employment. Alternative employment for females in as large numbers as in this sector are practically inexistent. Furthermore, job losses as a result of contraction and closures of textiles and clothing factories will compound the problems of unemployment, thereby creating social unrest and increasing poverty.

6. Activities will be disrupted not only in this sector per se but will also induce negative multiplier effects permeating throughout other sectors in the respective countries. While the direct contribution of this sector to the overall economic growth and development is high, one should not underestimate its linkages to other related

economic sectors, such as banking and insurance, transport and logistics and other service providers, particularly in the small enterprise segment. The overall economic and social consequences can therefore be very disastrous.

7. The unbalanced distribution of the benefits of the liberalisation in this sector is cause for serious concern. The losers in this process have seen their market share shrink drastically while the few winners have seen phenomenal growth. If this trend remains uncorrected, the Doha Round would be utterly disappointing for these countries. How will the objectives of placing their needs and interests "at the heart of the Doha Programme" be achieved? Paragraph 2 of the Doha Ministerial Declaration recalling the Preamble of the Marrakesh Agreement, enjoins WTO Members to "continue to make positive efforts designed to ensure that developing countries, and especially the least-developed among them, secure a share in the growth of world trade commensurate with the needs of their economic development. In this context, enhanced market access, balanced rules and well-targeted, sustainably financed technical assistance and capacity-building have important roles to play."

8. The post-ATC adjustments are fundamental to addressing and reinvigorating production and competitiveness in the LDCs and other small and vulnerable economies. In particular, the small suppliers will face acute hardship in adjusting to the new situation. The economic transition will be difficult and painful if one considers that they already have to face a high level of indebtedness and high costs of inevitable social safety nets to cushion the shock of these adjustments. Corrective measures need therefore be adopted and implemented within WTO and other related agencies within the framework of policy coherence among concerned institutions in order to enable the textiles and clothing sector of the adversely affected countries to adapt to the increasingly challenging market conditions.

9. The new market environment implies that there is ability and capacity to supply products on more competitive terms. This requires restructuring and modernising the textiles and clothing industry in these countries. However, the lack of resources and capacity to address issues of international competitiveness constitute serious set back if measures are not taken within the multilateral trading system to support the countries for both mitigating the adverse impact of trade liberalisation and withstanding the stiff competition from major players in the international market.

10. Keeping in view the aims and objectives of the WTO of contributing "to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand," the Marrakesh Agreement recognizes the need for positive efforts to ensure that developing countries, and especially the least developed among them, will participate in the growth in international trade commensurate with their needs for development.

11. As part of its mandate for overseeing the functioning of the WTO Multilateral Trade Agreements, the Council for Trade in Goods (CTG) has had within the purview of its work the oversight of the implementation of the ATC. With the expiry of the ATC and the integration of the textiles and clothing sector in the multilateral trading system, the CTG will now have to play an even more important function in this particular sector. Positive measures will need to be identified and put in place to address the difficult predicament of the LDCs and other small and vulnerable economies. In this context, it is the considered view of the LDCs and other small and vulnerable economies that an urgent work plan be undertaken by the CTG.

12. Based on the above considerations, it is of utmost importance that the WTO, through the work of the CTG, undertakes an in-depth analysis of the adjustment-related issues and costs that may arise in various developing countries that are affected as a result of the phase-out of the quota system under the ATC. There is a need to ensure a smooth transition and minimizing the disruptions resulting from the adjustment process.

13. With this in mind, the following proposals are made:

- **The WTO Secretariat should carry out a study aiming at identifying the adjustment-related issues and costs that may arise with the phase-out of the ATC, including recommendations on measures to address such issues. This study should look at the global impact of the phasing-out of the ATC agreement in a disaggregated manner at country level for the LDCs and other small and vulnerable economies who are the losers in the process;**
- **The CTG should establish a Work Programme to discuss with a view to finding solutions to the problems identified as above as well as those raised by Members in relation to the adjustment-related issues costs concerning the ATC phase-out.**

Attachment V

WORLD TRADE ORGANIZATION

Council for Trade in Goods

TURKEY'S CONTRIBUTION TO THE DEBATE ON POST-ATC RELATED ISSUES

The following communication, dated 25 October 2004, is being circulated at the request of the Delegation of Turkey.

Textile and clothing sector is one of the most global industries in the world today. It constitutes a major source of income and employment for many countries, especially for the developing ones. This sector also plays a crucial socio-economic role in many of countries' development efforts, by offering entry-level jobs for unskilled labor. The clothing sector in particular employs a larger number of workers, the majority of which are female as also indicated in the Discussion Paper of the WTO.

Businesses engaged in this sector vary from small and medium size enterprises employing labor-intensive methods of production, to highly automated and technologically advanced, large scale units. However, in many countries, textile and clothing sector is dominated by small-scale enterprises.

For more than forty years, textiles and clothing sector has received more comprehensive and persistent protection than any other industrial sector. Integration of trade in textiles and clothing into the GATT system was one of the hardest-fought issues during the Uruguay Round and in this regard, the Agreement on Textiles and Clothing (ATC) is considered one of the biggest achievements for the developing countries.

Even though the rationale of the quota system was to provide a temporary relief so that the quota imposing countries' industries could adjust for international competition on their own, many developing and the least developed countries, with the help of a guaranteed market share, have been able to use the system to develop their textile and clothing exports.

At present, for a good number of the developing countries, the sector is the main source of export revenue, accounting in some instance for as much as 90% of manufacturing exports. Depending on the country, the sector also accounts for 20–60% of manufacturing jobs. These figures are more than enough to show how some countries' economies are dependent on this sector. This fact is often compounded by the dependence on European Union and/or the United States' markets, which together absorb the lion's share of world textile and clothing imports.

Today, just a few months before the end of the ATC, it can be clearly put forward that the sustainability of textiles and clothing sectors are at stake in many developing and the least developed countries.

In the third integration period of the ATC, the WTO members have witnessed a dramatic transformation of global production and sourcing patterns in this sector.

In some of the liberalized quota categories in the U.S. market the increase of Chinese products soared as high as 800% in 2002. Also, the unit price decline in those liberalized categories was around 60%. This is also true for the EU market. In some individual categories, the expansion of market share has multiplied several times over with an average unit price reduction of up to 75%.

Nevertheless, developments in the Japanese textile and clothing market between 1990 and 2002 display another sign of such dramatic change in that period. The share of Japanese imports originating from a single country soared from 31% to 79%.

Numerous credible studies on the implications of the quota phase-out have shown, by the removal of quotas by 2005, global textile and clothing trade will be monopolized by a WTO member with an estimated share of 50% or more. It is also important to stress that the quantitative restrictions that will be eliminated by 2005, cover both the most sensitive and the highest value-added products. As a result of this, more than 30 million jobs around the world are estimated to be lost to a few in a short span of time.

The textiles and clothing sector takes substantial place in Turkey's economy and foreign trade as well. It constitutes the largest industry and accounts for 10% of GDP, 22.6% of manufacturing output, and 21% of employment in the manufacturing sector. Turkey's exports of textile and clothing products contributed 34.4% to total

merchandise exports in 2003. The EU has traditionally been the main market, followed by the United States.

The comprehensive report of the Textiles Monitoring Body on the implementation of the ATC during the third stage of integration process draws WTO members' attention to the fact that the post-ATC period will bring about important trading opportunities and challenges that the WTO members will have to face. It is very clear that full implementation of the ATC is fundamental to the credibility of the multilateral trading system. However, the current data indicate that market dominance will limit the opportunities only for a small number of countries, whereas the great challenges are going to be left to the rest. In that case, the economic and social disruption will be significant for many developing and the least developed countries.

It should also be noted that the prospective problem, besides the least developed ones, is in the interest of many developing countries. To that end, it should permanently be kept in the WTO agenda unless an urgent satisfactory solution is generated for all countries that will be affected negatively.

The ambitious agenda of ongoing market access negotiations for non-agricultural products under Doha Development Agenda too, necessitates an urgent full review of global textile and clothing production, export and market circumstances so as to develop appropriate remedies within the multilateral trade system. In this respect, the ongoing market access negotiations for non-agricultural products provide us with an opportunity to develop appropriate trade policies that will be needed from 2005 onwards.

All of the WTO member countries have a responsibility to address the justifiable concerns of the developing as well as the least developed countries about the sustainability of their economic growth and its main components such as textile and clothing exports.

Turkey strongly believes that the answer to the question of how the major challenges ahead are going to be handled should be given by all WTO countries in compliance with their WTO commitments and by developing appropriate remedies within the multilateral trade system.

It is obvious that there are rules in place in order to protect domestic markets against unfair trade practices. Likewise, there is a strong need for the establishment of such mechanisms to protect the market shares of the developing countries in their export markets.

At this stage, various options; from a monitoring mechanism that will concentrate on the threat of market distortions to a unique safeguard mechanism that has a self-triggering structure and aiming at smooth functioning of trade in the major export markets and avoiding unfair practices can be discussed towards a comprehensive and exhaustive solution under a WTO work program.

Consequently, new mechanisms should urgently be developed to ensure smooth transition to the quota free trading environment if international trade is to stay as the engine of sustainable development. There is no doubt that timely and full implementation of the WTO commitments is vital for the credibility of the multilateral trading system. Likewise, it should also be kept in mind that all WTO members are in need to benefit from the increased opportunities and welfare gains that the multilateral trading system generates. Moreover, it is WTO member countries' commitment to continue their positive efforts to ensure that developing countries, and especially the least developed among them, secure a market share in the growth of world trade commensurate with the needs of their economic development. In this respect, the new mechanisms should make the WTO more flexible while responding to the needs of many developing countries timely and efficiently. This will, in turn, definitely enhance the credibility of the WTO system.

The complexity of the challenges that many developing countries will face, of course, requires policy coherence between the WTO and other relevant international organizations. However, it is clear that the WTO is the sole address to solve problems originating from the conduct of trade relations among its members in matters related to the WTO agreements and other associated legal instruments.

Cochair MULLOY. Thank you.
Mr. Raynor.

STATEMENT OF HARRIS RAYNOR
VICE PRESIDENT, UNITE HERE

Mr. RAYNOR. Thank you. My name is Harris Raynor, and I am the Southern Regional Director and an International Vice President of a labor union called UNITE HERE. I want to thank you for allowing us to be at this hearing and to present this testimony not only on behalf of the union but obviously on behalf of the employees of these companies who have been affected by the problems that we're here to discuss.

I hope that you'll forgive me for being a little bit emotional about this, but I represented a lot of people who lost their jobs due to the U.S. trade policies. I would like to remind the Commission that I testified before you before. The last time, I wasn't from this union. I was from a union called UNITE. We've since merged with the Hotel Employees and Restaurant Employees. Now, you might wonder why a union that represents needle trades and textile workers would be merging with a union that represents hotel employees and restaurant employees. I think the answers to this Commission ought to be obvious.

I also serve as a cochair of the unsecured creditors committee in the Pillotex bankruptcy, which, two years later, is still ongoing and in the bankruptcy of Cone Mills, the largest denim manufacturer in the United States. And in that capacity, I have got a unique way of looking at this industry and at the people that we have tried to bring in to purchase some of these companies and try to keep the industry going and keep jobs for people here.

Auggie mentioned a few minutes ago how labor intensive the apparel industry is. The textile industry is not as labor intensive. The textile industry in the United States is the most modern textile industry in the world and is a capital-intensive industry. That hasn't helped.

The fact of the matter is, we can use Pillotex as an example. There were over 8,000 employees affected by the Pillotex bankruptcy, most of them in the Carolinas but also in a number of other southern states and as far away as California. Pillotex was a company that was really made up of a merger of three different companies: an older company called Pillotex, which made pillows, and two more famous home furnishings companies, Fieldcrest and Cannon.

In one fell swoop, in July, those companies ceased to exist, were wiped off the face of the Earth, sold off their inventory, and don't exist anymore; not a single worker, not a single piece of production: There are now three people in a human resource office and a lawyer getting rich off the bankruptcy.

Now, you would think logically that their competitors, although they would be sad about this, would say whoa, customers out there, let's swoop down and get them. Where are Pillotex's customers? There are two major competitors of theirs in the textile industry. One company is called Springs Industries, and the other company is West Point Stevens. West Point Stevens is in Chapter 11 bankruptcy, just closed six plants. 3,500 workers in the Carolinas no

longer have jobs. Springs, as we sit here, announced today the closing of two more towel mills in Griffin, Georgia; 600 more employees don't have jobs.

Now, what that says to me, and what it would say to anybody else who has a brain and listens to this, is that there is no market share of Pillotex's that was gobbled up. The U.S. market share disappeared, and not only did it disappear, but along with it, the Springs market share, and the West Point market share have shrunk dramatically resulting in these plant closings. Those are the numbers that you saw on the charts. The Chinese in 2005 moved in and took everything, and it's growing, day by day by day.

Now, what does that mean to us? There are human beings involved, and those human beings lose their jobs. You haven't seen it yet, because most of the workers in the textile industry took advantage of the Trade Adjustment Assistance Act and went back to school, not because they really thought they could get trained for all these great jobs. It doesn't take a lot of training to teach somebody to say welcome to Wal-Mart, here's your shopping carts. They went to get the training because that's how you extend your unemployment benefits.

The two years and the period in which those benefits were extended are now gone, and of the over 3,500 Pillotex workers in the area around Kannapolis, North Carolina, only 1,300 of them are still in school. They don't count on the unemployment rolls, because those who went to school are not actively seeking work and are not included in the rolls of the people who are unemployed.

So we have, obviously, a serious issue for these people. These are people largely in their forties and fifties. They had good jobs. They had four weeks of vacation. They had pension plans, which the PBGC now owns, and those workers made a decent living. Many of them were two people working for the same company. They're losing their homes; they're losing their cars. Pillotex was self insured, so there's no COBRA coverage; they have no medical benefits; they can't afford to pay for coverage.

These are real, live human beings, human beings that I represent and that I feel I have failed but I also feel my government has failed. I was asked not long ago by the Charlotte Observer what I thought would happen when the quotas were lifted in 2005. And I spoke off the top of my head, as I often do, and I said it's going to be like a tsunami. Well, little did I realize how prophetic that comment was.

The difference between the tsunami that we all read about and experienced recently and the one that's going through the textile industry now is ours in the textile industry was preventable. This is not a force of nature, like some would have you believe. The problem that we are dealing with here is that the issue that the panel is supposed to be discussing, strategies for enforcement, begs the question: enforcement of what?

You have to have a trade policy, which ought to be an economic development policy, both for our country and the other countries we trade with. We are not looking to put up artificial barriers for trade. We are looking to use trade as a policy arm to improve the lot of people not only in our own country but also throughout the

world. That can only be done by a planned economic development policy.

During the previous panel, one of the Commissioners asked the question of someone about currency issues, and the Treasury Department's concerns, and the answer came back well, the Treasury Department, yes, that's right, they're really worried about interest rates and the bonds they're selling—not the big picture. The problem is when you don't have a comprehensive, coherent trade policy, then, what you have is every little segment of the economy reacting and dealing with this policy without a plan and dealing with this issue without a plan.

That's what we have today. My good friends to the left will tell you this is the most liberating thing in the whole world: everybody should be so happy that they can buy cheap junk at Wal-Mart, and that's going to enhance our living standards. I would say to you that logically, that is not necessarily correct. When a company, whether it's a retailer or a manufacturer, looks at its profits, at its economic health, it looks at the difference between the price that it pays for goods or the price that it pays for raw materials and the selling price. It's commonly called margin.

I don't believe that too many of the retailers in this country are in business as charities. They're not giving away their product. They're making money selling their product. They're not providing a service to the American economy, okay? And the same thing is true on the opposite end. People whose living standards are advanced and people whose purchasing power is increased can therefore afford to pay more for goods, and it's not an issue of how cheap the products are; it becomes an issue of the living standards of the people who benefit from having an economy. Companies can make money either way.

Cochair MULLOY. Mr. Raynor, I want to thank you very much. We will probably have further discussion of this during the question period, but if I could ask Mr. Autor to speak now and then Ms. Hughes.

STATEMENT OF ERIK O. AUTOR
VICE PRESIDENT, INTERNATIONAL TRADE COUNSEL
NATIONAL RETAIL FEDERATION

Mr. AUTOR. Thank you. I'd like to thank the Commission for the opportunity to appear at today's hearing on behalf of the National Retail Federation and American retailers. The National Retail Federation is the world's largest retail trade association, with membership that comprises all retail formats and channels of distribution, including department, specialty, discount, catalogue, Internet and independent stores as well as the industry's key trading partners in retail goods and services.

The NRF represents an industry with more than 1.5 million U.S. retail establishments, more than 23 million employees, about one in five American workers, and 2003 sales of $8.3 trillion.

In order to understand the impact of the elimination of quotas and imports from China on the U.S. textile and apparel industries, it's necessary to put several things into perspective about textile and apparel trade, production, post-quota competition the current conditions of the textile and apparel industries.

According to the American Apparel and Footwear Association and other sources, 96 percent of all clothing by volume that is sold in the United States is sewn outside the United States. By value, the import penetration for clothing is still very high, at 86 percent, due to more expensive labor and inputs such as fabrics.

This extraordinarily high level of import penetration has been a trend that has occurred well before China became a major player on the scene and has come about notwithstanding the fact that textile and apparel remain the most protected sectors in U.S. manufacturing. Textiles and apparel are shielded behind a tariff wall that, with the exception of footwear, is higher than any other manufactured product, around 16 percent for non-preferential trade.

These high tariffs continue to cover products from China and every Asian country except Singapore. Textiles and apparel are also subject to the most onerous and restrictive rules of origin under our free trade agreements and preference programs of any manufactured product, a system designed mainly to restrict access of Chinese goods to the U.S. market.

Although the textile and apparel quotas system ended on January 1, 80 percent of all textile and apparel products under quota remained so until the bitter end. During this time, China was subject to the most stringent quota restrictions of any country. For example, Cambodia, with about 13 million people, had larger quotas than China on key apparel categories such as cotton bottoms.

The severe quantitative limits placed on Chinese products combined with the back loading of quota elimination to the very end created the conditions that virtually guarantee an increase in imports from China. In addition, one of the biggest culprits to pushing trade to China is, ironically, the U.S. textile industry.

By opposing the preference programs that would help Third World producers compete more effectively, handicapping producers in our free trade agreement partner countries through unworkable rules of origin, pushing for new quotas on companies like Vietnam and pressuring Customs into harassing textile and apparel imports under the claim that everything is really transshipped from China, they have made it as difficult as possible for their customers, American retailers and apparel manufacturers to do business in countries that would be alternatives to sourcing in China.

This is an important point, because retailers are loathe to put all their eggs in the Chinese basket, as evidenced by the modest growth in retail orders in China: around 12 to 20 percent. Retailers have been actively seeking alternative places to source product in places like India, Pakistan and Honduras.

The reasons are fairly simple: the risks for putting all your orders in China are becoming too high. These risks include the likelihood that U.S. manufacturers will file trade cases targeting Chinese goods. Also, with most imports from China coming through the West Coast, particularly L.A.-Long Beach, the growing port congestion crisis as well as labor strife in 2002 that resulted in a shutdown of the West Coast ports were a wakeup call for retailers.

The port shutdown was followed by the SARS scare in 2003, when retailers were unable to send their sourcing and design staffs to China for over a month. China is also experiencing a serious energy crisis, which is causing blackouts and factory closures. Finally,

with the huge influx of foreign direct investment, labor costs are increasing along coastal China. In response, the Chinese government is trying to push investment inland, which has a backward transportation infrastructure, resulting in substantially increased transportation costs and delays in shipment.

Another important element affecting trade and the conditions of competition is fundamental changes in apparel production. It is important to remember that the textile industry is but one element in the overall supply chain for clothing, which includes fiber producers, yarn spinners, fabric manufacturers, apparel manufacturers, importers and retailers and finally the consumer.

Under the old cut and sew model of apparel production, U.S. fabric and components were purchased and shipped offshore for assembly into garments and re-exported into the United States. Under the current full package model of apparel production, retailers and importers place orders with their vendors, who are responsible for meeting the specifications on fabric, design, price and just in time delivery.

While price remains an important factor under this system, speed to market is a more critical factor. Under this system, the most competitive suppliers are those who have integrated production and provide superior customer service. This means meeting customer needs, providing consistently high quality and on time delivery, assisting the consumer in product development from concept to market.

Suppliers that are unable or unwilling to provide according to these customer requirements will lose out to their competition regardless of price or how much new technology they have. The U.S. apparel industry has largely succeeded in adjusting to this new environment from transforming itself from local manufacturers into successful and competitive branding and marketing companies with worldwide operations.

During this transformation, commodity apparel production has shifted overseas, as apparel manufacturers follow their customers. Therefore, apparel manufacturers have benefited from the end of the quota system and the business relationships that they have established throughout the world.

In addition, for those apparel manufacturers that have remained in the United States, the quotas are not an economic rationale for their competitiveness. These manufacturers often occupy key niche, high-end and specialty apparel categories that will remain in the United States due to various factors, including military procurement rules, and their customers need to have some production nearby to fill production gaps quickly.

Like the apparel industry, the textile industry has seen these changes coming for the past 15 years. Some followed the example of the apparel industry and succeeded in adjusting to the new global environment. Spurred by import competition, successful entrepreneurial companies like Milliken and Company and Wilbur Ross' International Textile Group are adapting by creating global operations, getting out of the production of low-cost and commodity yarns and fabrics for apparel production, and focusing on specialized high performance yarns and fabrics, building successful busi-

nesses serving the automotive sector and residential and commercial construction.

This change requires a more highly skilled and highly trained work force than currently exists. The jobs of the future in the textile industry are marketers, designers, chemists and lab technicians and engineers, not low-skilled workers making commodity apparel yarns and fabrics.

Cochair MULLOY. Mr. Autor, do you want to——

Mr. AUTOR. I'll conclude, and I'll be happy to talk further about the other issues that the Commission wants to address.

Cochair MULLOY. Thank you.

Mr. AUTOR. I will just say that the success of these companies demonstrate that the textile industry is not on the verge of extinction but rather is undergoing a fundamental transformation that will make it more competitive. These companies actually represent a majority of the textile industry, which in 2003, saw a profit of $1.3 billion.

I'll conclude my remarks with that.

[The statement follows:]

Prepared Statement of Erik O. Autor
Vice President, International Trade Counsel
National Retail Federation

I would like to thank the Commission for the opportunity to appear at today's hearing on behalf of the National Retail Federation and American retailers. By way of background, the National Retail Federation is the world's largest retail trade association, with membership that comprises all retail formats and channels of distribution including department, specialty, discount, catalog, Internet and independent stores as well as the industry's key trading partners of retail goods and services. NRF represents an industry with more than 1.5 million U.S. retail establishments, more than 23 million employees—about one in five American workers—and 2003 sales of $3.8 trillion.

1. Effect of Post-Quota Global Competition on the U.S. Textile and Apparel Industries

In order to understand the impact of the elimination of quotas and imports from China on the U.S. textile and apparel industries, it is necessary to put several things into perspective about textile and apparel trade, production, post-quota competition, and the current conditions of the textile and apparel industries.

According to the American Apparel & Footwear Association and other sources, 96 percent of all clothing by volume that is sold in the United States is sewn outside the United States. By value, the import penetration for clothing is still very high at 86 percent due to more expensive labor and inputs, such as fabric.

This extraordinarily high level of import penetration has come about, notwithstanding the fact that textiles and apparel remain the most protected sectors in U.S. manufacturing. Textiles and apparel are shielded behind a tariff wall that, with the exception of footwear, is higher than any other manufactured product—around 16 percent for non-preferential trade. These high tariffs continue to cover products from China and every Asian country except Singapore. Textiles and apparel are also subject to the most onerous and restrictive rules of origin under our free trade agreements and preference programs of any manufactured product, a system designed mainly to restrict access of Chinese goods to the U.S. market.

Although the textile and apparel quotas system ended on January 1, 80 percent of all textile and apparel products under quota, remained so until the bitter end. During this time, China was subject to the most stringent quota restrictions of any country—for example, Cambodia, with about 13 million people, had a larger quota than China on key apparel categories such as cotton bottoms.

The severe quantitative limits placed on Chinese products, combined with the backloading of quota elimination to the very end, created the conditions that virtually guarantee increases in imports from China. In addition, one of the biggest culprits in pushing trade to China is, ironically, the U.S. textile industry. By opposing the preference programs that would help third-world producers compete more effectively, handicapping producers in our free trade agreement partner countries

through unworkable rules of origin, pushing for new quotas on countries like Vietnam, and pressuring Customs into harassing textile and apparel imports under the claim that everything is really transshipped from China, they have made it as difficult as possible for their customers—American retailers and apparel manufacturers—to do business in countries that would be alternatives to sourcing in China.

This is an important point, because retailers are loathe to put all their eggs in the Chinese basket as evidenced by the modest growth in retail orders in China—around 12 to 20 percent. Retailers have been actively seeking alternative places to source product in places like India, Pakistan, and Honduras. The reasons are fairly simple—the risks of putting all your orders in China are becoming too high. These risks include the likelihood that U.S. manufacturers will file trade cases targeting Chinese goods. Also, with most imports from China coming through the West Coast, particularly LA/Long Beach, the growing port congestion crisis as well as the labor strike in 2002 that resulted in a shutdown of the West Coast ports were wake-up calls for retailers. The port shutdown was followed by the SARS scare in 2003, when retailers were unable to send their sourcing and design staffs to China for over a month. China is also experiencing a serious energy crisis, which is causing blackouts and factory closures. Finally, with the huge influx of foreign direct investment, labor costs are increasing along coastal China. In response, the Chinese government is trying to push investment inland, which has a backward transportation infrastructure resulting in substantially increased transportation costs and delays in shipments.

Another important element affecting trade and the conditions of competition is fundamental changes in apparel production. It is important to remember that the textile industry is but one element in the overall supply chain for clothing, which includes fiber producers, yarn spinners, fabric manufacturers, apparel manufacturers, importers and retailers, and finally, the consumer.

Under the old cut-and-sew model of apparel production, U.S. fabric and components were purchased and shipped offshore for assembly into garments and reexported to the United States. Under the current full-package model of apparel production, retailers and importers place orders with their vendors who are responsible for meeting the specifications on fabric, design, price, and just-in-time delivery. While price remains an important factor under this system, speed to market is a more critical factor. Under this system, the most competitive suppliers are those that have integrated production and provide superior customer service. This means meeting customer needs, providing consistently high quality and on-time delivery, assisting the customer in product development from concept to market. Suppliers that are unable, or unwilling to perform according to these customer requirements will lose out to their competition regardless of price or how much new technology they may have.

The U.S. apparel industry has largely succeeded in adjusting to this new environment, by transforming itself from local manufacturers into successful and competitive branding and marketing companies with world-wide operations. During this transformation, commodity apparel production has shifted overseas as apparel manufacturers followed their retail customer. Therefore, apparel manufacturers have benefited from the end of the quota system and the business relationships they have established with partners in China and elsewhere. In addition, for those apparel manufacturers that have remained in the United States the quotas are not an economic rationale for their competitiveness. These manufacturers often occupy key niche, high-end, and specialty apparel categories, that will remain in the United States due to various factors, including military procurement rules and their customers need to have some production nearby to fill production gaps quickly.

Like the apparel industry, the textile industry has seen these changes coming for the past 15 years. Some followed the example of the apparel industry and succeeded in adjusting to the new global environment. Spurred by import competition, successful, entrepreneurial companies, like Milliken & Company and Wilbur Ross' International Textile Group, are adapting by creating global operations, getting out of the production of low cost, commodity yarns and fabrics for apparel production, and focusing on specialized high-performance yarns and fabrics, and building successful businesses serving the automotive sector and residential and commercial construction. This change requires a more highly skilled, and highly-trained workforce than currently exists—the jobs of the future in the textile industry are marketers, designers, chemists and lab technicians, engineers, not low-skilled workers making commodity apparel yarns and fabrics.

These companies are also succeeding in developing export markets, including China, which is now the fastest-growing U.S. export market. American sales of fabric and yarn to Chinese clothing factories have jumped 150 percent from $83 million

four years ago to a quarter of a billion dollars last year and China is becoming an important export market for U.S. cotton.

The success of these companies demonstrates that the U.S. textile industry is not on the verge of extinction, but rather is undergoing a fundamental transformation that will make it more competitive in the long run. These companies actually represent the majority of the textile industry, which saw a profit in 2003 of $1.3 billion. This success is not dependent on what happens in the production and trade of commodity apparel products.

Also, the productivity gains these companies have achieved necessarily mean that they are able to produce more output with fewer workers. Like other manufacturing sectors, many studies confirm that improvements in productivity and technology, not trade, have had the most significant impact on employment in the textile sector, which is now a capitol intensive industry.

Nevertheless, it must be recognized that a minority of the textile industry is struggling in the face of global competition in large measure because they have failed for a variety of reasons to adapt to the fundamental changes I have described. Many are privately-owned with limited access to capital, which leaves them comparatively inefficient and behind in the use of new technologies. Others are heavily leveraged with unsustainable debt loads or find their productivity hampered by U.S. high tariffs that limit them from using a broader selection of competitively-priced foreign yarns. Many lack the flexibility and ability to provide the full range of services their retail and apparel customers demand. It is these factors, not the end of the quota system or competition from China, that are the source of their competitiveness problems.

These points are discussed more fully in a study by economist, Laura Baughman, of the Trade Partnership that looks at the current condition of the U.S. textile and apparel industries. A copy is appended to these comments.

2. Effectiveness of the China Textile Safeguard

We contend that the China textile safeguard is ineffective if its goal is to protect U.S. manufacturers and jobs. The vast majority of clothing sold in the United States is now imported and most of the world can export to the United States quota free. Therefore, penalizing Chinese producers by imposing a safeguard quota will only result in shifting production to other Asian producers. Even though the safeguard may succeed in limiting imports from China, it will not change the overall level of imports. Nor will it prevent corresponding surges from other countries as production from China is shifted to places like Pakistan and India. Finally, even with a safeguard quota in place, Chinese manufacturers can still sell their yarn and fabric to another country like Indonesia, which can, in turn, export clothing made from that yarn and fabric to the U.S. without restriction.

The textile industry apparently agrees that the safeguard mechanism is ineffective. For example, they re-filed a petition against brassieres, claiming market disruption and injury in 2004 when the product was under a textile safeguard quota. If their claim is correct, it is evident that the quota provided them no real benefit.

3. Appropriate Uses for the China Textile Safeguard

The trade remedies laws are designed to protect U.S. production and U.S. jobs, a principle that must also apply to the China textile safeguard. Therefore, the textile safeguard should not be used against products, such as brassieres or fully-fashioned sweaters, that are not made in the United States. Nor should the textile safeguard be used mainly to protect production in certain favored foreign countries. Finally, the textile safeguard should not be applied against categories of clothing when U.S. apparel producers oppose the petition, as was the situation, for example, in the brassieres case.

4. The Legal Suit Regarding Administration of the China Textile Safeguard

The Commission has asked for NRF's views on the lawsuit filed in December, challenging the Committee for the Implementation of Textile Agreements' administration of the China Textile Safeguard, specifically with respect to cases filed that have alleged threat of market disruption.

First, I want to state that the National Retail Federation is not a party to that suit, but we are clearly interested observers. I will, therefore, defer to my colleague, Julie Hughes, who represents USA–ITA, the plaintiff in that case, to provide a more complete analysis, and NRF associates itself with her views.

I would, however, like to provide the Commission some general thoughts about this case. For three decades, the textile quota system was administered by CITA, an interagency government entity run out of the Department of Commerce. Because it fell under the President's foreign affairs exception, CITA operated largely as a star chamber in setting and administering quotas. It acted by fiat, it lacked any

transparency or accountability in its decisionmaking, and its decisions were final and not subject to any sort of appeal or review.

That system of decisionmaking has remained largely intact as CITA was tasked with administering the China Textile Safeguard mechanism—a quasi judicial administrative mechanism that is arguably fundamentally different than CITA's previous role. What has angered importers and retailers is the fact that CITA has operated in a clearly arbitrary and capricious manner with impunity. For months, CITA had told retailers and importers that the language in its procedures and the terms of China's WTO accession, precluded it from accepting cases based on threat of market disruption. Then, it did a complete about face and announced at a press conference that it would accept such cases. Then CITA told retailers and importers it would publish new guidelines for administering threat-based cases in the Federal Register and would provide an opportunity for public comment. That never happened.

This situation underscores our view that it is simply unacceptable, in a democratic system, for a government entity to operate in a completely arbitrary and capricious manner without any of the most basic requirements and protections assuring fundamental fairness to interested parties. The only way to correct this situation is ensure that CITA's deliberations and decisions are subject to the Administrative Procedures Act, which will ensure that its actions follow the basic tenets of American administrative law.

5. The Impact of the Chinese Government's Export Tax on Textiles and Apparel on U.S.-China Trade

American retailers expect that the Chinese government's recent decision to impose an excise tax on its textile and apparel exports will have little impact on trade flows, sourcing decisions, or prices. The tax applies to six apparel categories covering 148 tariff lines, including coats, skirts, knit and non-knit shirts, pajamas, and underwear, and is assessed at a rate of 2.4–3.6 cents by unit rather than by value. Thus, while the tax rate is low, it is designed to make it relatively harder and more expensive to export low value as opposed to higher value goods. Accordingly, the tax will have a marginally greater impact on retailers that import low-end garments, like a $1 T-shirt, rather than on retailers who import higher value garments, like a $25 fully-fashioned sweater.

The U.S. textile industry has made it very clear that they want to pressure the Chinese government into creating some mechanism of this sort to restrain its textile and apparel exports to the U.S. market. However, they have criticized the excise tax as too modest to have any real impact. Since the cost of any restraint mechanism, including this excise tax, will ultimately be passed on and borne by American consumers, the textile industry's objective and the Chinese government's action raise a more fundamental question for policymakers. Why would we want the Chinese government to impose a tax on U.S. consumers? Although the excise tax is currently low, with the taxation mechanism now in place, there is nothing to prevent the Chinese government from increasing the rate at any time. It should be recalled that, thanks to the quota system, American consumers paid over a billion dollars a year in quota costs that went right into the coffers of the Chinese government.

6. Byrd Amendment

On the subject of burdens on the U.S. taxpayer, the Commission heard earlier today from Members of Congress defending the Continued Dumping and Subsidy Offset Act, also known as the "Byrd Amendment." I would like to take the opportunity to give this Commission another viewpoint.

The Byrd Amendment requires the U.S. Government to distribute antidumping and countervailing duties it collects to domestic manufacturers that are petitioners and petition supporters in these cases. Those monies had previously been deposited into the Treasury general revenue fund.

The Byrd Amendment has been on the books for over four years now after it was slipped into an agriculture appropriations conference report the night before it went to a vote, without the benefit of committee hearings or debate of any sort. It is troubling that the passage of the Byrd Amendment was achieved through a flagrant abuse of the legislative process by a Member of Congress who is otherwise a staunch defender of the integrity of that process.

What is really disturbing about the Byrd Amendment, however, is that it is illegal corporate welfare of the worst sort that favors some American companies at the expense of other American companies with no real objective or constraints. As a result of the Byrd Amendment, the government is now forced to subsidize the filing of antidumping and countervailing duty cases by doling out hundreds of millions of dollars to a handful of companies merely for checking a box on a questionnaire from

the Commerce Department. Companies that choose not to support a petition are placed at an obvious competitive disadvantage. Moreover, the money dispensed under the Byrd Amendment is no longer available for any other purpose—supporting our troops in Iraq or assisting our ports to pay for security costs to protect our country from terrorist threats.

7. Conclusion

Although Congress has defined this Commission's mandate, I would challenge you to ask some bigger questions than just examining job losses attributed to competition from China. Commission Members need to look at the record so far in answering the question whether trade protectionism is an effective or even wise policy to address our trade issues with China. I would argue that protectionism has been a manifest failure in protecting jobs and production, even in the most highly-protected sectors such as textiles, and it makes no sense to continue a failed policy, which has come at a huge cost to the American economy, taxpayers and consumers. The Commission should also examine the benefits from expanded trade relations with China for the U.S. economy, U.S. industries, the jobs and the quality of those jobs they support. Twenty years ago, many were wringing their hands over perceived challenge from Japan. While Japanese economy has been in the doldrums for the past 15 years, the United States has continued to surge ahead. We clearly have challenges, but I think we need to have much greater faith in the strength and dynamism of the American economy, the ability, creativeness, and entrepreneurship of our people, and our ability to adapt in the face of adversity.

A Current Assessment of the Health of the U.S. Textile and Apparel Industries: On Life Support or a Case of the Sniffles?

by Laura M. Baughman *

I. Introduction

The American textile and apparel industries face a major change in their business environment that will begin on January 1, 2005. That is the date on which quotas—restrictions on the quantities of products that may be imported into the United States—must end for textile and apparel products. These quotas, which by 1995 affected over 1,000 individual textile or apparel products from more than 50 countries, have existed for decades, with a primary goal of limiting import competition and thereby preserving U.S. textile and apparel jobs.[1]

But in 1995, the United States and its World Trade Organization (WTO) trading partners implemented the Agreement on Textiles and Clothing (ATC), which replaced the longstanding and ever-expanding Multifiber Arrangement (MFA). The ATC stipulates that WTO Members, like the United States, must gradually eliminate their quotas over a 10-year period (1995–2005).[2]

The looming deadline has intensified textile industry advocates' demands that Washington "do something" to help them withstand an anticipated tsunami of imports, particularly from China. But pleas for increased protection are met with equally vociferous objections from many apparel producers as well as U.S. importers, retailers, and consumer organizations. They argue that consumers (be they apparel producers who consume yarns and fabric or American families who purchase clothing) pay a huge cost for quotas that raise prices but have been ineffective in preserving U.S. textile or apparel employment. They suggest that industry and union demands for resisting the end of protection for this sector—and even for increasing it—should be rejected by U.S. policymakers.

The appropriate direction for future U.S. textile and apparel trade policy depends on the facts regarding the current health of the industries and the root causes of any aches and pains. Is the health of the industries such that they need assistance, or should the marketplace determine the shape of the industries going forward? If assistance is in order, what will do the industries the most good? Should policymakers continue to limit imports in some way, or would other policy tools be more helpful?

To answer these questions, this paper first provides a description of recent trends in the industries in order to understand the degree to which they are healthy, sick, or on life support. The analysis relies on published U.S. Government and industry data (e.g., from company financial reports) as well as trade press accounts of company efforts to adjust to marketplace dynamics. Based on the diagnoses, the paper offers prescriptions for policy action—or inaction. Beating the medical analogy still further, the overriding framework for ascertaining whether action is called for, or not, is "do no harm."

II. A Current Description of the Patient

When one speaks of the "textile and apparel industry," in fact one is speaking of three very different industries. The first produces yarns and fabrics; the second, made-up textile products except apparel; the third, apparel. The U.S. Census Bureau classifies these industries in three North American Industry Classification System (NAICS) codes.[3]

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* Laura Baughman is President of The Trade Partnership, a Washington, D.C.-based trade and economic consulting firm. She has been analyzing U.S. textile and apparel trade policies and trends for more than 20 years. She holds degrees in economics from Georgetown and Columbia Universities.

[1] A concise and recent history of textile and apparel import protection can be found in Dan Ikenson, "Threadbare Excuses, The Textile Industry's Campaign to Preserve Import Restraints," Cato Institute Trade Policy Analysis, No. 25, October 15, 2003, pp. 3–7.

[2] The United States backloaded most of its apparel quota liberalization until January 1, 2005, and now the "cliff" from which the textile and apparel industries must jump to a quota-free trading environment looms large—as predicted more than 10 years ago. In other words, rather than a gradual phase-out of the quota system over the 10 years beginning 1995, the U.S. industries must face an abrupt, and potentially much more disruptive, end in 2005. See Laura M. Baughman, Rolf Mirus, Morris E. Morkre and Dean Spinanger, "Of Tyre Cords, Ties and Tents: Window-Dressing in the ATC?," *The World Economy*, Vol. 20, No. 4, July 1997.

[3] Tracking data for the textile and apparel industries over a long time series can be difficult. The U.S. Government has been phasing in the change in the way it reports data for the two industries, from the Standard Industrial Classification (SIC) system to the North American Industrial Classification System (NAICS). Under the SIC system, "textiles" was classified in SIC

Continued

"Textile Mills" (NAICS 313) consists of firms that take basic fiber (cotton, man-made fibers, wool, to name the major ones) and transform it into yarns, thread or fabrics, or finish and coat the yarns, thread or fabrics. More than three quarters of the total value of shipments for this sector comes from making fabric. But contrary to popular perception, textile producers sell only 28 percent of the yarns and fabrics produced by this sector to apparel manufacturers; they sell 72 percent of their output to home furnishings and industrial manufacturers.[4] In other words, the health of the companies making yarns and fabrics is more closely tied to what is happening in the U.S. Textile Product Mills sector and even the motor vehicle sector than it is to the apparel sector.

The "Textile Product Mills" (NAICS 314) Census category consists of firms that manufacture carpeting, bed linens, curtains, towels, as well as textile bags, rope, cordage, twine, canvas, and tire cord and tire fabric. Thirty-eight percent of the sector's shipments come from the manufacture of carpets and rugs; 26 percent from curtains, drapes, and household furnishings. The remainder is industrial products. As noted above, the sector is the largest consumer of U.S.-produced yarn and fabric products. The health of companies in the Textile Product Mills sector depends on trends in the U.S. construction (commercial as well as residential) and motor vehicle sectors, for example. This matters importantly to the discussion later in this paper on the impact of apparel imports on the U.S. textile industry, and appropriate policy responses to maintaining or improving the competitiveness of the industry, broadly defined.

"Apparel Manufacturing" (NAICS 315) not surprisingly consists of firms making knit or woven apparel. Two different manufacturing processes characterize the U.S. industry: firms that cut and sew purchased fabric into a finished garment, and firms that manufacture apparel from fabric they knit. Domestic apparel manufacturing is spread across a wide array of apparel products. Trousers, pants and jeans represent about 15 percent of total shipments, shirts and blouses, 14 percent. Knit shirts (e.g., t-shirts) account for just 1 percent of total U.S. apparel shipments; infants' wear, less than 1 percent.

The U.S. textile industry (NAICS codes 313 and 314) was composed in 2001 of 10,291 companies (see Table 1). This is actually a surprisingly large number of firms; however, in terms of employment, the largest companies (listed in Table 2) accounted for about 40 percent of total textile industry employment in 2003. It should be noted that carpeting companies top the list of largest textile manufacturers, both in terms of sales and employment. Carpeting production is not impacted by imports. Textile production is concentrated in the South, with Georgia, North and South Carolina accounting for 49.1 percent of total industry employment.

The U.S. apparel industry (NAICS code 315) differs in many ways from its textile suppliers. For starters, it is more diffuse, with a company count totaling 15,523 in 2001. Apparel production is concentrated in New York and California, which accounted for 36.9 percent of total industry employment. The companies listed in Table 3, the largest U.S. apparel producers, are quite international in their operations. The net sales reported include large amounts of imported apparel.

Table 1
Textile and Apparel Industry Firms, 1998–2001

	1998	1999	2000	2001
Textile total	10,548	10,520	10,143	10,291
Textile mills (313)	*3,851*	*3,767*	*3,662*	*3,703*
Textile product mills (314)	*6,697*	*6,753*	*6,481*	*6,588*
Apparel (315)	16,391	15,815	15,744	15,523

Source: Small Business Administration.

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category 22, which included some apparel production (e.g., apparel made in knitting mills, such as hosiery). Under the NAICS system, that apparel production has been transferred to the formal "apparel" category. In addition, under the SIC system, workers employed by a textile company who were primarily engaged in warehousing tasks, or transportation, for example, are no longer counted as textile or apparel industry workers but now as warehousing sector or transportation sector employees under NAICS. All would be well if NAICS data extended back historically for a longer period than it does. Not only is the time series relatively short, but it is inconsistent from one sector indicator (shipments, employment, profitability, etc.) to another. In this paper we report the longest time series of NAICS data available for each indicator of sector health discussed, except for productivity data, which are not available in NAICS categories yet.

[4] CITE TO ORGANON.

Table 2
Leading U.S. Textile Firms, 2003 (NAICS 313, 314)

	Net Sales (million)	U.S. Employees	Products Made
Invista (2002)	$6,300	18,000	Fibers, polymers, resins, flooring
Mohawk Industries, Inc.	$5,005	33,300	Carpets and rugs, ceramic tile, stone flooring, wood and vinyl flooring
Shaw Industries, Inc.	$4,660	30,000	Carpet, laminate, ceramic tile, hardwood flooring
Milliken & Co., Inc.	$3,400E	14,000E	Fabric for: rugs/carpets, furniture, apparel, automobiles, tennis balls, and specialty textiles; chemicals and petroleum products, colorants
Springs Industries	$2,500E	17,000E	Bath rugs, bedspreads, pillows, sheets, shower curtains, towels, fabric, hardware, infant apparel, window blinds
WestPoint Stevens, Inc.	$1,646	13,886	Bed linens and bath towel comforters, blankets, pillows, table covers, window trimmings
W.L. Gore & Associates, Inc.	$1,330	6,600	GORE-TEX fabric for clothing, shoes, guitar strings, dental floss, space suits, sutures; insulated wire and cables, filtration products and sealants
Beaulieu of America, LLC (2002)	$1,100E	7,000E	Carpet
Burlington Industries (2002)	$993	7,600	Fabric (including denim) for apparel and interior furnishings
Interface, Inc.	$924	5,210	Carpet, office panels, upholstery fabric, adhesives, chemical compounds for flooring
Parkdale Mills	$900E	2,500E	Yarns for home furnishings and apparel
Unifi, Inc.	$849	4,500	Yarns for apparel, industrial, upholstery and automotive fabrics
Avondale Inc.	$591	5,000	Apparel fabrics, yarns
Dan River	$477	5,100	Apparel fabric comforters, drapes, pillowcases, sheets
Guilford Mills	$446	2,600	Automotive textiles, specialty textiles, small amount of apparel fabric
Galey & Lord	$437	3,265	Apparel and home furnishing fabrics

E = estimated by Hoover's (www.hoovers.com).
Sources: Public companies: The Trade Partnership from company filings with the Securities and Exchange Commission; Private companies: Hoover's.

Table 3
Leading U.S. Apparel Firms, 2003 (NAICS 315)

	Net Apparel Sales (million)	U.S. Employees	Products Manufactured or Sourced from Others
Sara Lee Corp.	$6,399	50,000E	Intimate apparel, knit products, legwear made in 10 U.S. states, Argentina, Brazil, Canada, Costa Rica, Dominican Republic, El Salvador, Europe.
VF Corporation	$5,207	17,700	Jeans, sportswear, intimate apparel, children's wear, outdoor apparel and equipment, occupational apparel, made in VF-owned facilities in the U.S., Mexico, Caribbean, or sourced from independent Asian contractors. 95% of products sold in U.S. were imported.
Liz Claiborne, Inc.	$2,834	6,800E	Designs and markets branded women's, men's and children's apparel, accessories, jewelry, cosmetics products. Does not own manufacturing facilities. Sources product from U.S. and international suppliers, including China, Hong Kong, Taiwan, Turkey, the Dominican Republic, Sri Lanka, Indonesia, Philippines.
Jones Apparel Group Inc.	$2,785	9,600E	Women's, men's and children's sportswear, suits, dresses, jeans, footwear and accessories made in the U.S. and Mexico (24%), China; also sources from Central America using "807," Hong Kong, Taiwan, Philippines, Thailand, Indonesia, Korea.
Levi Strauss	$2,606 [1]	4,360	Branded jeanswear, casual wear and dress pants for men, women and children. Owns manufacturing facilities in Europe, South Africa, Turkey, Australia, Japan, Indonesia and Philippines. Also sources apparel from global network of international suppliers.
Polo Ralph Lauren Corp.	$2,380 [2]	11,000	Men's and women's apparel, home furnishings. Owns no production facilities; sources about 5% of product from U.S. manufacturers, 95% abroad.
Kellwood	$2,347	not avail.	Women's and men's sportswear, intimate apparel, infant apparel and tents, sleeping bags, backpacks and related recreation products. Product is sourced from contract manufacturers, primarily in Asia, and from company-owned facilities in Asia.
Tommy Hilfiger Corp.	$1,876	5,400	Designs, sources and markets men's and women's sportswear, jeanswear and children's wear under the Tommy Hilfiger trademarks. Imports most of its finished goods.
Phillips-Van Heusen Corp.	$1,430 [3]	9,000	Designs, sources and markets dress shirts, sportswear, footwear. Makes 7% of dress shirts in its own U.S. production facilities; the rest from approximately 225 different foreign manufacturers.
Russell Corp.	$1,086E	12,500E	Designs, sources and markets sports apparel and sports equipment (e.g. balls); weaves, knits, dyes, finishes and cuts fabric in its own U.S. facilities for apparel made in overseas factories (99% of apparel sold is imported).
Oxford Industries, Inc.	$1,117	3,088	Produces and markets branded and private label apparel for men, women and children. Manufactures 11% of products in company-owned foreign facilities, sources 86% from offshore joint ventures and third party producers; 3% comes from U.S. manufacturers.
Columbia Sportswear Co.	$500E	1,119	Designs, sources outerwear, sportswear, footwear, related accessories, and equipment from (largely) Far East manufacturers (98%); the rest from U.S. manufacturers.

[1] Sales in North and Latin America: it was not possible to obtain or estimate U.S. sales alone.
[2] Sales of apparel, home furnishings, accessories and fragrances. It was not possible to obtain or estimate U.S. apparel sales.
[3] Sales of apparel and footwear. It was not possible to obtain or estimate U.S. sales of apparel only.
Source: The Trade Partnership from company SEC filings.

III. The Symptoms

Textile industry representatives and apparel unions complain of several symptoms: declining shipments, large numbers of bankruptcies and plant closings, declining employment. They attribute the cause of most if not all of these symptoms to imports, particularly from China, and the medication they seek is some form of import restraint. What is really going on?

Shipments

Both textile and apparel industry shipments have grown and declined over the last 10 years. Textile industry shipments increased steadily to 1997, then declined back to their 1992 level 10 years later. Apparel industry shipments increased as well until 1997, and have declined since. Textile industry representatives suggest that the Asian currency crisis in 1997 resulted in a huge and sustained influx of apparel imports into the United States, which caused the declines on both textile and apparel shipments.[5]

Table 4
Textile and Apparel Industry Shipments

(millions)

	Textiles (NAICS 313, 314)	Apparel (NAICS 315)
1992	$77,686	$61,535
1993	80,998	63,210
1994	85,840	64,894
1995	87,861	65,214
1996	88,311	64,237
1997	89,759	68,018
1998	88,553	64,932
1999	86,995	62,305
2000	85,766	60,339
2001	77,652	54,598
2002	77,402	53,621
2003	75,022	52,970

Source: Bureau of Census.

Bankruptcies and Plant Closings

According to the National Council of Textile Organizations, illegal trade practices of China and other Asian governments have caused the closure of more than 300 textile plants in the United States since 1997. It is well known that a large number of "big name" firms have been in bankruptcy proceedings—some, like Burlington Industries, more than once. Many of these firms were forced into bankruptcy because of debt burdens that became too heavy to bear.[6] As noted above in Table 1, the data for the number of textile companies (as opposed to plants) show net declines from 1998 to 2000, but an increase in 2001. Within the category, companies making home furnishings and industrial textiles experienced more up and down movement. For apparel, the data show a steady decline in the number of apparel companies over the 1998–2001 period.

Job Losses

Whenever textile and apparel industry lobbyists plead for government assistance, be it research grants or import protection, their favorite rationalization is dramatic declines in industry employment.[7] Indeed, employment in both industries has been

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[5] American Textile Manufacturers Institute, "Crisis In U.S. Textiles," August 2001. It is not clear that shifts in currency relationships have the impact ATMI believes they do. Most U.S. apparel importers order foreign goods in dollars. Others try to minimize the impact of currency fluctuations by trading currency futures or even (but rarely) shifting operations geographically. Scott Malone, "Dollar's Slide Pinches Margins Abroad," *WWD*, June 10, 2003.

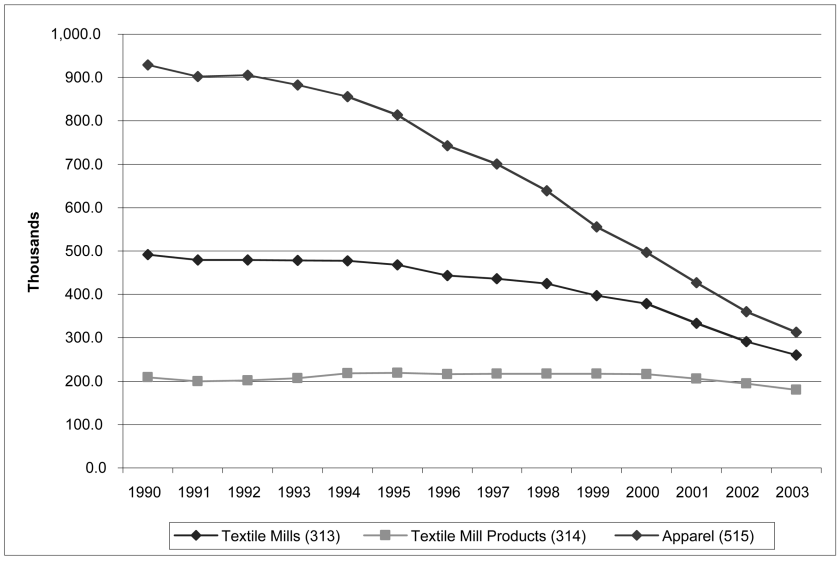
[6] Rick Rothacker, "Despair in Mill Town, Textile Firms Struggle to Find Loans to Survive; Once They Were Courted; Now Money Comes with Strings, High Interest," *Charlotte Observer*, June 30, 2002.

[7] See, for example, American Manufacturing Trade Action Coalition, "Labor Union UNITE Joins Textile/Fiber Coalition," Press Release, September 3, 2003, *www.amtacdc.org/media/030903.asp*, downloaded November 3, 2003; American Manufacturing Trade Action Coalition, "Textile and Apparel Industry Loses 13,000 Jobs in April—U.S. Trade Policy Responsible for Much of Loss," Press Release, May 2, 2003, *www.amtacdc.org/media/030502.asp*, downloaded November 3, 2003.

Continued

in decline, for decades. The U.S. Department of Labor has noted that textile industry has been declining since its peak in June 1948 (1.3 million jobs), and apparel employment has been declining since its peak in April 1973.[8] Textile industry employment has declined at an average annual rate of 1.1 percent since its peak in 1948. Apparel industry employment increased at an average annual rate of 1.4 percent from 1958 to 1973, and has been declining at an average annual rate of 3.1 percent ever since. By 2003, according to the Bureau of Labor Statistics, total textile employment stood at 440,100 (compared to 701,100 in 1990), and apparel employment at 312,700 (compared to 929,100 in 1990).

Textile and Apparel Employment, 1990–2003



Source: U.S. Department of Labor, Bureau of Labor Statistics.

IV. Diagnosis

Before accepting the patients' claim that the presence of high volumes of imports in the U.S. textile mill, textile product and apparel markets have caused the various ills besetting the industries, it is useful to dig deeper into the data.

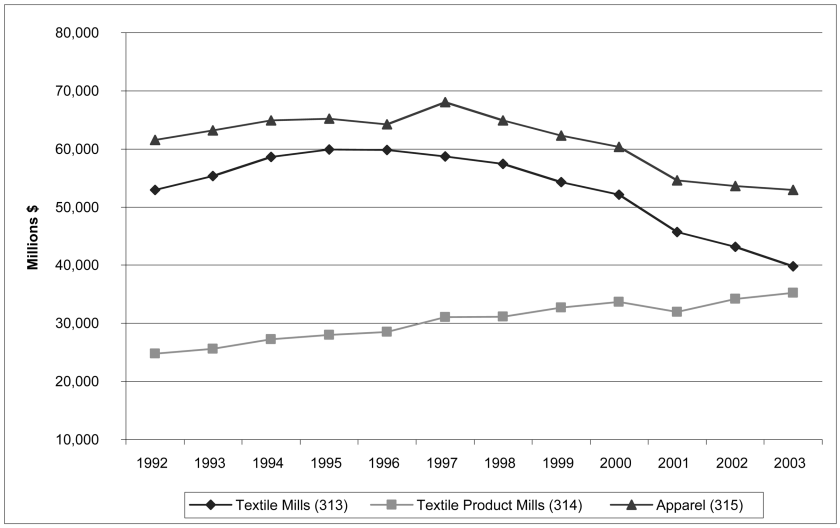
Shipments

While recent trends in apparel and textile mill shipments show declines, trends in textile product mill shipments are decidedly up. Again, this is the segment of textile manufacturing that produces residential and industrial carpeting, and home textiles (sheets, towels). Textile manufacturers that sell products to consumers furnishing their new or renovated homes with household textile products have seen steady increases in shipments. Those supplying commercial and residential construction customers as well as motor vehicle producers with carpeting are also experiencing steadily increasing business.

It should also be noted that unions speak for very few textile and apparel workers. In 2002, just 4.8 percent of the textile workforce were members of a union or represented by a union. In that year, 8.4 percent of the apparel workforce were members of a union or represented by a union. U.S. Department of Labor, Bureau of Labor Statistics, unpublished table, "A31. Union affiliation of employed wage and salary workers by class of worker and intermediate industry," 2002.

[8] Lauren A. Murray, "Unraveling Employment Trends in Textiles and Apparel, *Monthly Labor Review*, August 1995, pp. 62–63.

Textile and Apparel Industry Shipments, 1992–2003



Source: Bureau of the Census.

But what about producers of yarn and fabric for apparel? Apparel manufacturers and retailers who are the customers for that yarn and fabric have complained that producers are more interested in selling them products they already make, in the colors they make them and the size runs that are best for them, rather than the fabrics, colors and size runs sought by the apparel producers and retailers. This insistence that customers buy what the U.S. producers already make, not the yarn or fabric the customers' designers have specified for apparel lines, forces many buyers offshore where foreign textile producers are more than willing to supply exactly the yarns and fabric sought by the customers. This mindset of the U.S. fabric producers has been a longstanding complaint of their customers, and likely one of the causes of declining shipments for that segment of the industry.

Shipments of U.S.-made apparel are also down. A highly competitive retail environment has forced all apparel companies to squeeze as much "fat" out of their operations as possible.[9] As U.S. costs of production exceed those abroad for many apparel items, many of the largest U.S. apparel companies have over the last five to 10 years reformed their operations from high-cost and uncompetitive domestic producers of apparel to more competitive international producers or sources of apparel. The largest and most successful U.S. producers have transformed themselves into branding and marketing companies, licensing out production of brands to foreign producers. The thrust of their U.S. operations is now focused on design and the management of production operations spread around the world making licensed apparel brands. The health of their companies, including their remaining U.S. employment base (now largely classified in NAICS codes for warehousing and distribution), is now inextricably intertwined with international sourcing.

Bankruptcies

Newspapers are replete with stories of textile and apparel companies shutting down and laying off hundreds of workers and one might be tempted to conclude from these stories that they are dying U.S. industries. But in fact these closings are evidence of structural shifts in both the textile and apparel industries that have been under way for several years, shifts—albeit painful for many—that are creating stronger industries. Few of the companies that have entered bankruptcy have gone

[9] These pressures come from a variety of sources. Consumers are allocating less of their total discretionary spending to apparel, apparel prices have been falling steadily for years, department stores are feeling the pressure from mass retailers and passing on demands for lower-cost apparel to their suppliers, mass retailers insist on lower-cost apparel, and increasing numbers of vertically-integrated specialty stores with proprietary brands are claiming increasing shares of consumers' retail dollars. It should be noted that Wal-Mart is the largest single customer of most of the apparel firms listed in Table 3.

completely out of business. Many have consolidated operations (which meant closing plants and laying off workers) to get rid of overcapacity that plagued the industry and eroded profits, and reemerged as new ventures or new companies formed out of the merger of two firms.

The recent birth of International Textile Group is illustrative. The company is the result of the merger of Burlington Industries and Cone Mills in 2004 (both in bankruptcy at the time).[10] ITG, formed by investor Wilbur L. Ross, is cutting costs by eliminating redundant operations. Burlington and Cone both produced overlapping product lines and, in slack demand periods, were unable to run their plants at full capacity. Both also had duplicative denim facilities in Mexico. By rationalizing production, ITG aims to achieve longer production runs which are much more efficient (translation: profitable). ITG operates five businesses: Cone Denim, which makes denim fabric in the United States, Mexico, Turkey, India and, in the near future, Guatemala; Burlington Worldwide, producing apparel fabrics in the United States, Mexico, and a network of international mill partners coordinated out of Hong Kong; Home Furnishings, which produces interior fabrics in U.S. plants with sourcing offices located around the world; Carlisle Finishing, a domestic commission dyeing, printing and finishing operation; and Nano-Tex, LLC, a company that develops and markets a family of nanotechnolgy-based textile treatment.

ITG is not the only example of investor interest in the U.S. textile industry. Indeed, textile industry trade journals increasingly feature upbeat articles about prospects for the textile industry going forward. A typical example, published in January 2003, leads off with: "The U.S. textile industry is alive and well. That's not to say there still aren't some serious problems and question marks—or that any big new demand spurt is just around the corner. Rather, the point to keep in mind is this: mills have weathered one of their most wrenching downturns in history—yet textiles still remains a viable, innovative and forward-looking industry, one that's likely to edge back into the plus column after five years of decline."[11] And another from 2003, "If the American textile industry is in its sunset years; if the pressure of foreign competition is causing many domestic manufacturers to pull down the shades and lock the doors for a final time; if the outlook for the next 10 years is all gloom and doom, then someone forgot to tell Parkdale Inc., the world's largest supplier of spun yarn. . . ."[12] According to the President of the apparel division of Invista, the newly-formed firm arising from the acquisition by Koch Industries of DuPont's fiber unit, "'You don't go and spend over $4 billion unless you are committed to the industry.'"[13]

Investment enthusiasm extends to apparel as well. One report of recent activities begins, "So far, 2004 is turning out to be a blockbuster year for apparel mergers and acquisitions."[14] U.S. firms are buying foreign firms; foreign firms are buying

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[10] It is worth noting that Ross had to bid against Warren Buffett for Burlington. Said James Martin, President of textile producer Dan River, "'It's a great thing when somebody of Warren Buffett's stature and track record is investing in our industry. Warren Buffet doesn't invest in things that he doesn't think are going to make him and Berkshire Hathaway money. . . .'" Scott Malone, "Will Buffett Give Mills a Bump?," *WWD*, February 25, 2003.

[11] Robert S. Reichard, Economics Editor, "Textiles 2003," *Textile World 2003 Economic Outlook*, January 2003, *http://www.textileindustries.com/News__Current.htm?CD=2&ID-2917*, downloaded January 14, 2003. A sampling of other positive news can be found in: "Burlington, NC-Based Yarn Company Emerges from Bankruptcy," *Times-News*, Burlington, NC, April 17, 2003; Tony Mecia, "Morganton, NC to Celebrate Rare Textile Mill Opening," *The Charlotte Observer*, July 26, 2002; Kevin Harlin, "Schenectady Textile Plant Changing Hands," *The Times Union* (Albany, NY), May 29, 2002; Hunter Lewis, "Granville Expansion Will Add 75 Jobs; Sandusky Athol Plans a $6M Project at Butner's Coated Fabrics Plant," *The Durham Herald Co.*, June 5, 2002; Joseph Cigna, "Alamance County, NC Hosiery Maker Plans to Double Production, *Times-News* (Burlington, NC), June 12, 2002; "Western Nonwovens Inc. Announces Major Capital Spending Plan for HiLoft Business Unit," *Business Wire*, January 3, 2003; "KOSA Upgrading Plant in Shelby; Yarn-Thread Operation Will Get New Technology, Increased Capacity," *The Charlotte Observer*, October 20, 2002; S. Gray Maycumber and Vicki M. Young, "Buffett Bid a 'Shot of Adrenaline' for Textiles," *Daily News Record* (no date); Scott Malone, "Delta Woodside Plans Modernization At South Carolina Textile Factory," *Women's Wear Daily*, July 2, 2002; "Leaders Welcome Factory to Henry; Jobless Rate at 13.8% in County," *Roanoke Times and World News*, November 14, 2002; High Point, N.C. Textile Producer Announces Plans to Stay Open, Knight Ridder/Tribune Business News, February 5, 2004; Jim Nesbitt, "Avondale Workers to Return to Jobs," The Augusta Chronicle (Georgia), August 13, 2003; "Ramtex Yarn Mill Return to Full Production," News and Record (Greensboro, NC), October 18, 2003.

[12] Jim Phillips, "Parkdale Positions for Growth, Textile Industries.com, April 2001, *www.TextileIndustries.com/News.htm?CD=099&ID=455*, downloaded November 20, 2003.

[13] Scott Malone, "Consolidation Sweeps Textiles," *WWD*, July 27, 2004.

[14] Vicki M. Young, "A Busy Half of Buying and Selling," *DNR*, August 23, 2004.

U.S. firms. The article notes that "a good portion" of the acquisition activity reflects U.S. apparel companies buying firms in more specialized niches.

Thus, all the investment activity seems to suggest that the plight of the industries may not be as dire as the newspaper stories of plant closures would lead one to believe. Just as older trees in a forest eventually die clearing the way for new growth to flourish, so too with U.S. textile companies. A recent report from the National Textile Center concluded:

> Indeed, on the industry level, shrinking employment is discouraging, however plant level data tell a different story: [there has been] significant exit *and entry* in the textile industry. Historically, firms that exit an industry are generally the more inefficient firms. Those that remain and the ones that enter, on the other hand, are typically more productive and technologically advanced.[15]

Levinsohn and Petropoulos agree. They explored the question of whether the industries are "creatively destructing" or "just plain destructing" by looking at 20–25 years of plant-specific data, rather than industry-level data. Plant level data enabled them to explore plant openings ("entry") and plant shutdowns ("exit") as discrete events, while industry-wide data (reported in Table 1 above) is "net" data (it subtracts the entries from the exits and reports only the resulting number of plants). They conclude that, on the basis of plant-level data, "creative destruction" best characterizes the dynamics of the industries:

> Without a doubt, the U.S. textile and apparel industries have faced difficult times over the past quarter century. What is less obvious from the industry-level data [again, see Table 1 above] is the process by which these industries are re-inventing themselves as they adapt to new technologies (in the case of textiles) and new organizational structures (in the case of apparel). . . . As we've documented . . . , there is substantial entry into the industries, job creation rates are high, and productivity dynamics suggest surviving plants have emerged all the stronger while it has been the less productive plants that have exited. . . . [T]hese industries are indeed examples of creative destruction. *Although the industry-level evidence is certainly consistent with labeling the textile and apparel industries as declining industries, the plant-level evidence highlights substantial creation.*[16]

Profitability data help to explain some of this enthusiasm of investors. Net income for the textile industry has turned around from a loss of $445 million in 2001 to a profit of $1.3 billion in 2003 (see Table 5). Apparel profits, belying all other data suggesting a declining industry, have been strong and increasing, almost three times textile industry profits as a share of sales in 2003. How can a "dying industry" be so profitable?

Table 5
Recent Profitability in the Textile and Apparel Industries, 2001–2003
(millions and percent)

	2001	2002	2003
Textiles (NAICS 313, 314)			
Net sales, receipts, operating revenue	$35,708	$36,362	$47,046
Net income or loss before taxes	($445)	$675	$1,250
Operating profit (loss)/sales	(1.2%)	1.9%	2.7%
Apparel & Leather Products (NAICS 315, 316)			
Net sales, receipts, operating revenue	$71,083	$71,173	$85,852
Net income before taxes	$4,590	$5,540	$6,506
Operating profits/sales	6.5%	7.8%	7.8%

Source: U.S. Department of Commerce, U.S. Census Bureau, *Quarterly Financial Report for Manufacturing, Mining and Trade Corporations*, various issues. NOTE: Commerce does not report data for apparel alone.

[15] National Textile Center, "Optimal Investment Strategies for Enhanced Productivity in the Textile Industry, Year 11 Continuing Project Proposal," Project No. IO1–P13 (no date). Italics in original.

[16] Jim Levinsohn and Wendy Petropoulos, "Creative Destruction or Just Plain Destruction? The U.S. Textile and Apparel Industries Since 1972," *NBER Working Paper 8348*, 2001, p. 24. Emphasis added.

In fact, what we are seeing is a transformation of the textile and apparel industries. Growing pains, if you will, not a sickness in need of hospitalization. Successful textile producers supplying apparel producers tend to be entrepreneurial firms that produce specialized, high-performance yarns and fabrics and avoid the price battles being won by mass-market imports. Going forward, warn textile industry specialists, the United States will not be a competitive supplier of low-cost commodity yarns and fabrics, and it should move out of production of those products. "The way out is to innovate, to reinvent the processes, to keep coming up with new fibers," said Roland Stephen, a faculty fellow with the Institute for Emerging Issues at North Carolina State University. "We are heading to the point where there will be a place for entrepreneurial, specialized firms in the U.S. and the place for mass market production is overseas." [17]

Similarly, successful apparel manufacturers have embraced co-production operations in trade preference partner countries and manufacture piece goods for those operations.[18] Still other competitive U.S.-based apparel producers manufacture products that mandate short lead times (from production to retail sales floor)—e.g., fashion apparel—or which need to be made in smaller quantities. In short, commodity apparel business has largely shifted abroad; niche and specialty apparel production remains in the United States. The CEO of Oscar de la Renta sums up the view:

> We continue to produce the majority of our [U.S.] line domestically, using both imported and domestic fabric. The special and complex nature of the garments produced necessitates the uniquely skilled labor force that we find in New York. Our ability to rapidly respond to customer requests due to the proximity of the contractors is a further bonus. Our mix of domestic and foreign sourcing has not changed over the last 10 years.[19]

Employment

A sizable body of research has demonstrated that improvements in productivity are the primary causes of job losses, at least in the textile industry. This research also suggests that imports likely have played a bigger role in job losses in the apparel industry. For example, McKenzie and Smith concluded that textile productivity improvements accounted for 80–85 percent of the industry's employment losses from 1973–84.[20] Using another methodology, Cline also concluded that productivity mattered more than imports as a factor in both textile and apparel sector job losses.[21] Using still another approach, Henderson and Sanford concluded that textile imports only partially displace domestic employment, and that the impact varies by U.S. region.[22]

If one tends to be suspicious of economic studies, plain data also support the conclusion that productivity is an important, and likely the most important, cause of job losses. The increase in shipments despite the decline in employment suggests

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[17] "As Textile Jobs Bolt Overseas, Creative North Carolina Firms Survive," *Atlanta Journal and Constitution*, September 21, 2003.

[18] See, for example, Phillips-Van Heusen Corporation, *Annual Report* (10K) for the fiscal year ended February 1, 2004, filed with the Securities and Exchange Commission, Commission File Number 001–07572; Jones Apparel Group, *Annual Report* (10K) for the fiscal year ended December 31, 2003, filed with the Securities and Exchange Commission, Commission File Number 1–10746.

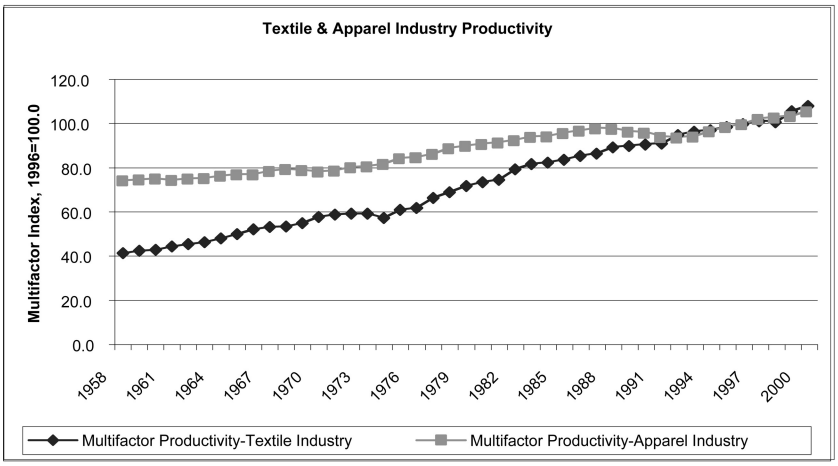
[19] Scott Malone, "U.S. Makers Fading Away," *WWD*, June 10, 2003.

[20] Richard B. McKenzie and Stephen D. Smith, "Loss of Textile and Apparel Jobs: Is Protectionism Warranted?," *Cato Journal*, 6 (1987), pp. 731–746. McKenzie and Smith used regression analysis to examine the impact on domestic textile and apparel employment of changes in textile and apparel productivity as well as U.S. textile and apparel imports. They concluded that "Contrary to the contentions of protection proponents, textile imports have not in any systematic and predictable manner, or to any statistically significant extent, adversely affected U.S. textile employment between 1960 and 1985. However, apparel imports appear to have had a significant negative impact on employment in both industries."

[21] William R. Cline, *The Future of World Trade in Textiles and Apparel*, (Washington, D.C.: Institute for International Economics, 1987). Cline follows a definitional decomposition approach that posits that the percentage change of employment must equal a weighted average of the percentage changes of demand and exports, imports and labor productivity. Applying this approach to textile sector data for different periods from 1962–85, Cline concluded that "the decomposition approach indicates that for textiles in virtually all periods and for apparel at least until the 1970s and even prior to 1982, the adverse effect of imports on employment has been much more limited than that of labor productivity growth (and, in the case of textiles, slow growth in demand). While the import surge of 1982–85 temporarily pushed the negative employment effect of imports in apparel to a magnitude almost equal to that of productivity growth, the pace of this import growth is unlikely to continue."

[22] David P. Henderson and Scott Sanford, "A Regional Model of Import-Employment Substitution: The Case of Textiles," *The Review of Regional Studies*, Vol. 21 (1991), pp. 79–90.

that output per worker has been improving, at least until 1997. Data for multifactor productivity[23] in the textile industry from 1958–2001 (the most recent year available) indicates that, except for 1974, textile sector productivity has been steadily increasing over the last four decades at impressively strong rates. The experience of the apparel industry was also positive: multifactor productivity has been increasing at a somewhat slower rate than for textiles over the same period, with dips in 1969–70 and 1990–92. One should expect that productivity improvements will continue to cause job declines, particularly in the textile sectors but also in the apparel sector.



Source: Derived from U.S. Department of Labor, Bureau of Labor Statistics. NOTE: these data are for SIC classifications, not NAICS classifications. Data classified by NAICS codes are not available.

Demographics may also play a role in explaining job losses. The U.S. textile and apparel workforces are relatively old and heading towards retirement ages. In 2003, the average age of a textile worker was 43 years and the average age of an apparel worker was 41 years.[24] Within 10 years, about 40 percent of the current apparel workforce will likely retire, and about 44 percent of the textile workforce will likely retire.[25] This suggests that future job losses in the sectors may result simply from demographics, rather than imports or some other cause.

Compounding the industries' employment problems is the growing need for hard-to-find highly-skilled, highly-trained workers to develop and produce the new, cutting-edge yarns and fabrics that are needed to keep the industry out of the commodity business and focused on the specialty fabric business. Some U.S. universities are responding. Students who see themselves as future marketers or designers, chemists or lab technicians, are signing up for college programs that offer degrees as high as Ph.D.'s (in Textile Engineering and Science at Philadelphia University).[26] North Carolina State University cannot turn out enough textile engineers to meet demand from U.S. companies.[27] The problem was acute even back in 1999/2000, when the trade press reported that the four top state schools in the textile belt (Clemson, South Carolina; N.C. State University; Georgia Tech; and Auburn, Ala-

[23] Multifactor productivity is designed to measure the joint influences on economic growth of technological change, efficiency improvements, returns to scale, reallocation of resources, and other factors.

[24] Bureau of Labor Statistics, Bureau of the Census, unpublished data from the Current Population Survey, "Table 16. Employed persons by detailed industry, sex and age, 2003."

[25] According to the Bureau of Labor Statistics, 26.3 percent of total textile workers in 2003 were aged 44–54; 16.1 percent were aged 55–64 and 2.3 percent were aged 65 or older. Moving each of these groups into the subsequent age grouping puts them in the appropriate ages for retirement. Similarly, in 2003, 23.8 percent of total apparel workers were aged 45–54; 12.1 percent were aged 55–64, and 2.6 percent were aged 65 and over.

[26] Chris Clark, "Philadelphia University Announces First Doctoral Program," PR Newswire, May 8, 2003.

[27] Eric Heisler, "N.C. State's College of Textiles Had a 96 Percent Placement Rate Last Year," *News & Record (Greensboro, NC)*, Oct. 6, 2002.

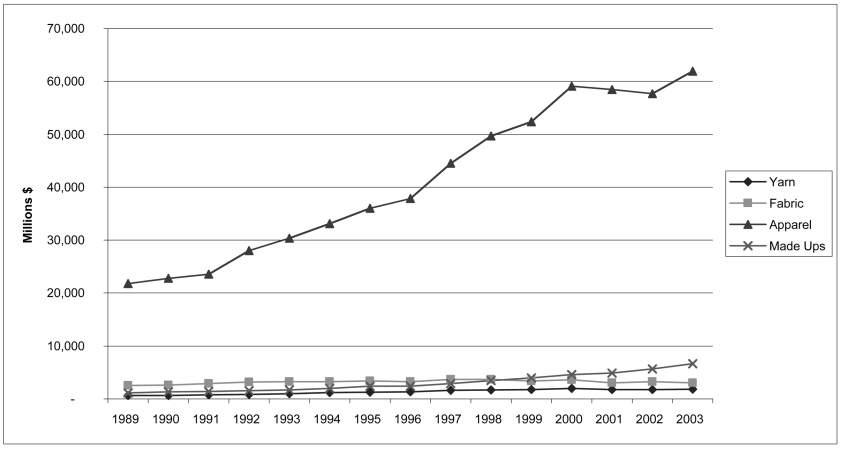
bama) did not have enough students to fill the needs of the industry for graduates seeking careers in textiles.[28]

One reason schools are having trouble turning out enough graduates is that many potential students are wary of entering the textile or apparel industries. They (and their parents) view the industries as dying when, according to Fred Cook, Chair and professor at Georgia Tech's School of Textile and Fiber Engineering, "the true facts [are] that home furnishing, industrial textiles and carpets are doing fine."[29] Said Bob Bowen, Director of Recruitment for Clemson University's School of Textiles, Fiber and Polymer Science, thanks to bad media on the industry, "[p]arents are the ones to dissuade. The kids come in all fired up. My job is to educate the parents and the educators [i.e., high school teachers and counselors]."[30] For their part, textile and apparel employers are responding with higher pay, more flexible work schedules, and offers to send managerial workers to the company's foreign subsidiaries for an overseas experience. Still others are recruiting legal aliens.[31]

V. The Role of Imports

The patients place a huge amount of blame on imports for their aches and pains. Thus, it is useful to look more closely at import trends and how the industries have been affected by those trends. The trends are quite different for textiles than for apparel, and therefore will be examined separately. In contrast to apparel imports, U.S. imports of yarns, fabrics and made-ups (home furnishings, textile-sided luggage, etc.) are small relative to domestic production and have been increasing at a much slower pace. In addition, because China figures so prominently in recent textile industry complaints, I explore the degree of presence of imports from China in each section.

U.S. Apparel, Yarn, Fabric and Made-up Imports, 1989–2003



Source: ITC Dataweb.

Yarns and Fabrics (NAICS 313)

U.S. fabric apparel producers import yarns or fabrics for use in their U.S. manufacturing operations. These imports supplement (declining) domestic shipments of yarns and fabrics. In other words, U.S. fabric and apparel producers are increasing their use of imported yarns and fabrics at the expense of U.S.-produced yarns and fabrics. North American Free Trade Agreement (NAFTA) partners supplied most—44.8 percent—of the volume of yarn imported into the United States in 2003. Another 12.5 percent represents high-end yarns from the European Union and Japan. Twenty-eight percent of the volume of U.S. fabric imports in 2003 came from our NAFTA partners—much of it from plants owned by U.S. textile producers who invested there after NAFTA went into effect—and 16.6 percent from the EU and

[28] Brenda Lloyd, "Jobs Go Unfilled as Textile School Enrollments Decline," *DNR*, January 12, 2000.
[29] Ibid.
[30] Ibid.
[31] Scott Malone, "Filling Jobs in a Shrinking Field," *WWD*, January 2, 2001.

Japan. Imports from China accounted for 6.4 percent of total U.S. yarn and fabric imports in 2003.

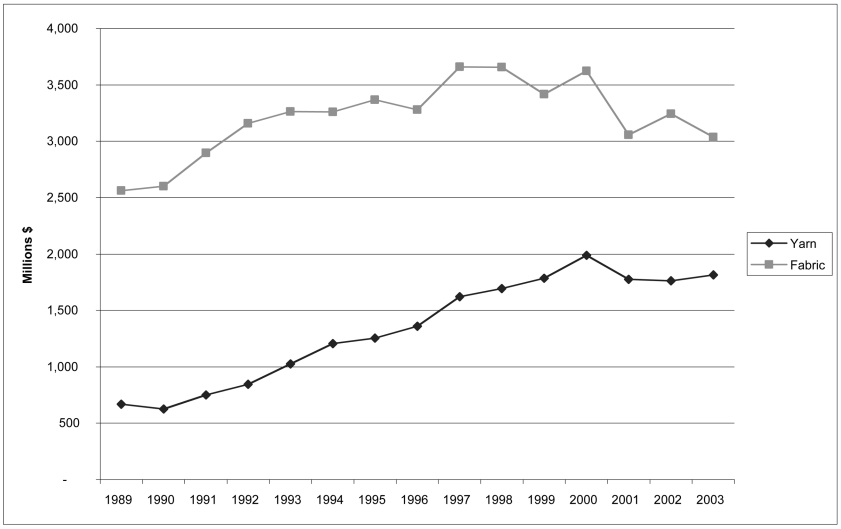
Table 6
Textile Mill Products (NAICS 313): Domestic Shipments, Imports, Market, 1989–2003

(millions and percent)

	Shipments	Imports*	Market	Imports' Share of Market
1992	$52,923	$4,638	$57,561	8.1%
1993	55,375	4,952	60,327	8.2
1994	58,607	5,142	63,749	8.1
1995	59,885	5,271	65,156	8.1
1996	59,796	5,250	65,046	8.1
1997	58,707	5,943	64,650	9.2
1998	57,416	5,992	63,408	9.4
1999	54,306	5,849	60,155	9.7
2000	52,112	6,287	58,399	10.8
2001	45,681	5,396	51,077	10.6
2002	43,170	5,578	48,748	11.4
2003	39,775	5,399	45,174	12.0

*Landed, duty-paid value of imports of yarn and fabric combined.
Source: The Trade Partnership from Census data.

U.S. Imports of Yarns and Fabrics, 1989–2003



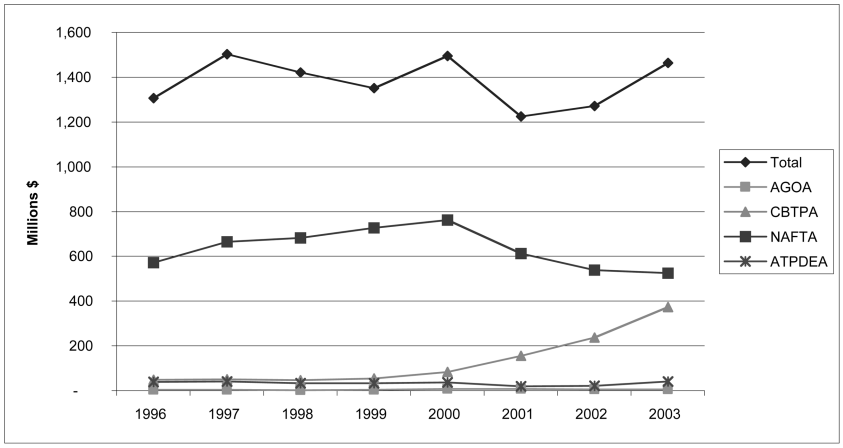
Source: ITC Dataweb.

Ironically, U.S. quotas and tariffs restrict the degree to which U.S. fabric and apparel producers can use certain foreign yarns and fabrics in their U.S. production. Almost 200 (196) individual quotas applied to fabric and yarn imports from 27 countries in 2003. Eighteen separate yarn and fabric quotas restrict imports from China.

In addition to quotas, yarns and fabrics face relatively high tariffs when imported into the United States. In 2003, the average tariff rate applied to fabric subject to duty (i.e., not duty-free under a preference program or free trade agreement) was 10.4 percent. For yarns, the average tariff rate for products subject to duties was 8.0 percent. These are relatively high tariffs: the comparable average tariff rate for *all* merchandise imports was 4.9 percent in 2003.

U.S. import preference programs[32] and free trade agreements offer a new twist to the trade debate as it affects the textile mill (yarns and fabrics) sector. Preference programs like the African Growth and Opportunity Act (implemented in 2000), the Caribbean Basin Trade Partnership Act (implemented in 2000) and the Andean Trade Promotion and Drug Eradication Act (2002), as well as free trade agreements with Mexico and Canada (1994), Singapore (2004) and Chile (2004) all require the use of U.S. or partner yarns and fabrics, finished in the United States,[33] in order for apparel made from those yarns and fabrics in the foreign country to receive duty-free or quota-free access to the U.S. market. One would expect that these opportunities would have caused a significant expansion in U.S. exports of yarns and fabrics to manufacture apparel in the preference countries for export to the United States. While yarn exports overall have been flat; growth in exports under the CBTPA simply substituted for declines in exports to the NAFTA region. A more curious impact is seen for fabric exports: they generally increased in total until 2000, but have fallen since. As with yarn, fabric exports to the CBTPA region have displaced exports to NAFTA partners.

U.S. Yarn Exports, 1996–2003

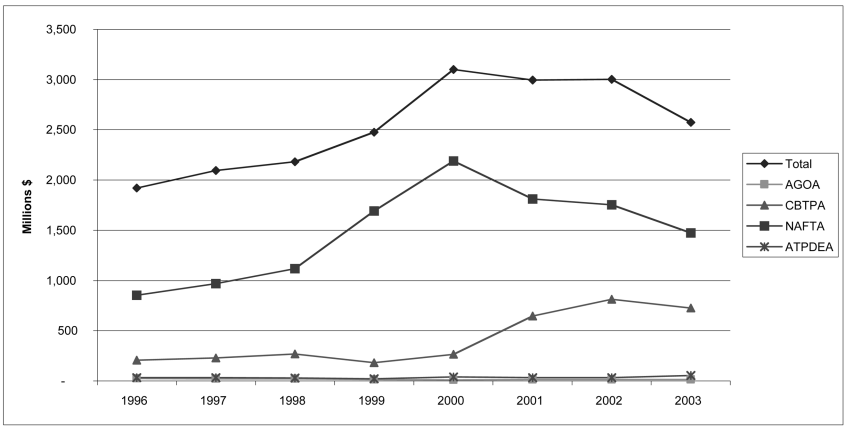


Source: ITC Dataweb.

[32] A preference program is a unilateral grant of a trade benefit to a specified country or group of countries. The United States extends a benefit (such as duty-free treatment to imports from the country) without the country extending to the United States a comparable trade benefit. A free trade agreement, in contrast, is a mutual grant of trade benefits to a specified country. The partner country gives the U.S. benefits in exchange for benefits the United States extends to the partner country.

[33] It is noteworthy that, at least from 2000–2001 (the most recent data available), a disaggregation of the data showing a net increase in the total number of textile mills reveals that the increases were coming from textile and fabric *finishing* mills. The increases at these mills more than offset declines in the number of firms making yarn, thread and fabric.

U.S. Fabric Imports, 1996–2003



Source: ITC Dataweb.

The key point is that, while there has been some shifting in patterns among countries, overall U.S. yarn and fabric exports have not increased dramatically as a result of the preference programs and NAFTA (data reflecting the impacts of the U.S.-Chile and U.S.-Singapore FTAs are not yet available for a significant period of time). U.S. companies sourcing apparel and other products from preference partners explain that U.S. yarns and fabrics are simply too expensive relative to local yarns and fabrics (if they exist) or even Asian yarns and fabrics to make it worthwhile to use them. Some have said that it is cheaper to import an apparel item into the United States made in the preference region with Asian fabric or yarns, and pay the duty on the apparel item (i.e., forego the duty preference) than it is to use U.S. yarns or fabrics to make the same apparel item in the preference region and import it into the United States duty-free.

What appears to be happening, instead, is that U.S. yarn and fabric producers are relocating production from the United States to, initially Mexico and now from Mexico to the Caribbean Basin. This makes sense: commodity apparel fabrics should be located as close to apparel production bases as possible, saving time as well as transportation expenses and improving the competitiveness not only of yarn and textile suppliers but also of apparel producers.

Textile Mill Products (NAICS 314)

Retailers or a company that sources for retailers typically import made-up products (sheets, towels, textile luggage, e.g.). Imports account for a growing share of the U.S. market. China supplied the largest share in 2003, at 45.3 percent of the total volume of made-ups imported into the United States. Pakistan, India, Mexico and Turkey along with China together accounted for over 76 percent of the volume of made-ups imported into the United States in 2003.

Table 7
Textile Products (NAICS 314): Domestic Shipments, Imports, Market, 1989–2003

(millions and percent)

	Shipments	Imports*	Market	Imports' Share of Market
1992	$24,763	$1,757	$26,520	6.6%
1993	25,623	1,938	27,561	7.0
1994	27,233	2,276	29,509	7.7
1995	27,976	2,724	30,700	8.9
1996	28,515	2,675	31,190	8.6
1997	31,052	3,200	34,252	9.3
1998	31,137	3,824	34,961	10.9
1999	32,689	4,447	37,136	12.0
2000	33,654	5,124	38,778	13.2

Table 7
Textile Products (NAICS 314): Domestic Shipments, Imports, Market, 1989–2003—Continued

(millions and percent)

	Shipments	Imports*	Market	Imports' Share of Market
2001	31,971	5,443	37,414	14.5
2002	34,232	6,370	40,602	15.7
2003	35,247	7,534	42,781	17.6

*Landed, duty-paid value of imports.
Source: The Trade Partnership from Census data.

The import share of the market has been increasing despite the fact that made-ups are subject to tariffs and quotas. In 2003, tariffs averaged 7.7 percent of the value of imports subject to duties. In addition, the United States restricted made-up imports with 47 individual quotas. The United States imposes quotas on seven made-up products imported from China. Imports from China in 2003 totaled $2.4 billion, representing 5.6 percent of the market.

Apparel (NAICS 315)

Apparel imports have been increasing for many years despite an ever-expanding web of import quotas and some of the highest tariff rates in the U.S. tariff schedule. In 2003, 17 countries accounted for 75.5 percent of total imports. By 2003, imports supplied over half the U.S. apparel market.[34] The average tariff for apparel products subject to duties in 2003 was 16.2 percent. In addition, as of 2003, the United States had in effect 569 apparel quotas affecting 45 countries. Quotas restricted 34 percent of the total volume of U.S. apparel imports in 2003. The United States imposes quotas on 49 individual apparel products imported from China. Much apparel is imported quota-free under preference programs or free trade agreements—and from Europe and other developed countries that have never been subject to the quota system.

Table 8
Apparel (NAICS 315): Domestic Shipments, Imports, Market, 1989–2003

(millions and percent)

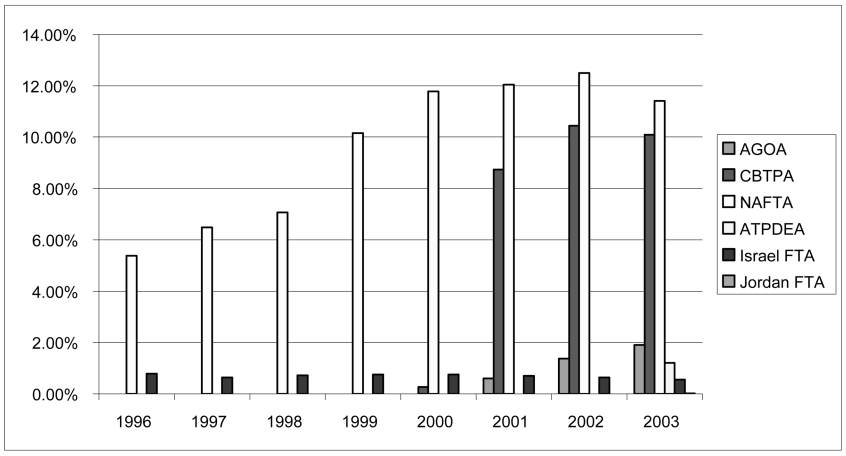
	Shipments	Imports*	Market	Imports' Share of Market
1992	$61,535	$34,214	$95,749	35.7%
1993	63,210	36,630	99,840	36.7
1994	64,894	39,831	104,725	38.0
1995	65,214	42,816	108,030	39.6
1996	64,237	44,599	108,836	41.0
1997	68,018	52,056	120,074	43.4
1998	64,932	57,835	122,767	47.1
1999	62,305	61,012	123,317	49.5
2000	60,339	69,008	129,347	53.4
2001	54,598	67,646	122,244	55.3
2002	53,621	67,036	120,657	55.6
2003	52,970	71,834	124,804	57.6

*Landed, duty-paid value of imports; includes U.S. content.
Source: The Trade Partnership from Census data.

One reason for the expansion of imports has been growing interest in using preference programs and free trade agreements to take advantage of duty-free and quota-free access to the U.S. market. Because apparel quotas are tight for key products and tariffs are much higher than for other textile products, these programs offer advantages of U.S. importers. More than one quarter of the value of all apparel imported into the United States in 2003 benefited from a preference program or free trade agreement, compared to just 5 percent in 1996. Imports from China totaled $8.6 billion, or 6.9 percent of the U.S. apparel market in 2003.

[34] When textile industry representatives talk about foreign supply of the U.S. apparel "market," their definition of "market" is imports only. They do not include the value of domestic shipments. Thus, their estimates of the import share of "the market" is considerably overstated.

Preference Program Shares of Total Apparel Imports, 1996–2003



Source: ITC Dataweb.

But as noted above, the preference programs and free trade agreements require the use of U.S. or regional yarns and fabrics, sometimes cut in the United States, for apparel to benefit from the duty-free or quota-free benefits. Consequently, apparel imports often contain some U.S. content. In 2002, that content represented 3 percent of the value (including cost, insurance and freight) of apparel imports as a whole. It ranged as high as 8.4 percent (for swimwear). The U.S. content is much higher for imports from suppliers in the Caribbean Basin and other countries that are partners with the United States in trade preference programs. It should be noted that there is U.S. content in the yarns, fabrics, apparel and made-up products China produces, some for export back to the United States. In 2003, the United States exported to China $737 million in cotton (exports in the first half of 2004 were 329 percent higher than the first half of 2003); $130 million in manmade fibers; $56 million in yarn; and $27 million in fabric. These inputs together represent just over 8 percent of the total value of textile and apparel products imported from China in 2003.

Table 9
U.S. Content of Selected Apparel Imports, 2002
(millions and percent)

	Imports*	Value of U.S. Content	Share of Total
Sweaters	$3,165.2	$5.3	0.2%
Tops (except sweaters)	23,438.1	780.8	3.3
Bottoms	16,502.5	682.7	4.2
Coats & jackets	5,433.1	79.4	1.5
Suits	991.0	4.7	0.5
Swimwear	668.9	55.9	8.4
Dresses	1,829.8	40.0	2.2
Skirts	1,566.8	28.4	1.8
Playsuits	22.5	0.4	1.8
Coveralls, etc.	457.9	23.9	5.2
Robes and dressing gowns	633.5	11.6	1.8
Pajamas and other nightwear	1,662.3	21.7	1.3
Underwear	3,171.4	85.2	2.7
Foundation garments	1,796.2	55.0	3.1
Infants' apparel	2,102.1	10.9	0.5
Total	63,441.3	1,885.9	3.0

*CIF value.
Source: U.S. Census Bureau, Apparel: 2002, Summary, Current Industrial Report, August 2003.

That U.S. apparel firms are benefiting from the trade preference program is evident from two important pieces of information. First, the growth in the net number

of apparel firms from 2000–2001 took place among cut and sew apparel manufacturers. Second, apparel manufacturers have abandoned their longstanding alliance with textile manufacturers seeking import protection and are now strongly supporting not only the end of U.S. textile and apparel quotas but also the elimination of U.S. textile and apparel duties.[35] Opposition to freer trade in textiles and apparel comes largely from apparel unions, which represent just 8.4 percent of the apparel workforce in 2002.

VI. Prescription for Responding to the Challenges Ahead

In summary:

- Firms are exiting *and* entering the U.S. textile industry. Investment interest in the sector remains strong. Producers are downsizing and refocusing their output away from commodity products (exception: carpeting) for which price competition is highest and toward specialty products, especially in apparel fabrics. Profits are back and on the rise.
- Firms are also exiting and entering the U.S. apparel sector, but overall the transition is to an international production platform for commodity products, and domestic production for inputs to that international production as well as specialty, niche/fashion apparel. Investment activity in the sector is strong. Profitability is very strong.
- Although the value of textile shipments overall has been declining since 1997, the total obscures the steady increases in shipments of textile mill products producers (carpets, sheets, towels, etc.). Both the textile mill sector (yarns and fabrics) and the textile mill products sector largely depend for their economic health on activity in the home furnishings, residential and commercial construction, and motor vehicle industries, *not* the apparel industry.
- Textile employment has been steadily declining, largely because of productivity improvements. Apparel sector jobs have been more vulnerable to import competition. That said, the average age of the textile and apparel workforces is relatively high, with many workers approaching retirement. New apparel workers are coming increasingly from immigrant labor pools. Textile jobs in the United States are increasingly high-skilled, and workers with the requisite skills are hard to find.
- Textile and apparel imports have been increasing and the import share of the market has been increasing. Import protection has long been higher than the average for manufacturing and it has not succeeded in forestalling employment losses in the sector. Preference programs are of interest to both textile producers (as export markets) and apparel producers (as sources of inputs as well as finished apparel). In most instances, apparel imported into the United States contains some level of U.S. content.

Thus, the widespread impression that the U.S. textile and apparel industries are vanishing is both true and untrue. It is true that employment in both sectors is declining and that firms are closing. But it is also true that consolidation and changes in production platforms are taking place and that, as a result, both industries are much more competitive than the headlines would have you believe. Indeed, a close look at what is happening in the industries leads one to the conclusion that many—but not all—firms stand ready to compete with imports when the textile and apparel quotas end on January 1, 2005.

So what should a policymaker do, if anything? On balance I believe that the weight of the evidence suggests that the U.S. textile sector is well on its way to recovery. It will survive. It will look different than the textile industry of 1990—more focused on research and development, more international in scope, and much leaner. The apparel sector is also well on its way to competitiveness. Policymakers need to accept that it, too, will be a very different sector than that which existed in the United States 10 or 20 years ago. The apparel sector of the present, and increasingly of the future, will be global in nature. U.S.-owned firms will contract out the

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[35] A typical opinion of the firms listed in Table 2 comes from Tom Glaser, Managing Director of Global Sourcing at VF Corp.: "VF's view is that open and free markets are a good thing for sourcing as well as selling our products." David Lipke and Ellen Askin, "Four Months and Counting," *DNR*, August 30, 2004. See also "'Big Bang' Will Change the Universe, for Apparel Manufacturers, Retailers and Consumers," press release issued by United States Association of Importers of Textiles and Apparel, American Apparel & Footwear Association, International Mass Retail Association, and National Retail Federation, January 6, 2004. It quotes Kevin Burke, President and CEO of the AAFA, on "the positive effect further trade liberalization, through tariff cuts or favorable financing and insurance, can have on the competitiveness of these [textile and apparel] U.S. firms. We need to open doors to ensure that U.S. firms can compete globally, instead of shutting ours."

production of labor-intensive apparel items to international producers. Some inputs—including design—will come from the United States. But for the most part the actual production of apparel items will move outside the United States. That said, there will remain in the United States apparel production focused on supplying goods that must be delivered to retailers very quickly (in a matter of weeks, rather than months).

As a technical matter, neither industry requires assistance from U.S. policymakers. However, politics may dictate otherwise. If, as Levinsohn and Petropoulos suggest, the industries are creatively destructing, public policy can be crafted to facilitate—or at least not hamper—"creative destruction." Rather than ease adjustment by helping firms exit the industry, the aim should be to enhance adjustment by encouraging the entry of these more productive, "clever" firms.[36]

How? Some proposals have already been offered by textile and apparel producers and consumers. I summarize the key proposals below and offer some specific ways they could be achieved.

Encourage further rationalization. Wilbur L. Ross, founder of International Textile Group, has suggested that textile producers need to continue to consolidate (too many factories continue to operate at low percentages of capacity and therefore are unable to be competitive). In short, we've seen a lot of consolidation already, but not enough. Thus, policy should not forestall further mergers, shutdowns, or closures. Ross also suggests that owners of the surviving mills must commit the additional capital needed to maximize efficiency of larger-scale operations. As capital is hard to come by in the textile industry, policymakers might consider promoting bank lending programs with low interest loans for capital investment for textile companies. In addition, they could shorten the depreciation schedule for textile producers, establish a capital investment rebate program, or extend the net-operating loss program.

Encourage further research and development. Clearly, new products are the future of both industries. As noted, healthy and competitive U.S. textile producers will be those developing new, proprietary yarns and fabrics, and U.S. apparel producers who use those products to make stain-resistant, water repellant, even odor-resistant apparel will have an edge over "run of the mill" imported pants and shirts. Policymakers could increase funding of already-existing Federal R&D programs aimed at developing new textile products.

Encourage skill development appropriate to the textile labor force of the future. As the National Association of Manufacturers has pointed out, this is a fundamental need of manufacturing as a whole, not just of textiles or apparel.[37] Policymakers should ensure that U.S. schools train students with sufficient math and science skills to enable them to succeed in today's manufacturing industries, including textiles. In addition, students need to fully understand that they enter a global marketplace and they will need not only skills but an outlook on business that will prepare them to embrace, not run from, that marketplace.

At the same time, policymakers should not forget those who lose their jobs as a result of industry downsizing. They should not attempt to prevent that downsizing, but they could do more to help affected workers transition to new jobs. For example, policymakers could modify the Trade Adjustment Assistance program to allow for benefits to be paid to displaced textile and apparel workers without requiring that they link the loss of their jobs to increased imports or production shifts abroad.

Say "no" to demands for new import barriers, and encourage the end of existing import barriers. Import protection is not the policy option that will promote positive change in these industries, because import competition is motivating it. When weighing various pleas for action, bear in mind three key facts detailed in this paper: first, apparel imports impact at most 15 percent of the textile industry (based on shipments),[38] meaning that textile industry claims that increased apparel imports threaten to put it out of business are grossly exaggerated. Second, apparel unions represent just 8 percent of the apparel workforce, so they can hardly claim to "speak for" the industry's workers. Third, most apparel producers (but not the unions) prefer the elimination of quotas and tariffs, including those affecting imports from China. The data suggest that more benefit from trade liberalization than

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[36] Levinsohn and Petropoulos, *op. cit.*, p. 1.

[37] National Association of Manufacturers, The Manufacturing Institute and Deloitte & Touche, "Keeping America Competitive: How a Talent Shortage Threatens American Manufacturing," May 29, 2003.

[38] As noted above, 28 percent of textile mill shipments are apparel fabric, which arguably would be negatively impacted by apparel imports. But the textile mill shipment segment is just one of two textile industry segments. Looking at shipments for the industry as a whole, that 28 percent works out to a total effect of 14.8 percent.

from trade protection. Import protection is an appropriate policy for an industry that is destructing, but not for an industry that is creatively destructing.

Develop rules of origin for trade agreements and preference programs that provide meaningful alternatives to sourcing from China. The irony of the textile industry's insistence that rules of origin of these agreements require the use of U.S. (or usually scarce regional) inputs is that the resulting agreements provide little incentive to apparel importers to shift sourcing to the trade agreement partners, and away from China. Moreover, the rules are short-sighted as they preclude U.S. textile companies with international production operations from exporting their yarns and fabrics made in, for example, Thailand or even China to trade agreement partners like Australia or Singapore.

Many of these proposals have already been suggested by trade associations representing American apparel producers, importers and retailers. The reaction from trade associations representing the textile industry is less than enthusiastic. Cass Johnson, then the President of the now-defunct American Textile Manufacturers Institute, said that the proposals failed to address the industry's "biggest problem," surging Chinese imports. Clearly, in light of the data and other information detailed in this paper, the "China problem" is a gnat, not the vulture these industry representatives would have policymakers believe it to be. As noted, China currently accounts for 12 percent of total U.S. apparel imports, or 7 percent of the U.S. apparel market. Even if that gnat grows considerably, its importance to promoting the health of the textile—and apparel—industries has been blown wholly out of proportion. Policymakers would do well to place all claims in their proper perspective, devise policy responses that will do the industries some good, and avoid those that will "do harm" to others and the broader economy.

Cochair MULLOY. Thank you, Mr. Autor.

Ms. Hughes?

STATEMENT OF JULIA K. HUGHES
VICE PRESIDENT FOR INTERNATIONAL TRADE AND GOVERNMENT RELATIONS
U.S. ASSOCIATION OF IMPORTERS OF TEXTILES AND APPAREL

Ms. HUGHES. As the last speaker on the last panel today, I promise that I will try to keep my remarks as short as possible. I know you have our written statement.

Cochair MULLOY. It will be included in the record in full.

Ms. HUGHES. Fabulous.

While we didn't volunteer for the role, we are here today in part because the textile and apparel industry is at the center of decisions that will affect the U.S.-China relationship for years to come. I don't have to talk about the history. My colleagues have talked about that. I may disagree with some of the ways it's been portrayed, but I'm sure we'll be able to talk about that later.

While China joined the WTO only in 2001, the elimination of the quota system was one of the positive developments for the Chinese. The ability to rationalize textile and apparel factories and to eliminate those suppliers that were propped up only because they were guaranteed an allocation of the scarce quota we believe is an important step in the move in China to go from a state-controlled economy toward a market economy structure.

Even though today, China is the number one supplier for textile and apparel imports to the United States, the fact is that when we look at the U.S. import statistics for the apparel products that U.S. consumers most demand, China actually remains a relatively minor supplier due to the quota system. For example, if we look at Chinese shipments of cotton pants, China is only the 23rd largest supplier, selling fewer cotton pants to the U.S. market than Jordan, Lesotho, or even Russia, that's not a WTO member.

I realize that some of the speakers may say this merely highlights the threat from China, but we think it should be recognized by the Commission as an opportunity as well. The commitment that the U.S. has shown to eliminate the quotas and to allow growth in the imports from China, which will come at the expense of other foreign suppliers, we recognize, should provide strong support to the credibility of U.S. trade officials when they press for market opening in other sectors of the Chinese economy for U.S. manufacturing exports, as the earlier panel discussed.

Let me try to briefly respond to the specific questions from the Commission, and I'm sure that we'll have many questions. First, the Commission asked about the impact of the termination of the Multifiber Arrangement on the U.S. textile and apparel industries, and we consider ourselves part of those industries as retailers and importers.

Our member companies see a very positive long-term impact for the sector. The elimination of the global bureaucracy that was needed to administer a complicated quota system with dozens of quotas on dozens of countries is gone. There will be no more need to divert resources that should have gone to commercial activities and to economic expansion toward monitoring quota systems. Over time, this should mean positive cost savings for U.S. companies and for U.S. consumers.

If I had more time, I would also have talked about some of the findings of a paper by the Progressive Policy Institute, which highlighted the positive impact for least developed countries and U.S. consumers.

Second, the Commission asked whether the textile safeguard mechanism included in China's accession protocol is an effective mechanism for dealing with the post-MFA surges. Certainly, China made a concession during its accession negotiations to remain the only WTO country that has a separate safeguard process against textile and apparel imports. Our member companies believe that the textile safeguard is an effective way to deal with the post-MFA surges. Frankly, just the existence of the textile safeguard mechanism through 2008 has served as a deterrent to U.S. companies that might have otherwise placed new orders in China.

Companies make sourcing decisions based on a variety of factors, but one of those factors is a desire for predictability and certainty, and the China textile safeguard introduces four years of uncertainty, even if the U.S. never used it. However, we do think that there have been some missed opportunities to enhance the competitiveness of the U.S. textile industry, and we really are differentiating here between the textile industry and the apparel industry, which are mainly our members as apparel retailers, versus textile manufacturers.

Frankly, restricting shipments from China is not the most effective way to support the U.S. textile industry. When our companies talk about how they make their sourcing decisions, they look at quality, competitive pricing and compliance as three basic requirements for any vendor. A fourth criteria for sourcing is what we call speed to market, the ability of a supplier to quickly manufacture fashion items and deliver them to the selling floor, and that is where China does not have an advantage.

That's why our members strongly support quick approval for the Central America Free Trade Agreement, an agreement which is not perfect but offers the best way to maintain yarn and fabric production here in the United States and let us manufacture the apparel close to home, in Central America. We would like to expand that partnership. We would like to work with the U.S. yarn and fabric companies if we can get that agreement to move forward, even though none of us think it's ideal.

The third question is about are there instances where the China textile safeguard is appropriate, and we certainly say yes. We anticipate the use of that safeguard, and we think there are really three criteria: that the product is no longer subject to quota; that the U.S. actually produces the product at issue; and that there is a demonstration of market disruption, not just an increase in imports.

As you know, the willingness of the administration to consider and act upon requests for safeguard measures, even before the products were quota free and whether or not that is a violation of U.S. law is the focus of a lawsuit brought by our association. That case is pending before the Court of International Trade, so that limits some of what I can say today, but let me say that we believe that the widespread understanding was that the textile safeguards were only intended to be used on products where the quotas were removed, and we can cite statements from U.S. Government officials, from textile industry officials, and even Members of Congress to that effect.

But what I really want to emphasize about the lawsuit before my time runs out is the suit is really about whether the public has a right to prior notice when the government wants to change its rules or its interpretation of the rules and whether the public should be permitted to comment on those rules before they are implemented.

This isn't as exciting as the media reports that are trying to pit top name retailers versus the textile industry, but the truth is that that's what the lawsuit is about: it's about basic American values, the democratic process, our representation before government, and the promotion of transparency in government. It's not really about China.

At issue is the May 2003 Federal Register notice, which has been cited several times today, and I'm sure that we'll talk about that more in the question and answer period, and our charge is that CITA has violated its own rules. But since my time is done, and I know we're going to have questions on this issue, let me conclude now and thank you very much for the chance to appear today.

[The statement follows:]

Prepared Statement of Julia K. Hughes
Vice President for International Trade and Government Relations
U.S. Association of Importers of Textiles and Apparel

On behalf of the member companies of the United States Association of Importers of Textiles and Apparel, we are pleased to respond to the Commission's request to participate in the hearing, "China and the WTO: Assessing and Enforcing Compliance." The Commission has requested comments from the textile and apparel community with respect to "strategies for enforcing China's textile commitments" under its World Trade Organization Accession Agreement. In addition, the Commission provided a list of specific questions to which we will respond in this statement.

Before beginning a response to those questions, we do want to start with our recognition that the essential mandate for the Commission is to review compliance by China with the WTO Accession Protocol and also to "explore what incentives and policy initiatives should be pursued to promote further compliance by China." We believe that the textile and apparel sector plays a critical role in the exploration of incentives and the impact of U.S. policy initiatives on compliance activities by China. The landscape of the broad economic and political relationship between the United States and China has changed now that we are in 2005. And while we did not volunteer for the role, the textile and apparel sector is at the center of decisions that will affect the U.S.-China relationship for years.

For more than 40 years, the international quota system significantly distorted all segments of the international textile and apparel trade. On January 1, 2005, the quota system ended for all countries that are members of the World Trade Organization. The elimination of the discriminatory quota system—which restricted investment in the developing countries—was hailed as a major success of the Uruguay Round Agreement. And it certainly reflected one of the few times that the international community negotiated a smooth conclusion to a protectionist system. The elimination of the quotas was phased out over ten years—a lengthy phase-out but one that allowed all companies and countries to plan for the changes in the industry. As the WTO Director General stated at the final meeting of the Textiles Monitoring Body:

> *The expiry of the ten-year transition period of ATC implementation will put an end to a special and discriminatory regime that has lasted for more than 40 years. With the full and timely implementation of the ATC, trade in textile and clothing products will cease to be subject to this regime and become governed by the general rules and disciplines embodied in the multilateral trading system. Hence the completion of the integration process under the ATC will not only contribute to increasing trading opportunities, but will also be of major systemic importance.*
>
> *All in all, the elimination of the trade-distorting quantitative restrictions that are still in place will be beneficial for the global economy in terms of increased market access opportunities, efficiency gains and consumer welfare.*

While China joined the WTO only in 2001, the elimination of the quota system was one of the positive developments for the Chinese economy. The ability to rationalize the textile and apparel factories, and to eliminate those suppliers who were propped up only because they were guaranteed an allocation of the scarce quotas, is believed to be an important step in the move in China from a state-controlled economy to a market economy. That opportunity for China to expand production of textile and apparel products also offers an important avenue for incentives that the United States can use to ensure compliance with other WTO commitments by China. There is a clear linkage between the U.S. elimination of the quota system and the early implementation of other WTO commitments by China.

Even though today China is the number one supplier for textile and apparel imports to the United States, the fact is that when we review the U.S. import statistics for the apparel products with the highest consumer demand, the quota system has meant that China is a relatively minor supplier of those products. For example, if we review the U.S. imports of cotton trousers and shorts, China ranks as twenty-third largest supplier. China sells fewer pairs of cotton pants to the U.S. market than Jordan, Lesotho, or even Russia, which is not even a WTO member country. We realize that some speakers may say that this merely highlights the "threat" from China. But we think that it should be recognized by the Commission as an opportunity. There is no question that in a rational economic world that is not distorted by the quota system, China will gain market share. And the commitment by the United States to allow growth in the imports from China—which will certainly come at the expense of shifts from other, less efficient suppliers—will provide strong support to the credibility of U.S. trade officials when they press for more market opening in the Chinese economy for U.S. manufacturing exports.

Let us now turn to the responses by USA–ITA to the questions that were specifically asked by the Commission. First, the Commission asks about the impact of the termination of the Multi-Fiber Arrangement on the U.S. textile and apparel industries. Our member companies see a positive long-term impact for the sector. The elimination of the global bureaucracy that was needed to administer the complicated quota system should mean that resources will no longer be diverted from commercial activities. Over time this should mean positive cost savings for U.S. companies and for U.S. consumers.

Second, the Commission asks whether the textile safeguard mechanism included as part of China's accession to the WTO "is an effective mechanism for dealing with post-MFA surges." Certainly China made a substantial concession by agreeing to remain the *only* WTO member country that will continue to be subject to a separate safeguard process against textile and apparel imports. USA–ITA believes that the Textile Safeguard is an effective way to deal with post-MFA surges from China. Even the existence of the Textile Safeguard mechanism through 2008 serves as a deterrent to U.S. companies that might otherwise place new orders in China. Companies make sourcing decisions based on a variety of factors—but one of those factors is a desire for predictability and certainty. The China Textile Safeguard introduces four years of uncertainty—even if the United States never uses the safeguard.

However, in many ways, we would suggest that the wrong question is being asked. While today's hearing is about U.S. relations with China, the fact is that the quota system was eliminated on all WTO member countries, which includes a number of other major suppliers to the U.S. market. In the context of the quota elimination, we suggest that the question could be revised to ask what steps industries took during the term of the MFA and its successor, the Agreement on Textiles and Clothing, to prepare for increased competition from imports (from all sources) in the absence of protection, and whether the United States has taken the most effective steps to promote production in this hemisphere. The answer to both questions is no. Some manufacturers have implemented strategies to compete globally and are certainly going to benefit from that foresight. Many others, however, have not, perhaps in part because they did not believe that the protection would ever end. The United States also has established preference arrangements and negotiated free trade agreements that include textile and apparel products. But the restrictive rules established under those arrangements are not as attractive as they could be, if we want to truly encourage partnerships in this hemisphere and enhance the competitiveness of both U.S. and other Western Hemisphere manufacturers. USA–ITA strongly supports quick approval for the Central American Free Trade Agreement (CAFTA). The best mechanism to maintain yarn and fabric production in the United States is to enhance the competitiveness of the Central American apparel industry. The partnership that exists—particularly with duty-free treatment for all apparel made in Central America and market-opening through the cumulation provisions to allow sales into Mexico and Canada—will allow the U.S. industry to out-compete China. In the absence of improved options for maintaining apparel manufacturing in this hemisphere, the practical effect of renewed quota restrictions on China will be to shift production to other Asian suppliers, such as India and Pakistan.

Of course there are instances when the use of the China textile safeguard is appropriate. Those instances meet three criteria: (1) the product is no longer subject to quota when the safeguard is requested, (2) the United States actually produces the product at issue, and (3) there is a legitimate demonstration of market disruption. An increase in imports by itself does not equal market disruption. In addition to a rapid and significant increase in imports, market disruption historically has been demonstrated through a thorough review of a range of factors having a bearing on the evolution of the state of the industry, including turnover, market share, profits, export performance, employment, volume of disruptive and other imports, production, utilization of capacity, productivity and investments.

The textile safeguard included as Paragraphs 241 and 242 of the Working Party Report on China's accession to the WTO had its origins in the "consultation mechanism" that was included in every bilateral textile agreement the United States had with China since 1980. The terms of Paragraph 242 actually represent a multilateralized version of two provisions contained in the bilateral textile agreement reached between China and the United States in 1997 (paragraphs 8 and 21).

It is apparent that the textile safeguard mechanism was not intended to be used before goods became quota-free. Even the predecessor organization to NCTO—ATMI—recognized this. We note that in September 2002 ATMI issued a press release which expressly acknowledged that "The use of the temporary quota is allowed until December 31, 2008 only for products that have already been removed from quota-control under the terms of the WTO Agreement on Textiles and Clothing." The Bush Administration also recognized this, as evidenced by the press release issued by the Commerce Department in April 2003, which expressly described the China textile safeguard mechanism as applicable to "imports of textile and apparel products from China that have been 'integrated' (i.e. removed from quota) into the WTO trade regime."

That press release announced the establishment of U.S. procedures for considering whether to take safeguard actions, either in response to requests from private parties or through self-initiation by the Administration. Those procedures, published

in the Federal Register in May 2003, were intended to implement the textile safeguard.

Regrettably, the domestic textile industry decided in 2004 that it was not content with abiding by the rules both the United States and China agreed upon as part of the 1997 bilateral textile agreement and again as part of the China accession agreement. Starting in the summer of 2004, the industry began pressing the Administration to disregard those rules and allow the industry to get a jump-start on new restrictions. It is apparent that both the industry and the Administration understood full well that initiating a safeguard measure before products were even quota-free is not permissible under the Accession Agreement. Proof of the Administration's view is clear from its own press release, from the wording of the May 2003 procedures, as well as from a letter from the Chairman of the Committee for the Implementation of Textile Agreements expressly rejecting a July 2003 safeguard request because it covered products that were not yet integrated. Even Members of Congress recognized that the textile safeguard was not applicable to products still under quota, so they introduced legislation, H.R. 5026, to instruct the Administration to disregard the agreed rules.

That brings us to the third question raised by the Commission. The willingness of the Administration to consider and act upon requests for safeguard measures even before products were quota-free, and whether that is a violation of U.S. law, is now the focus of a lawsuit brought by USA–ITA on December 1. That case is pending before the U.S. Court of International Trade and it would be inappropriate for USA–ITA to argue its case before this Commission. However, we can say that the suit is about much more than trade with China. The suit is about whether the public has a right to prior notice when the government wants to change its rules or its interpretation of its rules, and whether the public should be permitted to comment on new rules before they are actually implemented.

Obviously, that sounds a lot less intriguing than an international dispute pitting top name importers and retailers against U.S. mills trying to cope with a new onslaught of competition when a decades-old quota system is finally dismantled. But viewed in its actual terms, the case is a lot more important to basic American values, the democratic process and promotion of the concept of transparency, than about China.

At the center of *USA–ITA v. United States* is the May 2003 Federal Register notice. Before May 2003, CITA decided in complete secrecy whether to impose new textile quotas. The first public notice of a new quota would come when CITA issued a Federal Register notice revealing that it had already requested consultations with a foreign government to establish a new quota. But the May 2003 notice told private parties—domestic producers and importers alike—that a three step process would henceforth determine whether new quotas would be established for Chinese goods. First, if a private party request were submitted, CITA would take 15 days to decide whether it met the minimum requirements for a request. Second, if the request was sufficient, or if CITA wanted to self-initiate consideration of a safeguard measure, a 30-day public comment period would follow. Third, following the comment period, CITA would take up to 60 days, and perhaps more if necessary, to decide whether a safeguard was appropriate. If the decision was to approve the request or self-initiation, CITA would request consultations with China. Requesting consultations also would determine the quota period and the quota level. The quota would apply to goods exported from China on or after the date the consultations were requested. The quota level would be based upon U.S. imports from China during the one year period ending two months before the month in which the request was presented, plus 7.5 percent for cotton and man-made fiber products or 6 percent for wool products.

USA–ITA charges that CITA violated its own rules by considering safeguards before products were integrated and violated the Administrative Procedures Act by failing to provide private parties with fair notice of a change in these important rules. The issue of whether CITA has authority to implement the safeguard provision of China's Accession Agreement is also before the Court. Is CITA above or outside the law when all other Federal agencies have to follow such rules, and when producers and importers of products other than textiles have the right to notice and to comment? That is what the U.S. Court of International Trade will decide.

Finally, the last question from the Commission is about the impact of the recently-announced China export tax on textile and apparel products. Our understanding is that the purpose of the Chinese decision was to try to eliminate some of the fears of developing country manufacturers, as well as U.S. companies, that once the quotas were removed, the prices for Chinese shipments would decrease and put pressure on global prices. It is too soon to say what the impact of this measure

will be or whether it is the only measure China will take in response to the concerns.

Thank you for this opportunity to provide the views of the importing sector of the textile and apparel industry in the United States. China's accession to the WTO presents important opportunities and challenges for all of us, and we look forward to meeting them.

Panel IV: Discussion, Questions and Answers

Cochair MULLOY. Thank you, Ms. Hughes. That was most interesting testimony.

Commissioner Wortzel, you have some questions for this panel?

Commissioner WORTZEL. Thank you all very much. I learned quite a bit.

I have to say, Mr. Tantillo, my greatest regret in this whole process is that I can't get a good Russell sweatshirt made out of pure cotton here in the United States, and I hold you personally responsible.

Mr. TANTILLO. The times have changed in that regard; that's for sure.

Commissioner WORTZEL. Times have changed.

I heard a couple of things that I'll ask you to comment on, but I'll try to summarize a couple of things that I understand. One thread of your argument, Mr. Johnson, Mr. Tantillo, has been or seems to be that as a foreign policy tool, the United States should consider imposing restrictions on some imports from China so that Islamic countries are able to export to the United States, improve their economies, and those are places that we are wanting to reach out to as part of a major foreign policy initiative in the Muslim world.

So that's Indonesia—Malaysia is not that competitive; but certainly, Bangladesh, Turkey. It's kind of a unique argument. I think it's an interesting argument. It's one that people that are more conversant in policy arguments rather than that nuances of trade could embrace, you know, so I'd kind of encourage that.

I've heard a lot of arguments about CAFTA, the Central American Free Trade Agreement. Certainly, Ms. Hughes, you seem to be happy with it. You support it. It would help folks who want to bring in more stuff more quickly; probably help some of your textile manufacturers here in the United States.

I wonder how Mr. Raynor feels about that, because you all seem to be absolutely odds, and Mr. Autor, I guess, completely at odds on that point.

Go ahead.

Mr. JOHNSON. Can I address that?

Commissioner WORTZEL. Yes, please.

Mr. JOHNSON. Our trade association, NCTO, has not taken a position on CAFTA. We have members who support it and members that are hurt by some of the provisions, which allow Chinese yarns and fabrics to use the agreement to enter the U.S. and displace U.S. production.

But I think one thing is important to realize about CAFTA, and that is CAFTA will not solve the China problem. As Erik mentioned, apparel items get about a 16 percent duty benefit if they're part of a free trade agreement. Textile items get about an 8 percent benefit. The size of the China price advantage is much, much larg-

er than that, so you may pass a CAFTA, but you may still see apparel production in Central America vanish very quickly.

As a matter of fact, when we have looked at areas that have benefited from zero duty access, that's the Sub-Saharan countries under AGOA, the Indian countries under ATPA, the Caribbean countries under CBTPA, and the NAFTA countries, none of them have done any better against China than any other country. The Chinese advantage is just too great.

So while I think you can posit, if you keep China under control, these agreements may work, and they have worked. But if you don't do something about China, they really don't matter. That's all I have to say.

Commissioner WORTZEL. That's sort of where I came down on it. I guess the other complicating factor would be what happens when Chinese manufacturers begin to buy companies in Central America, because they have got all of this money of their own to export? What does that do?

Mr. TANTILLO. Well, I might just comment: our association has taken a position in opposition to CAFTA for the specific reason that it contains numerous loopholes that allow for Chinese components to be shipped to Central America, assembled, and then, exported to the United States duty free.

We simply believe that we do not need any more avenues for China to impact the U.S. market, especially under duty free treatment, when they are already having an enormous direct impact on our industrial base and on our producers.

Commissioner WORTZEL. So they would the back door——

Mr. TANTILLO. Absolutely.

Commissioner WORTZEL. —and get the advantage both ways.

Mr. TANTILLO. Absolutely.

Ms. HUGHES. If I could just comment on that, though, because the fabrics that are actually being used from Asia and Central America are not Chinese. It's actually Taiwanese and Korean. And so, as we look at what the impact may be on China, I'm not sure that there is, frankly, very much of a back door avenue, because other Asian competitors are there first. I don't really see China manipulating CAFTA.

Mr. AUTOR. I'm sorry; I just wanted to mention something quickly. There has been a lot of talk about the impact of Chinese competition on other countries. We have a whole range of FTAs and preference programs that have been proposed to help give these countries a competitive boost up, and what's really been surprising is, in practically every instance, the textile industry has opposed them or insisted upon rules that watered them down to such an extent that they were to a large extent unworkable.

The Caribbean Basin Trade Partnership is a good example. The rules in order to claim duty-free preference under that program are so complicated and the compliance costs are so high, all in an effort to ensure that China somehow doesn't gain some toehold through this initiative that the textile industry's customers, the retailers and the apparel manufacturers, are finding that they can't use the program.

It ends up being cheaper because of the compliance costs to import fabric from other Asian countries and pay the duty than to

incur the compliance costs necessary to claim the duty free preference, and we have seen this time and time again, that where we actually have an opportunity to provide other countries a competitive leg up, it's been consistently opposed or undermined.

Mr. TANTILLO. Can I respond to that?

The reason the imports from China are cheaper than those produced under preference arrangements such as NAFTA or CAFTA or CBTPA is because China cheats. China provides a macro system of subsidies, which allow them to ship goods to the United States 70 percent below the cost of most other suppliers in many key product categories. As a result, they are able to overwhelm the preference structure that was put into place under these arrangements.

If you do not deal with China's cheating, the preference programs become obsolete. That's why the importing community is not interested in expanding their output or sourcing from preference programs. The enticement to take goods from China is simply overwhelming.

Mr. RAYNOR. Let me comment for a second about this, because we're opposed to the CAFTA agreement as well, but I think that the points you've made are absolutely correct. The data that were presented before shows us that no matter what trade agreement there is, the Chinese are able to beat that.

I want to go back to the issue that I raised initially: this is not about bashing China; this is not about, at least for me and for my union, this is not about saying—you have to have a policy that has negative restraints, which everybody then cheats around; instead you have to have a policy of positive restraints that says we encourage certain kinds of behavior.

It wasn't that long ago that our union was engaged in ending domestic sweatshops in this industry when this was a national industry and not a global industry. And we did that by raising the standards, in partnership with the government, for everybody that was in the textile and apparel industries. We did it mainly through things like having minimum wage; you remember the Triangle Shirtwaist Fire; having occupational health and safety laws, having waste treatment laws, having all these kinds of things that required the industry to do something to reach a level playing field. And then, we said now, you want to compete? Make a better product, have a better idea, have a better design. Don't compete off the backs of the people who work for you.

That's what this is all about. When you say free trade with no restraints, when you say free trade with no rules, then, it's got to go to whoever can produce cheapest, and if producing the cheapest occurs by manipulating your currency, if it occurs by oppressing your employees and not allowing them collective bargaining, if that occurs by not treating your water and your waste, then that's a way of doing that.

In a society as totalitarian as China's, that's exactly what's happening, and you don't fix that piecemeal.

Cochair MULLOY. Thank you, Commissioner Wortzel. Did you have a followup? One——

Commissioner WORTZEL. If the Chinese are that—I won't even call it competitive—are that predatory—would that be a—but if

they can put it out that cheaply, then, why is it that if you're over there, for instance, in France or Spain or England, you really, if you go through the clothing rack, you don't find Chinese products?

For global branding, when you look at global branding, it's coming out of Vietnam for the most part. Why is that?

Ms. HUGHES. Actually, we might argue that China is not the lowest cost producer. And I recognize that the other organizations did their study, but when we look at the U.S. Government statistics on unit values of imports, China is not the low cost producer right now; Bangladesh is a lower cost producer; Vietnam is a lower cost producer of the products that are coming to the United States and the data that's reported by Census.

I can't explain what is behind the huge discrepancy that we have, but clearly, the way that the data is looked at is very different from that import data versus the data that was presented here today. So you're absolutely right: China has not been the lowest cost producer, and while we do anticipate price deflation across the board with the elimination of quotas and all those administrative charges, we don't anticipate any huge drop in price from any single country.

Mr. JOHNSON. Can I answer the France question?

Commissioner WORTZEL. Sure.

Mr. JOHNSON. It's because Europe still has quotas on China. It's interesting, because we had someone from Eurocotton, and the European Union has just started a real time monitoring system of Chinese imports. Right now, we have a delay of two months before we find out. They're now doing real time monitoring. They post their data on their Website.

Quotas went off in Europe on January 1 as well. In some categories, it's all posted there, Chinese imports in January exceeded total imports in 2004. So they have seen a huge ramp up coming from China.

Cochair DREYER. What's the Website? Do you remember the Website?

Mr. JOHNSON. I can email it to you. It's very interesting.

And in regard to Julie and Erik's point about relative costs and costs for goods China is importing right now, I would really ask the Commission to look at what China did with prices once it went off quota. When China is under quota, then, it can raise the price, because there's a high demand and a relatively small amount.

Look at what China did when its goods went off of quota: prices dropped an average of 53 percent. Prices into the U.S. market dropped by an average of 53 percent. And look where the retailers ran when quotas went off: Erik and Julie say, well, we're not going to put all our eggs in this basket, and there are other suppliers and blah, blah, blah, and just in time.

Seventy-three percent of the goods coming in in these categories come from China, and that percentage is still increasing. The next highest supplier is Thailand, with 3 percent. That's putting all your goods in one basket, and it's a wide range of goods. So when they say no, we're not going to do this; we wouldn't do that, you know, I think if we didn't have safeguards, they'd absolutely do it.

Commissioner WORTZEL. Thank you, Mr. Chairman.

Ms. HUGHES. Can we respond to that, or shall we wait for other questions?

Cochair MULLOY. Sure.

Ms. HUGHES. Very briefly, part of the increase, what happened in 2002 is driven by the mix of products that were integrated, removed from quota at that time, which were the first tranches of the integration process, this 10-year phase-out. And intentionally, under the Clinton administration, when the products were selected for the 10-year phase-out, those where China was the major supplier were integrated early, because at that time, China was not a WTO member, and it was very uncertain when they might join.

So in many ways, the blip for China was much exacerbated in 2002 by products like luggage that have really driven the Chinese increases where frames are made in China, locks were made in China, fabric was made in China and they were assembled all over the world because of the quota restrictions; now, the production moved back to China as opposed to being in multiple countries.

Mr. JOHNSON. My figures do not include luggage. My figures were purely apparel figures. Luggage, China now has a 90 percent share of the U.S. market, 90 percent share.

Cochair MULLOY. Thank you. Thank you, Commissioner Wortzel.

Commissioner Becker.

Commissioner BECKER. I want to thank the Committee very much.

Ms. Hughes, I'd like to talk to you a bit about your job. You're the first real importer I think I've ever met.

Ms. HUGHES. We're very nice people.

Commissioner BECKER. Well, you smile a lot.

That's good. How long have you worked with them, anyway?

Ms. HUGHES. Actually, I've worked with the importers association since, I think it's 1996, but prior to that point, I worked for an importing company since the 1980s.

Commissioner BECKER. So most of your work experience or at least a very good portion of it——

Ms. HUGHES. Yes.

Commissioner BECKER. —has been working for importers bringing stuff into the United States.

Ms. HUGHES. Absolutely.

Commissioner BECKER. Well, then, at least it was before the expiration of the Multifiber Agreement.

Ms. HUGHES. Absolutely, yes.

Commissioner BECKER. It's my understanding that in 2001, the imports coming into the United States was in the neighborhood of 9 percent, and now, the imports coming in or the last, in 2004, was 73 percent. Whether that's right or not, that's what's printed here, and whatever the facts are, the facts are. What is the goal of the importers? To take it all?

Ms. HUGHES. Actually, no.

Commissioner BECKER. How much will satisfy the importers? How much penetration would make them happy?

Ms. HUGHES. Actually, I think you would be surprised to know that our member companies aren't looking at this from the perspective of how to maximize imports, but it's how to ensure that the

proper products that consumers want to buy are in the store at the right time, at the right price.

The surge in import penetration of whatever numbers that you're talking about, certainly, imports have increased. Some of that is explained by the Western Hemisphere preference programs, where we are importing products to the U.S. that actually are using U.S. industry inputs but still are counted as an import.

Commissioner BECKER. But you also represent importers into other countries?

Ms. HUGHES. Well, actually, we have members who export from the U.S., who ship product that's made overseas into operations in other countries. Now that the quotas have gone away, we do have many companies who are looking to become more global themselves, because the quota process and the restrictions made it very difficult.

Commissioner BECKER. Do you feel offended personally with the quotas that were in place that allowed 73 percent of the textiles to be imported? Did that offend you and the people that you worked for?

Ms. HUGHES. I wouldn't say that it offended me, but certainly, a goal of our organization, and we were supportive during the Uruguay Round negotiations for the 10-year phase-out of the quotas, not just because it helped our own companies, because it does to some extent, but also because it was eliminating a very discriminatory system where we had quotas only on developing countries and unrestricted trade between developed countries.

Commissioner BECKER. Would you feel good or bad if they replace all the textiles in the United States? Would that be a goal that as a representative of exporters or importers that you would be seeking?

Ms. HUGHES. Absolutely not. That is not our goal. We want to have a strong U.S. textile industry. Truly, and I had this in my remarks and really jumped over it today, we would like to expand the closeness with the U.S. textile industry, which we have not been able to do at this point because we are lobbying against each other in so many ways.

Commissioner BECKER. Seventy-three percent being imported seems like a—that's a good hunk of the—that doesn't leave much for the textile industry in the United States anyway. But anyway, let me skip over that. What about military hardware, the textiles?

Ms. HUGHES. Well, I think the Berry Amendment covers that, that all of the military——

Commissioner BECKER. Everybody's satisfied with that?

Ms. HUGHES. —has to be manufactured in the United States.

Commissioner BECKER. Mr. Raynor, you're not.

Mr. RAYNOR. We'd like to see expansion of the Berry Amendment, because we think that the Department of Homeland Security and other areas of what we consider to be defense need that protection. But I can tell you, I represent a manufacturer of body armor. I think we've all read in the papers about the parents of soldiers trying to buy body armor for their sons who are fighting in the war.

Commissioner BECKER. Even yet today?

Mr. RAYNOR. Well, I don't know about this week, but I know that I've seen those stories relatively recently.

One of the problems we have in our plants is they can't produce the body armor quickly enough, because they can't get the fabric, and they can't get the fabrics, because as the textile manufacturers have been devastated by the statistics that you were just shown, this industry requires a certain volume to run. And it requires a certain volume to run profitably.

Military manufacturers subcontract a lot of their work. They get a certain amount of orders. Then, when the government needs to ramp up, and, it can ramp up the orders by 25 percent any time it wants, manufacturers can't carry all of the workers that they need and the equipment that they need to meet that ramp up.

So they depend on subcontractors. But during the slow times, if those subcontractors aren't supported in some way, they go out of business, and then, all of a sudden, the primes don't have anybody to go to when we get into these situations. So it's that—as I was saying before, it's that comprehensive look at all of this that's so important. You've got to look at what we want from this industry as a country and what we need from it and how can we make sure that it can provide it.

Cochair MULLOY. Mr. Tantillo, I know that you had a comment that you wanted to get in there.

Mr. TANTILLO. Actually, I was going to make the same point that Mr. Raynor made. You cannot sustain a viable textile complex simply on military procurement. There has to be a substantial commercial market to justify the existence of the industry and the investment necessary to not only produce but do the research and development that is so vital in the military sector. And as the commercial sector shrinks, so does our ability to adequately supply that, which is so vital to our national defense.

Mr. JOHNSON. I would look at the situation where China supplied 75 percent of the U.S. textile and apparel market. Where would you need to go if you suddenly had to buy a lot of military textiles? There are over 5,000 textile products that are purchased in the United States by the U.S. military today——

Commissioner BECKER. I didn't realize until I was just listening to you all of that the penetration was that heavy into the market up to the end of 2004. It's on the verge of being wiped out.

Mr. JOHNSON. It was a flood the size of—let me give you an example. China increased its exports in those categories by 4 billion square meters. Mexico, which is the second largest supplier to the U.S. market, ships 4 billion. So China increased by as much as Mexico ships. It was astounding. The percentage increase was 1,100 percent.

Cochair MULLOY. Thank you.

Commissioner Bartholomew?

Commissioner BARTHOLOMEW. Thank you very much, Mr. Chairman, and thank you to our panelists for appearing. I suspect there aren't that many times that you all sit at the same table instead of across each other at the table, so we appreciate that, and we'll consider this our contribution to civil and civic discourse. Perhaps some good things can come out of it, but one never knows. I have three questions that I'm just going to put out there first, one for Mr. Autor, one for Mr. Raynor, and then, one, if there's time I'd like your thoughts on it.

Mr. Autor, I have no doubt that there are things that the domestic industry could have done along the way that would have made a slight—and I'm going to emphasize slight—difference in the status of where they are now. But I was frankly surprised to hear you blaming them or associating some of their demise to the fact that they're trying to stop transshipments.

Frankly, I was really rather taken aback by that, because in some ways, it sounds to me like, oh, it would be blaming the recording industry for trying to stop IPR, you know, stop counterfeiting. Perhaps I misunderstood you, in which case please correct the record, but if not, tell me, do you think that transshipping to avoid quotas is a fair trade practice?

Mr. AUTOR. Well, what I think I said was the problem. I don't have a problem with enforcement of the U.S. laws regarding illegal transshipment. What I do have a concern about is that there has been a considerable amount of pressure put on the Customs Service to, under the argument that essentially, we believe that transshipment wasn't as big a problem as the textile industry made it out to be, and they put a considerable amount of pressure on the Customs Service to leave no stone unturned to ferret out a problem that the Customs Service itself in its investigations determined was not as big a problem as the textile industry claimed it was.

If you hear the textile industry, it's everything coming into the United States is transshipped from China. That's simply not the case. That's not to say I don't think that there's some transshipment, and that should be addressed. But in their zealousness to try to force Customs to try to ferret out or, I guess, to address this problem, what they did was they created a tremendous chilling effect on companies sourcing legitimately from countries other than China.

And what that ironically had an effect on was that companies asked themselves, well, what country can I source from where I'm not going to be harassed by Customs? And the answer is China.

Mr. JOHNSON. Could I respond to that?

Commissioner BARTHOLOMEW. Yes.

Mr. JOHNSON. First of all, regarding Erik's statement that transshipment isn't such a problem, over the last six years, the average failure rate for a factory overseas that Customs has visited is 65 percent. In other words, 65 percent of the factories U.S. Customs visits overseas are either found to be transshipping or at high risk of transshipment. Those are Customs figures, numbers. That is one of the reasons why we think transshipments are pretty big, and they're a problem.

Now, on the compliance side, I agree that there are costs. And we have met with the American Apparel Producers Association and worked on reducing paperwork costs and simplifying forms so that in some cases, you don't have to have a piece of paper here; you don't have to have a piece of paper; and you don't have to have an electronic copy there; you just have to have the electronic copy.

So we recognize that there are costs that can be reduced and enforcement still continue. Ironically, that has happened, and it is ongoing. We want to make sure that those costs go down. Ironically, what we have found is that as trade agreements have been written, and attempts have been made to write in rules that would stop

Chinese transshipment, customs enforcement, actually going out and finding the transshipments has dropped off dramatically.

In the CBTPA bill, we got an appropriation with Ways and Means' help, to hire 72 new textile and apparel agents. Customs got the money and never hired the agents. And what do you do? What do you do? You can write the rules. If Customs doesn't enforce them, then, you're in the same place you always were.

So we are trying to get the paperwork costs down. I think we're all working together. But we need to see Customs actually enforcing these agreements so that our industry can have some faith in them.

Cochair MULLOY. If I can just clarify one thing, they got the money to hire these people from the Congress, and they didn't hire them. Why?

Mr. JOHNSON. There's no good answer.

Mr. TANTILLO. We're trying to find that out ourselves.

Mr. JOHNSON. They just never hired them.

Cochair MULLOY. Because we heard earlier that under the so-called Byrd Amendment, there were duties that were due from the goods that were being found dumped in our market——

Mr. TANTILLO. That were never paid.

Cochair MULLOY. And that the Customs, who are supposed to go out and collect that money, wasn't collecting it. So certainly, they could use some more additional bodies over there from what we heard today, and I'm just curious as to——

Mr. JOHNSON. Well, I don't, it seems incredible that Congress could authorize and appropriate money, and Customs could ignore it.

Cochair MULLOY. Yes.

Mr. JOHNSON. But that is what has happened. It is not unprecedented. The same thing happened in the NAFTA agreement, when 400 officers were authorized and appropriated to patrol transshipment along the Mexican border. Those officers were also never hired. They did get the money, though.

Mr. AUTOR. Could I just mention something with respect to what Mr. Johnson said about the failure rate in customs audits? Just because a factory does not pass a customs audit does not mean there's necessarily transshipment going on. It just means that they have not been able to verify their production. And when you look at the amount of paperwork that Customs requires from factories in order to conduct these audits, it's really quite substantial.

And when you're dealing with a factory in Cambodia or some other developing country, they may just not have had the means to collect that paperwork. So just because they failed an audit does not necessarily mean that there's transshipment going on, and I think that that conclusion is verified when you actually look at the audit reports that the Customs jump teams have done, whether it's been to Asia or Latin America or to Africa.

Mr. JOHNSON. Well, I don't want to belabor this, but the biggest category in those failure rates was factories, which actually did not exist where they said they were. They were phantom factories where they put up a sign, said I'm a factory in Hong Kong, and there was never a factory, and they went to the address, and there

was nothing there. That was the largest component of that failure rate.

Cochair MULLOY. This is really interesting, and you're really helping educate us on this issue.

Commissioner Bartholomew——

Commissioner BARTHOLOMEW. Mr. Chairman, I know it's late, and people are beyond time, but with the forbearance of my colleagues here——

Cochair MULLOY. Oh, absolutely, we'll forebear.

Commissioner BARTHOLOMEW. —I do have a couple of other questions, if you can spare a little bit more time.

Mr. Raynor, I well remember your testimony before this Commission. It was just about a year ago, probably a little over a year ago down in South Carolina. I commend you again for being so attentive to the conditions of the people on the ground. One of my complaints always has been in trade debates that people have a tendency to see it as the movement of goods and services free of the lives of the people who both produce and consume the goods and services.

So I guess my question is an update for you, which is since you last testified before us, what's the job situation in the communities that you represent and in the industry that you're talking about?

Mr. RAYNOR. I think there's been nothing but negative changes in those industries. That's why I said to you at the beginning why our union's name is UNITE HERE and not UNITE any longer.

Again, I'd go back to the previous question and what we said earlier: frankly, from a practical point of view, we've got to be involved with transshipment. You've got to be involved with counterfeiting, which nobody's talked about today. But at the end of the day, and I think everybody on this panel would agree, if you stopped every inch of illegal transshipment, and you stopped every piece of counterfeit goods, you would move the ball about an inch and a half down the field.

These are very, very practical questions. They're real questions. They're questions we have to deal with, and these folks on both sides of me, their job is to deal with these kinds of questions. But if we're talking about policy for our country, then, these are pimples. These are nothing compared to what the real issues are that we have to face, and if we don't face those issues, then.

Somebody mentioned Wilbur Ross before and how profitable the textile industry was. Wilbur Ross is a friend of mine. I thank the Lord for Wilbur Ross, or I wouldn't have any employees at Cone Mills in Greensboro, North Carolina. But let's not kid ourselves: Wilbur Ross bought Burlington and bought Cone because he's a very shrewd businessman, and your tax dollars and mine are paying for the pensions of all those people that were shed in bankruptcy, and thousands upon thousands of Americans lost all of the value of their stock in those companies.

So Wilbur did a very smart thing. He played by the rules that are available to him. He bought a company out of bankruptcy on the cheap, and he's going to make money doing that. The rest of us, many of the rest of us, suffered.

I don't blame importers for trying to make a living and be importers. They are going to play by the rules that are available to them. That doesn't make them evil people.

This is not about who's a bad guy and who's a good guy. This is about a system that forces us all to play by the wrong set of rules.

Commissioner BARTHOLOMEW. One more question, trying to tie it all together, we are now in a post-MFA world. I know there are efforts underway to try to make some modifications or changes or extensions, but one of the things we've been learning, of course, is that when companies shut down, the likelihood of them opening up again is really minuscule.

Do you think that the textile safeguard negotiated as part of the WTO accession agreement is an effective mechanism for dealing with the world that we are now facing?

Mr. TANTILLO. In general, no. It is a stopgap measure that provides some relief, and it only will provide relief if it is aggressively and effectively used by the administration. And by that, I mean you have to use it based on threat, which is clearly incorporated in the language associated with the accession terms.

In other words, we cannot allow China to go from 10 to 73 percent and then begin to address the problem or concern through a safeguard that regulates their trade from that point forward. When that happens, tens of thousands of people lose their jobs; companies go bankrupt; plants are closed; communities are devastated.

The safeguard allows for threat. The administration should use it in a preemptive sense, noting that China clearly has the capability to go from 10 to 70 percent, and we should then begin to work at the World Trade Organization to construct a system which identifies the fact that this industry is still unique; it is still important on a global basis to the development of numerous countries, to the stability and security of numerous regions, and as a result, we need a system which prevents China or any other one or two countries from monopolizing global markets.

Cochair MULLOY. Thank you.

Commissioner BARTHOLOMEW. A couple more comments.

Mr. AUTOR. Could I add a couple things to that? Sorry.

I agree that the textile safeguard mechanism is not terribly effective but probably for different reasons.

Commissioner BARTHOLOMEW. Had a feeling.

Mr. AUTOR. First of all, I think it's important in all this discussion about—and we obviously disagree on what share China accounts for in the import market, but I think an important thing to keep in mind is that when you look at total U.S. apparel imports over the past four years since China joined the WTO, it's only risen marginally from 72.3 million in 2000 to 77 million in 2003. That's essentially flat.

So as we talk about what's happening with Chinese imports, we have to bear in mind that the total number, amount of imports of apparel into the United States has essentially remained steady. And when you combine that with the fact that there is a very high import penetration of apparel into the United States, all that restricting Chinese goods is going to end up doing is shifting that production to other Asian producers, and that's exactly what we've

seen, and that, you know, that is going to have no positive impact on the U.S. textile industry.

And even with a safeguard quota in place, Chinese manufacturers can still ship their yarns and fabrics to another country like Indonesia, which is then made into a garment and exported to the United States. So I don't see how this mechanism really helps them.

And quite frankly, you know, as far as the appropriateness of how this or how this mechanism is appropriately used, I agree with Ms. Hughes on her assessment on that. I think as a general proposition, trade remedies laws are designed to protect U.S. production, U.S. jobs, and therefore, it's not appropriate to use on products like, for instance, brassieres or fully fashioned sweaters that are not made in the United States.

Commissioner BARTHOLOMEW. Any other comments?

Mr. JOHNSON. Can I make a comment?

Commissioner BARTHOLOMEW. Mr. Johnson, yes.

Mr. JOHNSON. First of all, I want to describe how—just give you an example of how it does help. Brassieres was one of the products that went off of quota, and brassieres were mainly made in Mexico and the CBI. Very little came from Asia. The CBI and Mexico had over 50 percent of the market. Our textile plants supplied most of the yarns and fabrics to make those brassieres.

Then the quota went off, and this was a relationship where those brassieres got zero duty entry back into the United States. The quota went off, and within 18 months, China had taken 40 percent of the market. And the textile mills that supplied those products went out of business.

So the quota stopped the increase from China, and some of the market came back. And it stopped China from taking all of the market. Now, if you let China get to 40 percent of the market, then, you're going to lose almost all the U.S. textile industry anyway, but we think the safeguard, if used effectively, will prevent China from getting 40 percent of the U.S. market and should prevent China from getting 40 percent of the U.S. market.

But this is a case where when the safeguard was used, it stopped China in its tracks in our industry.

Cochair MULLOY. We're going to move now.

Commissioner BARTHOLOMEW. Thanks.

Cochair MULLOY. Commissioner Dreyer.

Cochair DREYER. Grrr.

[Laughter.]

Commissioner BARTHOLOMEW. I thought I was the last one. Sorry.

Cochair DREYER. No.

Anyway, first of all, thank you all for coming. This has really been interesting. Most of us have been here since 8:15 this morning, and when you get around to 3:00, 3:30 in the afternoon, no matter how interesting the hearing is, frankly, it's hard to keep sitting. But I actually remained really interested in what you all were saying, so I very much appreciate this.

Just one follow-on comment to basically agree with what you were saying. That is just because the production was shifted out of China to other countries, it doesn't mean that there is no effect on

the United States, because when things move out of Mexico to China, the Mexican economy is hurt, which means more Mexicans try to flee illegally into the United States and problems like that increase as well.

So just shifting around the point of origin does not solve our——

Mr. JOHNSON. Well, we ship $5 billion worth of yarn and fabric to Mexico.

Cochair DREYER. To Mexico?

Mr. JOHNSON. To Mexico.

Cochair DREYER. Okay; this is a question for anybody and everybody, and that is that a couple of months ago, I read that in response to United States pressure about the imminent demise of the Multifiber Agreement, China suggested imposing an export tax on textiles and apparel. And I believe it was 5 percent and—lower than that?

Mr. TANTILLO. Two to four percent.

Cochair DREYER. Two to four percent.

In the commentary in the newspapers I read, which are just general New York Times, Wall Street Journal kinds of sources, they indicated that most people felt that that this percentage would not be enough to make a difference. And I would like your respective opinions on that.

Mr. AUTOR. I'll take a first crack at that. I would agree that it would really have no impact on trade flow sourcing decisions or prices. At 2.4 to 3.6 cents per unit, the tax is designed to make it relatively harder and more expensive to export low value as opposed to higher value goods. It will therefore have a marginally greater impact on retailers that import low-end garments like a $1 t-shirt as opposed to, say, a $25 fully-fashioned sweater. But I will agree that the tax is probably at a low enough level that it is really going to have no impact on sourcing decisions or trade.

But I think that a more fundamental question is raised by this, and that it is clear that the U.S. textile industry has been seeking to pressure China to impose restraints of this sort in one way or another to control its exports of textiles and apparel to the U.S. market, but they have criticized this as being too modest.

The cost of this restraint and any other restraint is ultimately going to be passed onto the U.S. consumer, and so, the question that I think that creates is why would we want to encourage the Chinese government to impose a tax on U.S. consumers. Although the tax is currently low, the tax mechanism is in place so that China could raise the tax at any time, and I think we need to recall that thanks to the quota system, American consumers paid over a billion dollars in quota costs a year that went directly into the coffers of the Chinese government.

Mr. TANTILLO. I might respond to that very briefly.

It is astounding to me that a 2 to 4 percent assessment by the Chinese has to be passed onto the U.S. consumer when the retail community is receiving a 50 percent price break on imports from China based on the quota elimination and the history associated with what the Chinese did with their prices after their products came off of quota in 2002.

And I think that is the fundamental issue here. What has to be passed on to the consumer? What are the margins that are being

generated as a result of China's entry into the marketplace in an unrestricted fashion?

A point was made earlier about no one wants to put all their eggs into one basket. They will diversify their portfolio, so to speak. That is absolutely true. But what we know based on conversations with producers on a global basis is that U.S. sources have come to them and said this is the price out of China. If you want to maintain your business with us, you have to meet this price.

Bangladesh, for example, told us we are a lower cost producer; however, the China price in many products is lower because their government has the ability to subsidize their production, and we do not. That is the fundamental issue at stake here: a China price that is artificially constructed.

Mr. RAYNOR. I can verify that when we sit in negotiations with a company, they will say to us we can't do something because we cannot raise prices; we've got to meet the China price; in fact, we've got to ask you to pay more for your medical costs, take less wage increases, because—they call it the China price. We've got to meet the China price, or we can't sell.

Cochair MULLOY. Thank you.

we're going to turn now to Chairman D'Amato. I'll have my own questions, and then, anyone who has final statements. Thank you for extending your time here before us. It's very interesting. I'm learning a lot.

Chairman D'Amato.

Chairman D'AMATO. Thank you, Chairman Mulloy.

What I get from the way China operates in this and other fields is it's a government, which manages its economy, and is basically rigged in all kinds of ways. So the question is, subsidies. I want to pursue this question of subsidies. We have someone said over 3,000 new textile facilities are being built. Now, if I were trying to save the textile industry, I would take a look and see what kind of subsidies are being given by the government to build those plants. I can't believe they're not being subsidized.

Okay, so, let's go to the WTO with a subsidy case on textiles. We've got to take actions. And this is a mercantilist government, and you've got to play it tough and analyze exactly how they're doing this, because it's unfair to our producers, and I don't believe that it's just a question of they're more competitive. I know that they don't pay their people anything, so they're more competitive that way. But they don't stop there. They rig it through subsidies and other kinds of operations that I think you can call them on and bring cases.

We're getting savaged in the WTO. We're being attacked in the WTO. Basically, it's a free play against the United States; it's called the WTO.

Mr. TANTILLO. Absolutely.

Chairman D'AMATO. Okay, so why don't we get into the WTO and—they're a member of the WTO. They don't play by the rules, but they're a member of the WTO. Let's bring them to bear. Let's start bringing cases on the textile area. It seems to me what we're looking for here are answers here against a manipulative regime.

Mr. TANTILLO. Unfortunately, we don't have a private right of action at the WTO. We need our government to take those actions.

You mentioned specifically the construction of new facilities. We can tell you that some of our own members have been invited to China, textile producers, and invited to make a major investment in China. And they've been told we will give you the property; we will give you the facility. We will give you a 10-year tax holiday. We will give you an export rebate on everything that you send overseas. We'll subsidize your utilities and your raw materials.

Chairman D'AMATO. Because they just want to control our market share, control the market, and then, later on, they've got it all.

Mr. TANTILLO. And we have supplied this information to the Executive Branch, and we have the same question, Mr. Chairman, that you have: why have we not taken China, which is the most blatant violator of unfair trade practices, why have we not taken them to the WTO and required that they justify what is transpiring within their economy, because it's taking place at the expense of hundreds of thousands of U.S. workers.

Chairman D'AMATO. Let me suggest this: There are Senators interested in this information. We had a Senator testify this morning from South Carolina, Lindsay Graham. I'm sure this information would be of great interest to Lindsay Graham and to other Senators who represent these areas, because if the administration is giving China a free pass on all this behavior, which is what it looks like now, my recommendation is you bring this to the Congress, and they'll get some attention and then see what happens.

But you've got to raise the political costs here for an administration that's not willing to enforce the rules of the game for your industry.

Cochair MULLOY. Mr. Johnson.

Mr. JOHNSON. Can I just say this issue came up at the conference, the International Coalition we had in Washington a couple of weeks ago, and the coalition committed to hiring a consulting firm and preparing cases that you could hand to the administration and say you've got to do these cases.

Our industry was part of the coalition that brought the 301 case against the Chinese currency. As you know, it's obviously an administrative decision, and we're not happy with how it ended up. But I think the pressure for the administration to start moving on these cases is going to increase over time.

Chairman D'AMATO. Yes, it will.

Mr. JOHNSON. And we will help with that pressure.

Chairman D'AMATO. Let me give you a way this plays out. Yes, the administration wouldn't take the currency issue, but you now have legislation for a 27.5 percent tariff. This is another route through the legislative process because you don't have any administration satisfaction on it. You can do other things in the textile area this way, too.

Thank you, Mr. Chairman.

Cochair MULLOY. Yes.

I just want to comment: in Washington Trade Daily, January 27, 2005, edition, I was reading this article: Textile industry groups representing 25 countries yesterday called on the WTO to create a special safeguard mechanism to prevent China from dominating the global textile and apparel market. So apparently, this isn't just the U.S. industry but a lot of other industries involved——

Mr. TANTILLO. Absolutely.

Cochair MULLOY. —and concerned about this issue.

Now, I want to ask: do the companies that import these goods from China, obviously, there must be something dealing with their profits that induces them to go and want to get Chinese-made goods. So you mentioned that, Mr. Johnson, that because China was so much lower priced than others, they want to go and source from China. So this is a profit issue? And obviously, we should have a profit issue, but is that what's going on here?

Mr. JOHNSON. Erik obviously knows much more about this than I do, but what we read everywhere is that price that low trumps everything else, and that is the way the trade patterns seem to develop as well. When you can drop your prices 50 percent, then, you know, all the other factors seem to go down in importance, and the sales and the imports go to China.

Cochair MULLOY. Is that correct that the companies can——

Ms. HUGHES. I'm afraid that——

Cochair MULLOY. Do companies increase their——

Ms. HUGHES. None of our companies have had prices offered to them that are 50 percent lower than they were paying last year, and so, if you have recommendations, I may know people who could be interested in that. But prices have not fallen to that extent at all. And many companies have continued to look at China as a good supplier, an excellent supplier, a supplier who maybe is the only supplier of certain products of the quantity and quality that they want, things like fine-gauge knit sweaters and some of the recent fashion trends.

But no one that I have ever spoken to in our industry has said I want to put all my business in China because it's the cheapest location to make product. That is just a fallacy.

Cochair MULLOY. Does price enter into your buying decisions from China at all?

Ms. HUGHES. Absolutely; I tried to talk a little bit about this, that it is a combination of factors. Price is critical. Wal-Mart is not a member of our association, but Wal-Mart helps to drive the competition at retail.

Cochair MULLOY. I see.

Ms. HUGHES. So there certainly is competition for price, but that is not the only factor, because if you only are buying on price, that doesn't get people in the store to buy your product. You need to have fashion. You need to have a level of quality that you expect when you go and buy something that it won't fall apart, that the color won't run.

You also have the compliance issues, which we really didn't have much of a chance to talk very much about today, but that compliance in terms of the rights of the workers, the safety in the factories, the security issues like the Customs Trade Partnership Against Terrorism, where our industry has really picked up a huge price tag to try to ensure that from the factory floor to the United States, every container is secure and checked in the war against terrorism.

All of that combines with the speed issue, where China really cannot, because of the distance, meet what we have in the Western

Hemisphere. The price is one element and certainly important, but it never is the only driver in the decision.

Cochair MULLOY. Here's what I'm trying to understand: there is in our WTO agreement with China this special textile safeguard.

Ms. HUGHES. Absolutely.

Cochair MULLOY. Which we can use now until December 31, 2008.

Ms. HUGHES. Yes.

Cochair MULLOY. And the language in that is if the imports are, quote, threatening to impede orderly development of trade in these markets due to market disruption, the WTO member can follow prescribed procedures, impose a safeguard measure restraining imports of such products.

Ms. HUGHES. Yes.

Cochair MULLOY. Is that——

Ms. HUGHES. Absolutely.

Cochair MULLOY. And so, that provision was put in the WTO agreement which was, then, approved by the Congress. And the Congress, I think, paid a lot of attention to the fact that that safeguard provision was there.

Mr. TANTILLO. Absolutely.

Ms. HUGHES. Yes.

Cochair MULLOY. Now, the administration, which has hardly been tough on exchange rate issues with China, if you heard that going on here earlier, did decide that this mushrooming imports from China, that they wanted to use this textile safeguard, and they were actually—this administration was going to implement that.

Ms. HUGHES. Yes.

Cochair MULLOY. But from my understanding, your industry sued to prevent the administration from utilizing that safeguard, and it's up into this International Trade Court in New York, which has a preliminary injunction against the government being able to do what the statute and what Congress, I think, thought they would be able to do.

So, I was just wondering: now, you told us that the reason that you did that was because of good government and transparency and decisionmaking. I just wondered, did price or profits play any role in your decision to throw a monkey wrench into what the government wanted to do there?

Ms. HUGHES. Absolutely not. There were actually three safeguards that had been in effect from the end of 2003 through 2004. We didn't challenge those. The only cases we challenged were the cases that were what are called the threat-based petitions, where the petitions were filed based on a presumption or a theory that imports would surge this year, not on actual increases in imports.

Our interpretation of the procedures in the Federal Register notice that the Committee for the Implementation of Textile Agreements published in May 2003 was that they did not intend to have products covered where you did not yet have an import surge, because quotas were still in place.

Cochair MULLOY. Right.

Ms. HUGHES. And to this point so far, the Court of International Trade has agreed with that argument, so that the injunction is in place.

We are not challenging the right to use the China textile safeguard provision. We do think that there should be procedures and public notice and transparency in the process, but nowhere are we saying that there should be no safeguards, nor was any of that driven by a price consideration.

Cochair MULLOY. What does this mean, this case? Does this mean that implementation of the safeguard will be delayed for a period of time, but obviously, what we expect to happen, it will be overwhelming that there is this damage being done, and then, you'll be able to use the safeguard.

Mr. TANTILLO. Absolutely.

Cochair MULLOY. What is the time period we're talking about?

Chairman D'AMATO. Well, that's a temporary injunction, isn't it?

Cochair MULLOY. No, there's a preliminary injunction, but I think it's going to go on for a while now, because the Justice Department asked for that preliminary injunction to be lifted, and the court refused——

Ms. HUGHES. Yes.

Cochair MULLOY. —and wants to continue proceedings. So I think it's going to go on for a while; is that right, Mr. Tantillo?

Mr. TANTILLO. Yes; in our opinion——

Chairman D'AMATO. A temporary injunction with no timeframe?

Mr. TANTILLO. Until the case is resolved.

Cochair MULLOY. It's a preliminary injunction, and they'll hold it until they finish——

Ms. HUGHES. Until the hearing is held in the case and a decision is issued.

Cochair MULLOY. They are going to carry out the fact-finding now in a hearing.

Mr. TANTILLO. Let me start with your basic point, which is that the safeguard provision was a major component of the debate and the discussion in order to convince Congress to approve the permanent normal trade relations with China, which allowed them, then, to join the WTO.

And the argument went as follows: we know China is a nonmarket economy. We know they have an enormous capacity to produce textiles and apparel. But do not worry; your constituencies will be well cared for, because we have a safeguard system that will prevent China and its unfair practices from destroying those jobs.

As I mentioned in my testimony, it took the government, the Executive Branch, almost two years after China joined the WTO to provide any relief using the safeguard system. During that two-year period, we lost 110,000 jobs. It's tantamount to calling the fire department after the house has burned to the ground.

As a result, we as an industry submitted petitions under the safeguard system based on threat, which is clearly allowed for, and the Chinese clearly agreed to as part of their accession terms. The importing community has filed suit asking the government to stop or asking the court to stop the government's actions in that area

based on a claim of irreparable damage. In other words, they'll have to source their goods from someplace else.

It is ironic that the irreparable damage that will take place is that hundreds of thousands of U.S. citizens will lose their jobs and face personal bankruptcy as a result of a court case now stopping the government from utilizing the one tool that's left for us to deal with the China threat.

Cochair MULLOY. How long will that tool be delayed in being used, do you think?

Mr. TANTILLO. It's impossible to know. We believe the Justice Department is going to appeal the temporary injunction. Unfortunately, it has taken over five weeks for them to file an appeal, and the judge seems to be in no hurry to rule on the underlying case itself. If, as you said, the case drags on until the spring, then the whole threat issue is overwhelmed by the fact that China has now had three to four months of unrestrained access to the U.S. market, and we're dealing with a market disruption.

Cochair MULLOY. Not just a threat.

Mr. TANTILLO. Not just a threat.

Cochair MULLOY. A real disruption.

And then, you could then move on and use the safeguard.

Mr. TANTILLO. Yes.

Cochair MULLOY. Erik and then Mr. Johnson.

Mr. AUTOR. Let me just say first of all that the National Retail Federation is not a party to this suit, but I did want to give you my thoughts on this case, and I really want to underscore some points that Ms. Hughes made.

For months, CITA told importers and retailers that it could not move forward on threat-based cases under its procedures that it had promulgated and based upon the language as it interpreted it in China's WTO accession terms. Retailers and importers acted in reliance on those statements that they got from CITA with respect to how it would handle threat-based cases.

Then, suddenly, in September, CITA did a complete about-face and announced in a press conference that they were now going to accept threat-based cases. In addition, we were told by CITA at that time that new guidelines would be published in the Federal Register on the administration of these threat-based cases and that the public would have an opportunity to comment on those. That never happened.

I think it's really outrageous and totally unacceptable in a democratic system that we have a government entity that's acting in a completely arbitrary and capricious manner without any of the basic protections provided for in American administrative law for interested parties to receive fair treatment under these procedures.

Cochair MULLOY. Do you want to comment on that, either of you, Auggie, Mr. Tantillo?

Mr. TANTILLO. I'm not here to defend the actions of CITA. My point is specific: whether it's the Executive Branch, or whether it's the Judicial Branch, for one reason or another, U.S. industry is continually denied access to the remedies that are promised to them when we negotiate trade agreements.

When the Executive Branch comes to Capitol Hill and pushes these agreements through the legislative process, we are told the

remedy exists; you need not worry; you need not be concerned, and when reality strikes, we find ourselves with nothing to lean on.

Mr. RAYNOR. May I make one comment about this? It's a little bit of a contradiction in some ways, but let's suppose that the safeguards, which we supported worked. We still have to answer Erik's question: what would happen if we didn't source from China? If we couldn't source those goods from China, where would they be sourced from, and would it mean more U.S. jobs or not? I think that's a real open question and part of our whole issue about trade.

But end of the day, why should the retailers or the importers care? Because if everybody can't import from China then, they'll all import from someplace else, and they'll all be on the same, level playing field with the same prices. So some of these arguments that cost doesn't matter don't really ring true unless you really believe that everybody is just trying to protect democracy here, which I don't.

Ms. HUGHES. I take offense at that, actually.

Mr. RAYNOR. Feel free.

Cochair MULLOY. If I could just follow up, it seems to me, based on what Mr. Autor said, maybe the industry, because the agreement clearly says that you can use it on threats, the WTO agreement with China on safeguards. Maybe the lawsuit should have been brought by you guys when they first put out the regs that didn't cover threat, because then, when they decided that they wanted to cover threat, then, they got accused by groups of violating the Administrative Procedures Act, although I didn't think the Administrative Procedures Act applied to foreign affairs decisions.

Mr. TANTILLO. There's a foreign affairs exemption—that has always been in place for the activities of CITA, and it's always been upheld by the court system whenever it's been challenged. This is a policy issue in terms of the interpretation and enforcement of an international trade agreement.

Ms. HUGHES. But the international trade agreement expired on December 31, 2004, so there no longer is a foreign affairs exemption.

Mr. TANTILLO. The WTO accession terms are in place today as we sit here.

Mr. AUTOR. What we have, too, is a quasi-judicial administrative remedy, and it is really, as I said, unacceptable. My response is this should be under the Administrative Procedures Act. This is a question of fundamental fairness in administering a quasi-judicial administrative proceeding of this sort. And I don't think that CITA should be allowed to make completely arbitrary decisions with impunity and without the ability for any recourse by parties to address that problem.

Cochair MULLOY. Well, we won't, obviously, we can't guess what the courts are going to do, but I did think that when they passed the Administrative Procedures Act, they did give a foreign affairs carve-out.

Mr. TANTILLO. Absolutely.

Cochair MULLOY. I used to do those cases at the Justice Department.

Mr. TANTILLO. Absolutely.

Cochair MULLOY. So I was very surprised, and I know Justice is appealing that.

But at any rate, I cannot thank you all enough for bearing with us. I think we've had a very fruitful discussion.

Oh, Commissioner Bartholomew?

Commissioner BARTHOLOMEW. Mr. Chairman, we don't usually do this, but today I would not only like to acknowledge our panelists, but I'd like to acknowledge the fortitude of the audience. Some of you have been sitting here almost as long as we have so——

[Applause.]

Cochair MULLOY. I thank you for coming. If you have anything else that you want us to consider, we'll be happy to take it, and then, we'll be considering all of this and then making some recommendations.

Thank you.

[Whereupon, at 5:52 p.m., the hearing recessed, to reconvene at 9:00 a.m., February 4, 2005.]

CHINA AND THE WTO: ASSESSING AND ENFORCING COMPLIANCE

FRIDAY, FEBRUARY 4, 2005

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION,
Washington, D.C.

The Commission met in Room 192, Dirksen Senate Office Building, Washington, D.C. at 8:59 a.m., Chairman C. Richard D'Amato and Commissioners Patrick A. Mulloy and June Teufel Dreyer (Hearing Cochairs), presiding.

OPENING REMARKS OF COMMISSIONER JUNE TEUFEL DREYER HEARING COCHAIR

Cochair DREYER. I'd like to call this morning's session to order. I'm pleased to welcome you to the second day of our hearing Examining China and the World Trade Organization and to take over the proceedings from my colleague and hearing Cochair, Patrick Mulloy.

China's entrance into the World Trade Organization, as you all know, was hailed as a historic development that would enhance both our export opportunities in the United States and move China toward adherence to rules-based systems, both domestic and international. Today, three years later, the jury is out on the success of both of these hopes.

United States exports to China have expanded, but they have not nearly kept pace with the surge in imports, driving our trade deficit with China to record levels. Internally, China has undertaken broad economic reforms to conform to its WTO commitments. Yet, considerable shortfalls remain, including in the two areas we will focus on this morning: agriculture and intellectual property rights, henceforth to be referred to as IPR protection.

We are going to start out this morning with a representative of the Government Accountability Office, GAO. The GAO completed a report in October 2004 for the Congress evaluating the U.S. Government's efforts to enforce China's WTO compliance. We look forward to hearing the GAO's recommendations for improving U.S. efforts in this area, and we also expect to discuss the ongoing GAO work on U.S. trade remedies. These reports on the China-specific textile safeguards, countervailing duties, antidumping duties and the product-specific China safeguard will examine many of the issues at the heart of this hearing.

Addressing continuing large-scale problems with China's IPR protection, where the Commission has found piracy rates running above 90 percent, will be the aim of the next panel. The panel will consider the development of China's IPR laws and regulations as well as the key issue of IPR enforcement. Many of the advantages

held by U.S. producers in the U.S.-China trading relationship stem from the advanced nature of U.S. intellectual property.

The ubiquity of IPR infringements in China thus presents a serious threat to U.S. producers and the U.S. economy as a whole. During high-level meetings between American and Chinese officials in April 2004, China pledged to improve IPR protection through a series of detailed steps. The Office of the United States Trade Representative is completing its review of China's implementation.

We are asking industry representatives to give us their perspective on what improvements have been seen in the wake of China's recent promises. We will also look for strategies that the United States might employ along with like-minded trading partners to encourage China's protection of IPR.

Our final panel, examining U.S.-China agricultural trade, will address problems with both market access for U.S. exports to China and the challenges to U.S. producers from increased imports from China in the United States market. China's WTO commitment specified improvements in its quota system. China is also obliged to cease employing unscientific safety standards as import barriers. Our panelists will discuss whether China's import administration has become more transparent and fair and whether improvements remain necessary to reduce uncertainty, arbitrary controls and import obstruction.

Imports of Chinese agricultural goods are also a concern to the United States agriculture industry. Chinese apple products are presenting a serious challenge to U.S. producers, and our panel will discuss outstanding concerns regarding the health standards applied to such imports.

Antidumping laws offer some relief against import surges, but the prevalence of uncollected dumping duties on imports of Chinese agricultural products has undermined the use of this trade tool and merits a close examination. We hope to come away from this panel with actionable recommendations for addressing these areas of concern.

We thank our panelists of yesterday and also today. The testimony of individuals and organizations involved in United States-China trade is critical to our mission of researching and analyzing the bilateral relationship. Yet it is precisely these individuals and organizations that are in a position to be threatened with retaliation from China for sharing their perspectives with us and with the United States public.

It is my sad duty to inform you that representatives of certain industries who were invited to be here, and whose voices are important told us that they were afraid to appear because they fear the consequences of retaliation by the People's Republic of China. We want our panelists to know that we are fully aware of these risks. We understand when our invitations are declined out of fear, but you ought to understand that this is taking place, and therefore, we appreciate all the more those of you who are willing to be here with us at this hearing.

I would like to welcome as our first panelist Dr. Loren Yager, who is Director of International Affairs and Trade at the Government Accountability Office. Mr. Yager, welcome. We look forward to hearing your words.

[The statement follows:]

Prepared Statement of Commissioner June Teufel Dreyer
Hearing Cochair

I am pleased to welcome you to the second day of our hearing examining China and the WTO and to take over the proceedings from my colleague and hearing Cochair Commissioner Patrick Mulloy.

China's entrance into the WTO was hailed as a historic development that would both enhance our export opportunities and move China toward adherence to rules-based systems, both domestic and international. Today, three years later, the jury is out on both. U.S. exports to China have expanded, but have not nearly kept pace with the surge in imports, driving our trade deficit with China to record levels. Internally, China has undertaken broad economic reforms to conform to its WTO commitments, yet considerable shortfalls remain, including in the two areas we will focus on this morning, agriculture and intellectual property rights (IPR) protection.

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Many of the advantages held by U.S. producers in the U.S.-China trading relationship stem from the advanced nature of U.S. intellectual property. The ubiquity of IPR infringement in China thus presents a serious threat to U.S. producers and the U.S. economy as a whole. During high-level meetings between American and Chinese officials in April 2004, China pledged to improve IPR protection through a series of detailed steps. The Office of the United States Trade Representative is completing its review of China's implementation. We are asking industry representatives to give us their perspective on what improvements have been seen in the wake of China's recent promises. We will also look for strategies that the U.S. might employ, along with like-minded trading partners, to encourage China's protection of IPR.

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Imports of Chinese agricultural goods are also a concern to the U.S. agriculture industry. Chinese apple products are presenting a serious challenge to U.S. producers, and our panel will discuss outstanding concerns regarding the health standards applied to such imports. Antidumping laws offer some relief against import surges, but the prevalence of uncollected dumping duties on imports of Chinese agricultural products has undermined the use of this trade tool and merits a close examination. We hope to come away from this panel with actionable recommendations for addressing these areas of concern.

We thank our panelists of yesterday and today. The testimony of individuals and organizations involved in U.S.-China trade is critical to our mission of researching and analyzing the bilateral relationship. And yet it is precisely these individuals and organizations that are in a position to be threatened with retaliation from China for sharing their perspectives with us and with the U.S. public. We want our panelists to know that we are fully aware of these risks, that we understand when our invitations are declined out of fear, and that we greatly appreciate those who are willing to be with us at this hearing.

PANEL V: EVALUATING U.S. EFFORTS TO MONITOR AND IMPROVE CHINA'S COMPLIANCE

STATEMENT OF LOREN YAGER
DIRECTOR OF INTERNATIONAL AFFAIRS AND TRADE
GOVERNMENT ACCOUNTABILITY OFFICE

Mr. YAGER. Thank you very much.

Madam Chair, Members of the Commission, I am pleased to be here today to discuss GAO's work related to U.S. monitoring of China's compliance with its WTO commitments. As you know, GAO and the Commission have worked together on this important issue, and we look forward to continuing this relationship.

This hearing takes place at a time of increasing concern about broader aspects of the U.S.-China relationship. I know that Members of Congress, administration representatives and expert witnesses in yesterday's panels provided significant background material on the nature of the U.S.-China economic relationship, so I will not repeat any of that material today.

Rather, in my statement, I will first briefly summarize the key findings and recommendations of our most recent report on U.S. agency efforts to monitor and enforce China's compliance with its WTO agreements. Second, I will describe GAO's larger body of work on issues related to China and mention some of the work that we have completed as well as studies that are ongoing for various committees of the Congress. I hope this update will set the stage for the question and answer this morning as well as for continued dialogue in the months to come.

The main point of our October report is that the complexity and the breadth of many of the problems associated with China's compliance require a more cohesive and sustained effort from the key trade agencies—and of course, those are USTR, State Department, Agriculture Department and Commerce Departments—in order to have effective monitoring and enforcement.

To that end, we have a series of recommendations in our October report, and let me just briefly summarize those: first, although U.S. Government efforts to ensure China's compliance emphasize high-level bilateral engagement, we recommended that USTR take steps to maximize the potential benefits of the WTO's annual multilateral review of China's compliance referred to as the TRM. Second, to more effectively plan and measure results, we recommended that each of the key agencies improve performance management of their China WTO compliance efforts. And third, we recommended that in an environment of high and regular staff turnover, the key agencies should direct additional management attention to ensuring that staff have an opportunity to acquire training relevant to their China WTO compliance responsibilities. I would be happy to discuss each of these issues with the Commission, and I can also talk about the agencies' response to our report and to these recommendations.

Let me now talk briefly about our broader set of reports. In preparing for this hearing, I spent some time assembling materials on the set of GAO reports relevant to China and comparing those reports to those that are covered by the Commission. Our work on China's WTO compliance was initiated by the Congress at about the same time as the Commission was created, although in our

case, the Finance and Ways and Means Committees indicated that they wanted GAO to begin a long-term set of studies to help inform the Congress on the key issues related to China's WTO implementation.

The initial group of studies we conducted related to the agreement itself, and we generated reports and a database which were designed to help others understand the breadth of the agreement as well as gauge business expectations about the agreement.

The second set of studies, the most recent of which I mentioned in the opening of my statement, relate to U.S. efforts to monitor and enforce China's compliance. We also performed a similar study after one year of experience, and I anticipate that we will be performing additional studies along those lines.

The third set of studies has more recently begun and relates to the various mechanisms that the U.S. Government has available to slow the growth of imports and to influence exchange rates and address other issues not directly covered by the WTO agreement. As I mentioned in my written statement, we are performing work on a variety of subjects that were discussed in yesterday's sessions, including China-specific import relief mechanisms for the House Appropriations Committee; currency issues for the Small Business Committees and a review of the CDSOA the Ways and Means Committee.

Given that these reports are not completed, I can only provide general background information and discuss our methodology at this hearing. As an aside, I don't want to downplay the value of future GAO reports, but I do have to note that many of the expert witnesses that appeared before the Commission yesterday are some of the same people that we meet with in order to conduct our work, and yesterday, they clearly articulated many of the key issues in those reports. And, in fact, I think we're meeting with Mr. Stewart this afternoon in the process of completing one of those reviews, so you're getting many of the same insights in your hearings as you will in our reports later. Nevertheless, I look forward to the opportunity to brief any interested Members and staff when those reports are released.

Finally, we have a body of work, which relates to the broader trade issues, which may also provide insight on China. For example, we recently completed reports on intellectual property protection abroad and on offshoring. While China was not the only country of interest in these reports, there are some key insights regarding these issues, which I can share with the Commission.

We also have ongoing work on human capital management at USTR and a general review of monitoring and enforcement of trade agreements by the key trade agencies. These studies could also provide some insights on the efforts related to the monitoring of China's WTO compliance.

Given this set of ongoing and completed studies, it is clear that there is significant complementarity between our work and the key interests of the Commission. Let me make a few final observations about the similarities and differences. First, the Commission has significant work on the foreign policy side of many decisions, while GAO has done less work in this particular area.

Second, GAO has periodically produced reports on export controls and foreign investments, and I think we spoke about this just before the hearing that there is obviously great interest in the CFIUS mechanism, but we have not done any work on that in the last couple of years.

And finally, we tend to focus our recommendations and our work directly on the agency efforts, and we go into great detail about their processes, their staffing, and other matters, while I understand that the Commission focuses most of its recommendations directly to the Congress.

I certainly look forward to continuing the dialogue both this morning as well as over the coming months, as the Commission continues to address these important matters. Madam Chair, this concludes my testimony. I would be happy to answer any questions that you or other Members of the Commission have on these reports. Thank you.

[The statement follows:]

Prepared Statement of Loren Yager
Director of International Affairs and Trade
Government Accountability Office

Observations on Ensuring China's Compliance with World Trade Organization Commitments

Mr. Chairman and Members of the Commission, I am pleased to be here today to discuss issues related to China's compliance with its World Trade Organization (WTO) commitments. This hearing takes place not only at a time of increasing trade between the United States and China, but also amidst a period of ongoing concern about the U.S. trade deficit with China and about China's adherence to its WTO commitments. As we have noted in our previous work, U.S. Government efforts to ensure China's compliance with these complex and far-reaching commitments require a sustained and multifaceted approach. To that end, we have recently put forth a number of recommendations to the key Executive Branch agencies regarding ways to improve the U.S. Government's monitoring and enforcement activities.

To provide you with an update on these issues, I will (1) discuss the key findings, conclusions, and recommendations from our recently issued work on China-WTO issues [1] and (2) update the Commission on a number of ongoing GAO reviews on China trade and economic issues. My observations are based on a series of reports initiated at the bipartisan request of various congressional committees. That work has included an analysis of China's commitments, surveys and interviews with private sector representatives, and the results of two annual assessments of the U.S. Government's compliance efforts.[2] Additionally, our work on China-WTO issues included fieldwork in Washington, D.C., China, and at the WTO headquarters in Geneva, Switzerland. Before I turn to the specifics on these issues, I will provide a brief summary.

Summary

The complexity, breadth, and ongoing nature of many of the problems with China's WTO compliance demonstrate the need for a cohesive and sustained effort from the key U.S. agencies to effectively monitor and enforce China's implementation of its commitments. The U.S. Trade Representative (USTR), and the Departments of Commerce, State, and Agriculture (USDA) have coordinated on policy issues and increased staff resources to enhance their capacity to carry out these efforts. However, there are three areas in which we noted that these key agencies should take steps to improve their efforts and maximize the effectiveness of the resources allocated to the task of securing the benefits of China's membership in the WTO. First, although U.S. Government efforts to ensure China's compliance emphasize high-level bilateral engagement, we recommended that USTR take steps to maximize the potential benefits of the WTO's annual multilateral review of China's compliance,

[1] See GAO, *U.S.-China Trade: Opportunities to Improve U.S. Government Efforts to Ensure China's Compliance with World Trade Organization Commitments*, GAO–05–53 (Washington, D.C.: Oct. 6, 2004).

[2] See Related GAO Products.

referred to as the Transitional Review Mechanism (TRM). Second, to more effectively plan and measure results, we recommended that each of the key agencies improve performance management of their China-WTO compliance efforts. Third, we recommended that, in an environment of high and regular staff turnover, the key agencies should direct additional management attention to ensuring that staff have an opportunity to acquire training relevant to their China-WTO compliance responsibilities.

Given the strong congressional interest in China's role in the world economy, we have both issued and ongoing work related to various aspects of the U.S.-China economic and trade relationship. For example, GAO recently completed reports on U.S. efforts to protect intellectual property overseas, offshoring, and textile transshipment. Additionally, our ongoing work on the U.S. application of trade remedies against China and our review and analysis of how the Department of the Treasury makes its currency manipulation determinations may be of specific interest to the Commission as it carries out its mandate.

Background

China became the 143rd member of the WTO on December 11, 2001, after almost 15 years of negotiations. These negotiations resulted in China's commitments to open and liberalize its economy and offer a more predictable environment for trade and foreign investment in accordance with WTO rules. The United States and other WTO members have stated that China's membership in the WTO provides increased opportunities for foreign companies seeking access to China's vast market. The United States is one of the largest sources of foreign investment in China, and total merchandise trade between China and the United States was projected to exceed $234 billion in 2004, according to U.S. trade data. However, the United States still maintains a $158 billion trade deficit with China: imports from China were estimated to total more than $196 billion, while exports were estimated to be about $38 billion in 2004.

The U.S. Government's efforts to ensure China's compliance with its WTO commitments are part of an overall U.S. structure to monitor and enforce foreign governments' compliance with existing trade agreements.[3] At least 17 Federal agencies, led by USTR, are involved in these overall monitoring and enforcement activities. USTR, USDA, and the Departments of Commerce and State have relatively broad roles and primary responsibilities regarding trade agreement monitoring and enforcement. Other agencies, such as the Departments of the Treasury and Labor, play more specialized roles. Federal monitoring and enforcement efforts are coordinated through an interagency mechanism comprising several management- and staff-level committees and subcommittees. The congressional structure for funding and overseeing Federal monitoring and enforcement activities is similarly complex, because it involves multiple committees of jurisdiction. Congressional agencies, including GAO, and independent commissions such as the U.S.-China Economic and Security Review Commission also support Congress's oversight on China-WTO trade issues. In addition to the Executive Branch and congressional structures, multiple private sector advisory committees exist to provide Federal agencies with policy and technical advice on trade matters, including trade agreement monitoring and enforcement.

Recommendations to Improve the U.S. Government's Efforts to Ensure China's Compliance with its WTO Commitments

Ensuring China's compliance with its WTO commitments is a continuing priority for the U.S. Government. The complexity, breadth, and ongoing nature of many of China's problems complying with its obligations demonstrates the need for the U.S. Government to have a well-coordinated, sustained effort to ensure China's compliance. To that end, we have recommended that the key agencies involved in this effort take steps to maximize the potential of the WTO's annual review of China's compliance, improve performance management, and ensure that staff have adequate opportunity to acquire the training necessary to carry out their responsibilities.

Problems with China's WTO Compliance Are Broad in Scope, Complex, and Ongoing

China's WTO obligations span eight broad areas and include hundreds of individual commitments on how China's trade regime is to adhere to the WTO's agreements, principles, and rules and allow greater market access for foreign goods and

[3] For more information on the overall roles and responsibilities of U.S. Government agencies in monitoring and enforcing trade agreements, see U.S. General Accounting Office, *International Trade: Strategy Needed to Better Monitor and Enforce Trade Agreements*, GAO/NSIAD–00–76 (Washington, D.C.: Mar. 14, 2000).

services. Some of these commitments are relatively simple and require specific actions from China, such as reporting information to the WTO or lowering tariffs. Other commitments, however, are significantly more complex and relate to systemic changes in China's trade regime. For example, some commitments require China to adhere to WTO principles of nondiscrimination in the treatment of foreign and domestic enterprises. China has successfully implemented many of its WTO commitments, but a significant number of problems arose in the first years of China's membership. Problems implementing these obligations spanned all areas in which China had made commitments. Importantly, many of these compliance problems have persisted from year to year, and many concerns relate to China's inability thus far to make some of the systemic changes that its WTO commitments require. For example, USTR's most recent report on China's WTO compliance cites continuing problems with lack of transparency and protection of intellectual property.

U.S. Government Should Take Steps to Maximize the Potential of WTO Annual Review of China's Compliance

We also found that, while the U.S. monitoring and enforcement activities reflected increased high-level bilateral engagement by Executive Branch officials, some multilateral efforts did not achieve their full potential. Specifically, the WTO's annual TRM was intended to be a thorough review of China's implementation, but many U.S., WTO, and foreign officials agree that the mechanism has limitations and that participation has declined. Nevertheless, the TRM and the benefits it provides could be enhanced by increased member participation and more timely U.S. preparation, which would improve the chances for full and informed responses from Chinese officials and maximize the potential exchange of information. Thus, the TRM can continue to provide an important avenue to pursue U.S. trade interests, even with a continued U.S. emphasis on bilateral and other multilateral engagement outside of the TRM.

To improve multilateral engagement with China on WTO compliance issues, we recommended that USTR take steps to maximize the potential benefits of the TRM. These steps could include establishing and meeting internal deadlines to submit written questions to the Chinese delegation 4 to 6 weeks or more before each TRM and coordinating with other WTO members to increase participation in the review.

Key Agencies Need to Improve Performance Management of China Compliance Efforts

We found weaknesses in the key agencies' ability to assess the effectiveness of their China-WTO compliance efforts and determined that agencies would benefit from increased emphasis on planning and performance management. The Government Performance and Results Act and our substantial body of work on planning emphasize the importance and usefulness of developing unit- and program-level plans and measures that are connected to an agency's overall mission. We acknowledge the challenges of developing measurable goals, given the extent to which external factors can influence agencies' trade compliance efforts; however, we believe that it is possible to better quantify and measure results annually.

We recommended that USTR and the Secretaries of Commerce, State, and USDA take steps to improve performance management pertinent to the agencies' China-WTO compliance efforts. Specifically, USTR should set annual measurable predetermined targets related to its China compliance performance measures and assess the results in its annual performance reports. The Secretary of Commerce should take further steps to improve the accuracy of the data used to measure results for the agency's trade compliance-related goals. The Secretary of State should require its China mission to assess results in meeting their goals and report this information as part of the annual Mission Performance Plan. The Secretary of USDA should further examine the external factors that may affect the agency's progress toward achieving its trade-related goals and present the agency's strategies for mitigating those potential effects. Furthermore, the head of each agency should direct their main China compliance units to set forth unit plans that are clearly linked to agency performance goals and measures, establish unit priorities for their activities, and annually assess unit results to better manage their resources.

Key Agencies Should Take Steps to Improve Training Opportunities

We found that the key agencies have opportunities to better manage their human capital involved in China-compliance activities. Specifically, in an environment of high and regular staff turnover, new staff are called upon to take up monitoring and enforcement activities that involve complex, long-term issues. New staffs' effectiveness and efficiency is reduced when formal training is not available to help them with their day-to-day activities, and when staffing gaps prevent them from learning from their more-experienced predecessors. Increased management attention to pro-

viding an adequate mix of on-the-job training and formal training can help ensure that new employees have the necessary tools for doing their jobs well.

We recommended that USTR and the Secretaries of Commerce, State, and USDA undertake actions to mitigate the effects of both anticipated and unplanned staff turnover within the agencies' main China-WTO compliance units by identifying China compliance-related training needs and taking steps to ensure that staff have adequate opportunity to acquire the necessary training. These actions could include determining which of the agencies' existing courses would be appropriate for staff, determining what types of external training are available, developing training courses on relevant issues, and establishing a plan and timelines for existing and new staff to receive training.

Other GAO Work on China-Related Trade and Economic Issues

Given China's increasingly important role in the global economy, we have both issued [4] and ongoing [5] work relating to several aspects of the U.S.-China trade and economic relationship. The following list provides a brief description of selected studies relevant to the U.S.-China Economic and Security Review Commission's focus:

- Intellectual property rights (issued): We recently issued a report examining U.S. efforts to protect intellectual property overseas. The report included a country case study on China, which described the state of intellectual property protection in China and the U.S. Government's actions to address problems there.
- Textile transshipment (issued): We reviewed the U.S. Customs and Border Protection's system for identifying and preventing illegal textile transshipments. We made several recommendations on ways to improve the U.S. Government's monitoring and enforcement efforts.
- Offshoring (issued; ongoing): In this report, we found that current government data provide limited insight into the offshoring of services. We are continuing work on this complex issue to examine various aspects of U.S. trade policy and experience in the offshoring of manufacturing and services.
- Import relief mechanisms (ongoing): We expect that this ongoing work will result in a series of reports on relief mechanisms available to U.S. producers who are adversely affected by unfair or surging imports and the manner in which these remedies have been applied to China. These reports will cover the China-specific textile safeguard, methodologies for applying countervailing and antidumping duties, and product-specific safeguard measures authorized under Section 421 of the Trade Act of 1974, as amended.
- Currency exchange rates (ongoing): As part of an ongoing review, we expect to issue a report examining how the Department of the Treasury makes its currency manipulation determinations (particularly for China and Japan) and the extent to which Treasury met its Trade Act of 1988 reporting requirements.
- Continued Dumping and Subsidy Offset Act (ongoing): As part of an ongoing review, we expect to issue a report on how U.S. agencies have implemented the act (also referred to as the Byrd Amendment) and the effects of the act on U.S. companies.

Mr. Chairman and Members of this Commission, this concludes my prepared statement. I would be happy to answer any questions that you may have on my testimony.

Contacts and Acknowledgments

For further information regarding this testimony, please contact Adam Cowles at (202) 512–9637. Matthew Helm and Richard Seldin also made key contributions to this testimony.

Related GAO Products

U.S.-China Trade: Summary of 2003 World Trade Organization Transitional Review Mechanism for China. GAO–05–209R. Washington, D.C.: January 25, 2005.

[4] Please see Related GAO Products for additional information on previously issued GAO products.

[5] Our agreement with congressional requesters requires that we limit discussion of ongoing work to descriptions of key questions, methodology, and reporting timelines.

U.S.-China Trade: Opportunities to Improve U.S. Government Efforts to Ensure China's Compliance with World Trade Organization Commitments. GAO–05–53. Washington, D.C.: October 6, 2004.

International Trade: Current Government Data Provide Limited Insight into Offshoring of Services. GAO–04–932. Washington, D.C.: September 22, 2004.

Intellectual Property: U.S. Efforts Have Contributed to Strengthened Laws Overseas, but Challenges Remain. GAO–04–912. Washington, D.C.: September 8, 2004.

World Trade Organization: U.S. Companies' Views on China's Implementation of Its Commitments. GAO–04–508. Washington, D.C.: March 24, 2004.

International Trade: U.S. Customs and Border Protection Faces Challenges in Addressing Illegal Textile Transshipment. GAO–04–345. Washington, D.C.: January 23, 2004.

World Trade Organization: Ensuring China's Compliance Requires a Sustained and Multifaceted Approach. GAO–04–172T. Washington, D.C.: October 30, 2003.

GAO's Electronic Database of China's World Trade Organization Commitments. GAO–03–797R. Washington, D.C.: June 13, 2003.

World Trade Organization: First-Year U.S. Efforts to Monitor China's Compliance. GAO–03–461. Washington, D.C.: March 31, 2003.

World Trade Organization: Analysis of China's Commitments to Other Members. GAO–03–4. Washington, D.C.: October 3, 2002.

World Trade Organization: Selected U.S. Company Views about China's Membership. GAO–02–1056. Washington, D.C.: September 23, 2002.

World Trade Organization: Observations on China's Rule of Law Reforms. GAO–02–812T. Washington, D.C.: June 6, 2002.

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Panel V: Discussion, Questions and Answers

Cochair DREYER. Thank you very much, Mr. Yager. Commissioner D'Amato has a question.

Chairman D'AMATO. Thank you very much, Madam Chairman.

Thank you very much for your testimony, and also, thank you for the continuing good work that you're doing on these subjects. All the work that can be done is needed to get an insight into these issues, and in our relations with the Members on both sides; I think there is a tremendous desire for really good information and analysis on the U.S.-China relationship. We are trying to do that, but, every day, there are a couple of stories that you don't really know that you've been following quite well on the front page of the newspaper.

Cochair DREYER. Right.

Chairman D'AMATO. I want to ask you a question, Mr. Yager, about the CFIUS reporting. You say you haven't done anything recently in the last couple of years. I know you've done work on CFIUS prior to that. It seems to me that this latest go-round with the IBM situation leads us into a new era on CFIUS in some ways. Would you think this would be an appropriate thing? We will not be in a position to make the recommendation to you, but we could easily have a Senator do that. It might be useful for you to get back into that particular area at this point, do you think?

Mr. YAGER. We certainly have had some internal discussions about this since the paper and the news was reported, obviously, regarding the Treasury and the CFIUS concern about this most recent transaction. What we do at this time of year is we generally pursue a set of outreach meetings with the key committees and their staffs in order to discuss issues that may be of importance for them over the coming months or year, and we will certainly bring this up as one of the things that we could look into.

We will review our prior reports on the subject, and we will mention that this is one of the things that we could look into if this is one of their highest priorities. So it is really this time of the year that we have the discussions about ongoing work and additional projects that we might take on, and we can put this into that list of things that we'll try to gauge their interest was one of the ways that we can follow up.

Chairman D'AMATO. Yes, great, and we will work on the other end of that in terms of the committees, so that if there's interest on their part, I would think there would be in terms of getting a new look at what's going on in that dynamic, what standards are being used in that process, which has not been very much overused in the last few years, quite underused. So thank you very much.

Mr. YAGER. Just if I could add, we would also have to consider the timing. Generally, what we do is we look at the agencies' efforts revolving around the decision, so at this point, it would be rather early for us to get in, but once there has been some activity and a decision, then, that would be a good time for GAO to go in and take a look at what might be done.

Chairman D'AMATO. Yes, I think that's right. And as I understand it, there is a 40 or 45-day period that has just begun in terms of the full-scale investigation on CFIUS, I'm sure some of the committees would be interested in just exactly how that process evolved and how it—what standards were used and how the whole thing happened in this 45-day—what kind of investigation was it? What standards were used? What were they looking for? I think it's a good test case in terms of the CFIUS process, so I think that would be an excellent subject for you to look into. Thank you.

Cochair DREYER. Commissioner Wessel.

Commissioner WESSEL. Thank you, Madam Chairman.

I appreciate all that GAO has done on this and many issues over the years. Your reports really shed a lot of light and provide a lot of information to Members of Congress, their staffs, and the public, and I also believe that some of my questions, I should probably do offline to understand later on exactly what's involved in terms of some of the resources of the agencies, I am very interested in that.

Let me ask a question, though, based on some of our field hearings, because we've heard from a number of small businesses that have limited access to the process, if you will, in terms of being able to raise complaints. They're not players in Washington; most of them don't have lobbyists; their trade associations are limited in terms of their resources.

What kind of work did you do in terms of the monitoring and compliance of looking at how the private sector concerns are presented, what kind of access is available, how do the concerns get raised? It's my view that the primary problems that are being raised are those that the private sector brings to the government, not necessarily those that they see on their own, because they're overworked, burdened, and really, they're going to respond to commercial concerns.

But could you just give me a little view as to how they look at the issues that they view as important? Is it primarily from the private sector? Is there some imbalance between small, medium and large-size businesses?

Mr. YAGER. That relates, actually, to some of the work that we've been doing as part of our ongoing monitoring of China's compliance. We've done a series of reports, which we call the Business Views reports, and we've done two now. The most recent one came out in March of last year.

And what we've tried to do in each of those reports was to do a broad scale outreach to firms of various sizes and in different areas to try to understand how it is that they actually do make their views known to the Federal Government as well as how well they believe China is actually making changes and being responsive to their needs.

And so, we have actually tried to outreach to the businesses in China through this series of reports, and I think we have some insights about the process and about the challenges associated with trying to get input, particularly from some of the businesses that don't have significant representation in China.

One of the things that we observe, which I guess was a little surprising to us, was that there were few companies involved in trade—even those with operations in China—that had a broad set

of concerns about China WTO implementation. Most of the concerns of the companies that we spoke to were very focused in the few areas where they were having some particular challenges, and so, we had a wide range of companies who, when asked about a set of the broader compliance issues that China was looking for said that they frankly didn't have many opinions on those things, but they had very specific concerns about particular areas that impacted their business on a daily basis.

And so, what we concluded in our observations in the most recent report is that this is all the more reason for USTR and the other agencies that are actually in the field in China to make a significant effort to get out there and try to understand just what those businesses are concerned about, because talking to a few businesses, particularly the larger ones, you're not going to get the kinds of concerns that you get from the smaller businesses.

They're well represented; they work with the Chamber; they have avenues for getting their views in. At the same time, the unusual thing again, and what we thought was somewhat of a surprise was that there was very little awareness of these broad types of concerns. It was those very focused concerns that mattered to these companies, and that's where they wanted action.

Commissioner WESSEL. Please, if you can provide the Business Views reports, assuming those can be shared, I would like to see those. How did you get those views? Did you go to trade associations in Washington? Did you do some sort of random sampling? Do you have access to the ITC company email lists—what kind of process do you use?

Mr. YAGER. We actually used different processes in the first as compared to the second report that we did. The first time, we tried to use a written survey instrument with followup on the telephone, and frankly, one of the things that we have realized in doing this Business Views work is that it is extraordinarily difficult to get systematic information from those firms. And there could be a variety of reasons for that. Some of it could be related to what the Chair said earlier, that some firms are not comfortable providing that information, even to a U.S. agency for fear that it might get back and affect their operations in China.

And the second thing is that finding the people who are actually most aware and most conversant about the problems is actually quite difficult. We switched between the first and the second Business Views report from that mail method to one where we actually interviewed people in a variety of cities around China, trying to get a little more interaction face-to-face. Of course, it limited the number of firms that we could actually speak to, but we felt it was a better way to get that kind of interaction and really understand what it is that they faced and the problems that they face.

We are certainly very aware of how difficult it is to get that systematic information, and we tried to communicate that to USTR and others in our concluding observations.

Commissioner WESSEL. If I could ask a followup, I had seen a light go on just a moment ago, you're talking about companies doing business on the ground in China. Therefore, they have made a significant investment and see a market niche. Many of the companies that we have talked to are primarily not interested in going

to China to produce there but want to export from the United States, and I think many Members of Congress are keen on getting access to the Chinese market not by producing there but by producing here and sending the products abroad.

How do you get access to those companies? And are you seeing different problems being voiced by those companies? For example, I assume that a company producing here, while a company in China is concerned with currency valuations, if they're producing there indigenously in terms of their product and their sourcing, currency is not as much of an issue as it is for a tile manufacturer we heard about yesterday in Ohio that wants to operate here and just send their products.

Mr. YAGER. Certainly, the problem that you bring up is that trying to get the universe of firms that have an intention or in fact are exporting, for example, on a lower level to China really expands the universe of firms that you would need to talk to to capture their views. That's really quite a daunting problem to try to address, and I don't have an easy answer for you as to how you would capture that particular segment of those firms who would like to have better access to the market but are having difficulty.

It is obviously an easier task to get those who are operating in China.

Commissioner WESSEL. Senator DeWine and a number of others have—I'm sure it's a broad view, but Senator DeWine has been quite vocal on the problem of small businesses not having access to the kind of help. Can you, at some point, let us know what the access points are rather than just an individual's name? We had one of our government officials yesterday offer to be the point of contact—I don't think he wants his name on the Web to receive every single complaint—to let us know where companies or where individuals who wish to trade with China, how they might access the process of getting some help.

Mr. YAGER. If I would make just one more addition, one of the other things that we did early in this process was that we created a database that was then distributed generally which helped people understand what those commitments were. Because again, one of the problems that I think small businesses have is trying to understand this incredibly complex and broad agreement.

So what we tried to do was make a somewhat more user-friendly way of learning more about the commitments when they are coming out and trying to group those and understand all the particular commitments having to do with specific areas. So we try to make some contribution as well in that area, but obviously, that doesn't necessarily mean that they can keep up with those things as they might need to.

Commissioner WESSEL. Thank you.

Cochair DREYER. Commissioner Mulloy.

Cochair MULLOY. Mr. Yager, I wanted to thank you and your staff. Adam Cowles and Matthew Helm have been particularly helpful to the Commission in keeping us abreast of some of the work you're doing, because I agree with you: I think the work we're both doing compliments one another, and we can get a better picture and help the Congress get a better picture of what's hap-

pening in this relationship, so we appreciate all of the work that you have done.

Mr. YAGER. Thank you, Mr. Mulloy. I will have to say again that it certainly is the staff that make it possible to conduct this work and not just those that you see here today, although they're obviously key players. But in order to do this work, as you know, you need the access to economists, to lawyers, to trade specialists, China specialists and a range of others because of the complexity of that work. And so, we have been able to draw on that within GAO.

Cochair MULLOY. When I worked for the Chairman of the Senate Banking Committee, we were great users of the GAO in a lot of work that we did dealing with the savings and loan problem, for one issue, or ExIm Bank.

Let me come back to an issue that was discussed yesterday, the currency. As you know, in their last report to the Congress, which was put in by the 1988 trade bill, which I worked on when I was working for the Congress, the Treasury has to report every six months on whether any countries are manipulating their currencies.

And in their last report, they said this: the report finds that no major trading partner of the United States met the technical requirements for designation under the Omnibus Trade and Competitiveness Act of 1988 during the first half of 2004. That's their finding. Technical. I think what is going on, they're saying, well the two criteria were are you running a major surplus with the United States? China fits there. Two, are you running a major surplus worldwide? I think Treasury hides behind that second.

But we've heard testimony now that China is running a major surplus worldwide now. And so, I'll be very interested in the work that you're doing for the House Small Business Committee.

Mr. YAGER. It's actually a combination of House and Senate Small Business Committees.

Cochair MULLOY. Okay; and when is that report due out?

Mr. YAGER. We are going to be sending that report to the agency for their official comment very shortly, within the next month. As our process goes, as you're familiar with, we typically give the agencies between two and four weeks for their official comments, and then, we incorporate those comments into the report as well as printing the letter from the departments in the back of the report.

So we will be sending that to the agency shortly for their comments and then publishing it as soon as we can after that, knowing that the committees like to have those come out typically during Congressional sessions, so we will work with them on the date, in order to have it come out when they can take advantage of it in session.

Cochair MULLOY. Well, I think the next Treasury report is due in April.

Mr. YAGER. That's right.

Cochair MULLOY. Because they submitted this one late.

Mr. YAGER. That's right.

Cochair MULLOY. It was due before the election.

Mr. YAGER. Right.

Cochair MULLOY. And they waited until after the election to make their finding of no currency manipulation. So I think it's due in April. Do you think your report will be out prior the next report by the Treasury?

Mr. YAGER. I anticipate that it will be out before that next report.

Cochair MULLOY. Okay; that would be enormously helpful if your staff could let us know when it's available.

Mr. YAGER. Of course.

Cochair MULLOY. We'd really like to get it.

Mr. YAGER. Of course, we'll get in touch with you on that.

Cochair MULLOY. One more thing: the Treasury says in their report that the Treasury has consulted with IMF management and staff as required by the statute, and they concur with our conclusions. Did you have a chance in your work to talk with the IMF as to their views on this issue?

Mr. YAGER. We have talked, obviously, very frequently with Treasury, and we also do get into the questions that you've raised, both about the nature of the Treasury reporting: what is the set of criteria that have to be used, and do they all have to be met, and what were the criteria that were not met. It is not just in this most recent reporting period, but we're actually going 10 to 12 years back to look at the pattern of their findings and the kinds of discussions that they've had, the way that they've explained their particular decisions, so we're going into significant detail on that.

We also will talk about the extent of their discussions with the IMF as well as others, so that will be included in the report we come out with.

Cochair MULLOY. Because we had testimony yesterday from Mr. Bergsten who was Assistant Secretary of the Treasury at one point, and he said really, the IMF doesn't move unless somebody's trying to move them and thought the U.S., if we were convinced that there was—and we worked the IMF, there's probably receptiveness in that organization, particularly now because of the Europeans and others, that we could get some movement. I would be very interested in your report on that.

Mr. YAGER. Let me just make one other mention: we did talk to the IMF, and as part of that report, we're not just looking at the Treasury process and their decisions, but we're also covering a couple of other issues. One, we are looking at the range of estimates on what experts believe the Chinese currency is devalued and by how much, and so, we will have a section on that.

And in addition to that, we'll talk a little bit about what the impact of an appreciation of the Chinese currency would have, how that translates into effects into the United States. So we'll walk through some of the complexities that are involved in that kind of a change, not that we can anticipate what the change would be, but given a particular change, how would that affect the United States in terms of increase in jobs and things like that.

Cochair MULLOY. Thank you.

Chairman D'AMATO. May I follow that up just quickly?

Cochair DREYER. Yes.

Chairman D'AMATO. And when you do that, I think it will be very useful to take a couple of scenarios: 15 percent, 25 percent, 40 percent, and show what the differences would be and the impact on their economy of those different levels, because they may start off at someplace and then end up someplace else later, so we want to know what that looks like.

Mr. YAGER. That's certainly something we're considering, and in not just looking at the scenarios in total, but we're thinking about some of the different transitions or some of the effects that you have to consider on what it would actually mean to the United States. For example, if China's currency appreciates by 10 percent, does that necessarily mean that all Chinese export prices to the United States will increase by 10 percent?

There's an issue and a concept called pass-through which, at least in the history of other countries, when currencies appreciate, the prices in those target markets do not go up by the full amount.

Chairman D'AMATO. Right.

Mr. YAGER. One of the interesting things that we have with China is, given that their currency has not fluctuated, there's very little data to go on. Calculating pass-through is a process that people used in previous currency fluctuations, for example, with Japan and others, but it's very country specific, and so, there are some difficulties and some real challenges associated with doing that work.

Chairman D'AMATO. Yes; let me just ask you one more question on that, and that is in your assessment, there is, of course, the impact on trade per se. Are you also going to try and look at the question of whether or not any major increase, let's say 30 or 40 percent in the Chinese currency, what impact that would have on the flow of capital to China; in other words, the relocation decisions of American businesses, if it's going to be that much more expensive to send goods back to the United States, will that have an effect, a negative effect on the flow of manufacturing capacity and so on to China from here, see?

I don't know how you're going to assess that, but that's, of course, an issue we're concerned about.

Mr. YAGER. I think we'll talk about that probably in qualitative terms. As you know, trying to make predictions about these kinds of behavioral changes, decisions by firms, is particularly difficult. I think we will talk about the directions, and to the extent we can provide some systematic information on that, we will do so.

Chairman D'AMATO. Thank you.

Cochair DREYER. Commissioner Reinsch.

Commissioner REINSCH. Thank you.

Welcome. It's always nice to see people from GAO. When I was in the Executive Branch, there was never a moment that my bureau was not subject to at least 10 GAO investigations, so I spent a lot of time I don't think with any of you but with some of your colleagues.

And I did want to start with a comment that grows out of the previous discussion on CFIUS, although it's not exclusively about CFIUS. When I was in the Executive Branch, there were a number of occasions when a Member of Congress asked the GAO to investigate a decision that had not been made yet, and GAO, under

those circumstances, wisely declined to do that, I think they realized the same thing we realized: that it was not an attempt to investigate how the decision was made; it was an attempt to influence the decision before it was made.

I just encourage you to keep on doing that from a separation of powers and good governance point of view; the government should make the decision; investigate all you want, and you're very good at it.

Mr. YAGER. Thank you.

Commissioner REINSCH. But I hope you will take my advice.

Now, on your report, I was interested in one aspect of your second recommendation, which related to improving performance management by the various agencies. When you made that recommendation to the agencies, what was their response?

Mr. YAGER. We have a process, as you may know, of looking at their responses not just——

Commissioner REINSCH. Yes.

Mr. YAGER. —the response in the report, but then, they are also required to submit their letters to the Congress to let the Congress know how they are planning to respond to the recommendations. And we were actually quite pleased with the responses of the agencies. With few exceptions, they were quite positive toward our recommendations.

I think they understand that not only do they need to coordinate and have a strong system of teamwork at the high levels between the agencies, but they need to change the incentives so that the people who are working these issues day-to-day have the incentives to stay with them, to follow up on training, and to learn about these complex agreements.

And that's really what we focused on, and frankly, as I mentioned, the letters that we got back from the agencies were all positive on that particular recommendation. They all agreed with that.

Commissioner REINSCH. And you also talked, I believe, about standards of performance, measurements.

Mr. YAGER. That's right.

Commissioner REINSCH. They were positive about that as well.

Mr. YAGER. Yes, they were positive about that. We had some pushback on the training, the human capital recommendation, because some of the agencies felt they were already doing as much as they could. One of the things that we wanted to emphasize, though, is that when you have an issue as complex and as long-term as ensuring China's compliance that making sure that that kind of skill and experience that can be passed on from one person to the next is done regularly at the agency levels, and we thought there were some improvements that could be made on that.

Commissioner REINSCH. Do you have plans now a year down the road to go back and see if they actually implemented any of the recommendations that they were enthusiastic about?

Mr. YAGER. We do go back and check, and we look for evidence. In order for us to tally this as something which is a recommendation that's implemented, we do go back to the agencies and talk to them. We look for evidence that they have, in fact, implemented the recommendation. We don't just take the letter that they write us and say that they agreed to it, but we do go back in, and we

follow up on our recommendations to see whether they have been implemented, and we will do that in this case as well.

Commissioner REINSCH. Good, so we could have you back at some future point, and you could make a future report.

Mr. YAGER. Well, as I mentioned, we have a few reports that may be of interest coming out in the next months.

Commissioner REINSCH. I'm getting to those.

Mr. YAGER. Okay?

Commissioner REINSCH. In your work on the specific report, did you visit China?

Mr. YAGER. Our team did visit China on a number of occasions, and in many cases, what we try to do, for example, in the intellectual property work is we try to take the teams that go to China and have them do work on a couple of our reports at the same time. So not only did we visit China for the work that we did on the monitoring, but we also conducted some interviews on the specific subject of intellectual property protection in China so that we could get that experience and those interviews and those answers at the same time.

Commissioner REINSCH. Did you meet with officials of the Chinese government?

Mr. YAGER. Yes, we did.

Commissioner REINSCH. Good.

Finally, you mentioned in your testimony, and I see it alluded to briefly in the statement, that you have also done work on offshoring or offshore outsourcing, and you offered to share your conclusions with us. Go ahead.

Mr. YAGER. Well, the first report that we did on this came out in September, and we tried to get a handle on how you could learn about the extent of offshoring that was going on. And the data are not where we might like them to be for a number of reasons, but in general, you can track offshoring activity through three ways.

One is by looking at imports of services. And this is an area where people obviously have a great deal of interest, particularly with regard to India. So you can look at those import statistics that are compiled by the Bureau of Economic Analysis. Similarly, you can look at foreign direct investment statistics, because there is some breakdown on those. And then, you can look to see the percentage of sales from those foreign affiliates to the local market as compared to back to the United States, and the third way that you can track offshoring is by looking at the Labor Department statistics, for example, the mass layoff data, to try to understand how many people in the United States might have been laid off as a result of overseas relocation.

Frankly, there is no perfect set of information about the extent of this activity, even with regard to India, where, in general, the investments or the contracts are made with India for services, and those services are reimported. I believe it's actually even more complicated for China, because much of the service investment that's being done there is part of a manufacturing process, and therefore, the R&D and some of the other components are embodied in the products, which are then reimported back into the United States.

So you would not be able to see those R&D services show up as service imports; for example, if the R&D is conducted in China and

then embodied in a physical product, and that product is imported back into the United States. You would not get a picture through the import statistics or observe that amount of service work even though research and development is one of the categories of services.

So we have two studies going on right now. One is looking very closely at the statistics, particularly the import statistics, and a second one is to track the development of trade in services and compare it to the development of trade in manufactured goods over the past decades. We think that provides a perspective to bring out the kinds of issues that people raise: how do you collect information, for example, on service imports compared to how we do it for manufactured goods?

Obviously, manufactured goods can be tracked when they come across the border. Customs has a process to do that. On the other hand, service trade is much more difficult to capture, and we'll be working with BEA and trying to learn more about how they do it as well as looking for opportunities to try to make improvement to what are very important series, much more important than they might have been a few years ago.

Commissioner REINSCH. Thank you.

Cochair MULLOY. Can I just ask one question?

Cochair DREYER. Pat, there are a number of people with interventions.

Cochair MULLOY. I want to clarify.

Cochair DREYER. Okay.

Cochair MULLOY. On the data, this Commission made a recommendation in its first report that we gather additional data about what is being outsourced. Do you have any recommendations on exactly what data—you mentioned that we don't have the data—what data we need to get a better picture of what is being outsourced, both white collar and blue collar?

Mr. YAGER. We looked hard at the U.S. data, and my own view and the findings of the report that we published in September is that it would be quite difficult to make a significant improvement in the labor statistics, because the mass layoff survey is only sent to a small share of total employers, and in order to get good numbers on that, you would have to expand your survey enormously in order to improve that.

The other problem with the mass layoff statistics is that they provide a list of potential reasons for layoffs, one of which is overseas relocation, but there are others: poor business conditions, lack of contract renewal, things of that nature. As you obviously know, these are not mutually exclusive factors, so overseas relocation was only mentioned in about 1 percent of these mass layoffs.

But, of course, it had to be a factor in many more. The way that that survey is structured, it's not easy to get much better information. That's why we think that the service import data is one of the ways to get better insights about this particular movement.

Cochair MULLOY. Thank you, Madam Chairman; thank you, Mr. Yager.

Cochair DREYER. The very patient Commissioner Becker.

Commissioner BECKER. Yes; thank you.

I appreciate very much your comments this morning. I am probably one of the few people at this table not familiar with the work of the GAO. But I was interested in your comments about working with USTR or monitoring the activities and also investigation into the effect that changes with various agencies, when changes were made, the effect it would have on the population of the United States, either employment. Did I misunderstand you about that?

Mr. YAGER. Are you speaking about the offshoring work?

Commissioner BECKER. No, I'm not, but if I understand right, you do work with USTR.

Mr. YAGER. Absolutely.

Commissioner BECKER. Is this while they are involved in certain changes or certain work or after it's done?

Mr. YAGER. Well, that's a good question.

Commissioner BECKER. Let me mention exactly what I'm talking about. Discussions are taking place in Geneva right now concerning the trade laws of the United States. This is the antidumping, countervailing duties, safeguards, what have you. I was wondering if you look at this as an ongoing process? Do you advise as to the effect this would have—a change in that would have on the United States?

Mr. YAGER. In that particular situation, we are not monitoring that set of discussions. We do monitor for requesters—in particular instances—we monitor, for example, the progress of the negotiations in the FTAA; we monitor the progress in the WTO; and we periodically produce reports on that progress, for example, leading up to a ministerial or just after the ministerial.

So there are times in which we do monitor the progress of particular negotiations. We do have the balance as Mr. Reinsch has mentioned. When it's looking at particular decisions, we don't get involved during the period when that decision is being considered and made. We often would go in afterwards to look at that decision.

But when you're talking about China compliance issues, obviously, this is a long-term process, and so, in that situation, we go in, and we talk to them about the changes they have made recently, but we also listen to the kinds of things that are being changed when we are there, so we do a combination of work.

Commissioner BECKER. What I'm talking about is not China compliance. It's changes in the existing trade laws that can take place that would have a profound effect upon the manufacturing industry of the United States if any changes are made.

And the other item I'd like to mention is the Section 421, which is the safeguard procedure that was negotiated at the time the PNTR was put together. It's a China-specific, and it's not being used effectively. We've had four or five cases, and our batting record is zero. These are companies that have played by the rules, followed the dictates of the way it was laid out. They've investigated. They've hired lawyers. They've examined the trade issue. They take it to the ITC, and there have been recommendations that they're right, and they forward this on to the President for signature. That doesn't happen. Do you investigate things like this?

Mr. YAGER. We do when we're requested to look into this. Obviously, we have a dialogue with our requesting committees, but we do at times look at issues when you're in the middle of a set of decisions. For example, we are doing some work right now on the textile safeguard, and we understand that there are some decisions underway, that there is a court case involved.

We don't actually rule, obviously, or influence the court case, but we do talk in detail about the procedures that have been set up. We would summarize the statistics that you mentioned, and at times, if we believe that the agencies don't have enough responsibility or they don't have the ability to make changes that we think are important, we can make matters for Congressional consideration about the law, so we can do that as well.

Commissioner BECKER. How are investigative issues raised with you? Who raises them?

Mr. YAGER. Committees of the Congress can request us to do work, and we have our own process of assigning priority to requests that come in. We try to make those requests meaningful and do the work quickly where it's important; for example, like on the textile safeguard, and others when we get requests.

Many of my requests come from the Senate Finance and House Ways and Means Committee, but we also respond to other committees of the Congress, for example, appropriations committees, Senate Government—or the Government Oversight Committee. So we do a wide range of work for the committees of the Congress.

Commissioner BECKER. Nongovernmental agencies cannot raise anything; is that right?

Mr. YAGER. No; as a matter of fact, our priorities right now suggest that we give highest priority to mandates that are written into legislation as well as requests from committees of jurisdiction. Given that we are overcommitted to work, that we have more requests than we can actually handle, we tend to do the work primarily for committees of jurisdiction rather than members or groups outside.

Commissioner BECKER. The reason that I'm concerned and raise the questions on our trade laws is once the action is taken to raise an investigation on that, it's too late. All the horses are out of the barn. How do we get GAO into this process as to the effect this would have on employment in the United States before it happens?

Mr. YAGER. There are some situations, and I think actually in the work that we're doing on import remedies, we do some analysis on trying to understand what the impact of decisions might be in the future. So we do try to weigh in where there is a systematic way of doing so. We try to bring up the type of information that might help you look ahead to think about the consequences of doing it one way versus another.

So when we can do the analysis, and we think we have an analytically viable way of doing it, then, we are able to do that and we put that in the reports.

Commissioner BECKER. That's exactly what I'm talking about. Thank you.

Cochair DREYER. Commissioner Robinson.

Vice Chairman ROBINSON. Thank you, Madam Chairman.

I just want to use an opportunity to underscore a point that Chairman D'Amato had raised earlier on the CFIUS question. As you can probably tell, we have more than a passing interest in what we hope to be an increasing use of the CFIUS process. This will likely be, of course, driven by the projects, acquisitions, and other transactions that come down the line. But we see the velocity and the size of Chinese acquisitions clearly on the rise.

We would like to share with you a letter that some of the Commission sent over to three of the Congressional House chairs of various committees who raised specific concerns with respect to the IBM-Lenovo transaction. In it, we tried to go back to the original statute, which several of our Commissioners worked on directly, that made plain that the CFIUS mandate is broader than security-related technology transfers and export control considerations. In fact, it implicates the U.S. defense industrial base, and the national security capabilities of the United States in a broader sense.

And of course, we're focused on not only whether that mandate is being properly acted upon but the leadership and structure of CFIUS as to whether that's appropriately configured today or whether some adjustments might best be made.

One suggestion, before I turn it over to my colleagues, who have some followup questions, is that we have valued your work at GAO on China's presence in the U.S. capital markets as well. As you might recall, you have done groundbreaking work in this area. The national security dimensions of that presence hadn't been looked at before by GAO or any other U.S. Government body. I say that with confidence. And accordingly, this may represent an interesting followup opportunity for GAO.

The first effort was in the classified venue, as you may recall, and it was protracted, not necessarily any fault of GAO. Leave it to say that this Commission is still engaged and very interested in this topic. You will notice a chapter on China's presence in the capital markets in our last two annual reports. We are the only government body that I know of that has this kind of focus. We certainly would urge GAO to be mindful of it and to keep an eye out, because again, look at the trend lines and scale of Chinese entities entering our debt and equity markets.

You have hundreds of Chinese entities that are literally in the queue to come to our markets. The nature of these entities, the corporate governance dimensions, the disclosure requirements, the minority shareholder rights, and a number of other considerations, all need to be, we think, taken into account.

This is not a matter of any discriminatory or negative perspective concerning China's use of, or access to, our capital markets. It's more of seeking an even playing field event like so many other dimensions of the relationship. We just think that the same kinds of standards of disclosure and corporate governance are appropriate for the Chinese as they are for other entities utilizing those markets.

So that's just a suggestion for your forward work program for your consideration. Thank you.

Mr. YAGER. Thank you. Let me just quickly respond.

We do understand it was a little tough to get you that report, and we apologize for the delay in that. We will be addressing some

of those issues, at least providing some of that information in the report that we're doing on the Chinese currency, and I think that will give us a good perspective. Again, we will raise these issues in our outreach meetings with the various committees of the Congress, and if there were further interest on these subjects, we would be in a good position to try to begin some work on that.

Cochair DREYER. I would like to ask whether are you getting the resources that you need to investigate these WTO-related matters, and if you could, what areas would you improve? Also, if there are such areas, are there any ways in which this Commission could be helpful to you?

Mr. YAGER. Are you speaking about the GAO resources in order to do this work or more generally the U.S. Government resources?

Cochair DREYER. Your resources, GAO's.

Mr. YAGER. Actually, over the last years, since I mentioned the Ways and Means and Senate Finance Committee originally asked us to do this work, we've had a fairly significant body of work going on related to China, and we've committed quite a bit of the resources of the International Affairs and Trade Team to these kinds of issues. Some are very specific to China and WTO compliance; some, as I have mentioned now, have to do with import remedies, and others are about broader issues that have significant relevance to China, for example, the IPR work that we've done.

So I actually think that this China work has been a considerable share of the work that we have done in our team. I certainly understand and believe that it will continue to be a big share. The kind of work that we do changes over time, depending upon the concerns that are raised by our members and our requesters, but we have had some significant resources, and some of those folks are here today.

But, as I mentioned earlier, it takes quite a lot of very specialized resources to conduct this: China specialists, economists; obviously, legal analysis is very important, for example, when we look at the import remedies. We think we have been able to get the resources to do a significant series and have a portfolio of this as we go forward, but ultimately, it takes a lot of resources, and we can only do so many reports.

Cochair DREYER. And what about the U.S. Government? Does it have the resources it needs?

Mr. YAGER. Well, we tracked that in the most recent report. We talked about the staffing, and we brought that up-to-date. And if I remember right, actually, we saw a fairly significant increase both in the Washington-based staff who are dedicated to China issues; that would then include USTR, State, Commerce and Agriculture as well as the personnel overseas who have those same functions. In our report, I guess we show that there has been more of a doubling both in the headquarters staff that are dedicated to this kind of work as well to the staff who are in the field.

So there has been a fairly significant increase in the resources to this kind of an effort. Now, ultimately, whether it's able to solve all these problems in the way that Members or their constituents here are satisfied, that's obviously a very tough call.

Cochair DREYER. But I take it you are reasonably pleased with the level of effort; is that correct?

Mr. YAGER. Yes, we did not make any recommendations about a need for additional resources. Our work was focusing on ensuring that the resources that they have dedicated to these efforts are functioning as effectively and as efficiently as possible.

Cochair DREYER. Thank you.

Commissioners Wessel and D'Amato have followup questions. I hope these can be brief. Thank you.

Commissioner WESSEL. I will try and make them brief, and part of this is actually a question because the leadership of our Chairman, Mr. D'Amato, going back to an issue you talked about earlier regarding data on offshoring outsourcing. You're primarily responding to the current data sets, that they're being collected at Commerce, DOL, et cetera, whether it's as part of their certified process of proprietary business data or otherwise.

Mr. YAGER. Right.

Commissioner WESSEL. We, as a Commission, have recommended that there be changes in corporate reporting that potentially could gain access to other information that would be of assistance and really understanding the outsourcing, offshoring phenomenon, how policy makers can best assess what's going on; you talked about using gross trade data, if you will, and I again understand that you go into some of the proprietary business data.

We'd like to meet with you, or I'd like to meet with you and I think probably others would as well to get your advice on if legislative changes, statutory changes were going to be made affecting corporate reporting, what kind of data would assist you in terms of being able to report on this effectively, do the analysis that's necessary, et cetera; that's number one.

Two, you talked about attitudes as part of your business survey. I think you mentioned that there is some concern about Chinese reaction to their participation. I'd be interested in understanding whether you have information on attitudes by our businesses on the U.S. Government role. I believe Mr. Becker raised the issue of the 421 process.

When we did hearings in Ohio, we heard from a number of business leaders that are frustrated by the lack of enforcement activities in certain areas by our own government and how that might, in fact, put a chill on those seeking monitoring, enforcement and compliance in the future.

Did you get any information on how the companies view their own government's performance? And I'd also like to talk to you about how that might be expanded in the future to really understand how companies view our own actions.

Mr. YAGER. Let me just address the first comment you made having to do with collecting additional information from firms. One of the things that we tried to do in our offshoring report was to get some real precision as to what kind of information people would really like to know, and to that end, we have a Venn diagram which allows people to be very precise about those kinds of information that would help us understand the extent of the activities. So we'd be happy to talk to you about that.

Let me make two points about what we see as some challenges in terms of understanding and collecting additional information. One of those is that some companies may be reluctant to report on

the issue of offshoring, particularly when it comes to jobs lost. So in fielding and making any changes, that type of information is important.

The other thing that we came up against when we spoke to some firms is that it may be very difficult for some of the larger firms, for example, to even know what of their work might be offshored. For example, if a large firm like IBM is contracting for work from some supplier in the United States, they may not even know whether that work is done in India or is done in the United States or is done in China. So there are a couple of very significant challenges in trying to improve the company reporting on these issues, so we certainly don't minimize how difficult it would be to make the kind of progress that you'd like.

Commissioner WESSEL. But there are certain areas that we could expand and gain better information, understanding you don't collect everything, for example, on current activities; that which is being contracted out. When one deals with a product, not a service, there are bills of lading; there is import documentation as to where the products are coming from and where they are being sold and what the stream of commerce has been.

So I am not expecting you to answer this here, but we'd like to understand from you——

Mr. YAGER. Sure.

Commissioner WESSEL. —what information would assist you in being able to respond more effectively to these questions, understanding that at some point, there's a limit to the data that we're all going to be able to look at.

Mr. YAGER. And with regard to your second question, though, we have two reports which address company views about U.S. Government activity. The most recent, we addressed it in the context of the intellectual property protection abroad. And we have a kind of mixed message on that. I think that the companies that we speak to are quite appreciative of the work that the U.S. Government is doing. In many cases, they are willing to say that the U.S. is by far the most aggressive among governments in trying to assist them in this area.

On the other hand, there is a mixed record of progress in terms of the mechanisms that we have in place in order to gain better compliance, not just in China and in other countries as well. I think that we got pretty broad support from the business community for the Special 301 process. They felt it was quite effective in some cases in encouraging other countries to change their laws.

Where the U.S. efforts have not been as successful is in the enforcement side, and both the mechanisms that the United States in place, which is called the NIPLECC, National Intellectual Property Law Enforcement Coordinating Committee, I believe those are the initials. That has not been effective. It has basically been a mechanism by which they put out an annual report each year, but beyond that, there has not been much effective use of the law enforcement side of the house.

And so, there's kind of a mixed picture on that. I think the businesses, again, are appreciative of some of the efforts, but obviously, the enforcement problems are enormous.

Commissioner WESSEL. Thank you.

Cochair DREYER. Commissioner D'Amato, really quickly?

Chairman D'AMATO. Thank you, Madam Chairman.

I understand that you've got an ongoing study going on on the so-called Byrd Amendment.

Mr. YAGER. That is correct.

Chairman D'AMATO. Can you tell us what the timeframe is on that?

Mr. YAGER. Yes, we have actually recently started doing the work on the Byrd Amendment, and in order for us to do a credible job on the report, what we're going to do is we're not only going to be working with the U.S. agencies, the ITC as well as Customs, but we'll also be speaking to some firms about the effect of those payments on their operations.

So we have begun the study. I'm going to Indianapolis on Tuesday, because that's where Customs has their finance center, where they keep all the information with regard to the Byrd Amendment, and we will also be talking to some companies. We're going through a process now to try to determine how best to use our resources and understand who we should talk to in terms of the firms, what industries, and trying to understand the impact of those Byrd payments on those firms.

So we have a study underway. We think it will provide a lot of statistical information as well as clarify any legal questions that might come up about it, and we plan to be reporting on this subject in the summer.

Chairman D'AMATO. In the summer?

Mr. YAGER. Yes.

Chairman D'AMATO. It was my understanding that the Appropriations Committee might want to offer some other questions to you in terms of that very subject, so you would be timely, I presume, in terms of that study.

Mr. YAGER. We try to keep the other members aware of our studies to the extent that we can. Our protocols require that we work with our own requester committees first. If they allow us to provide briefings to some of the other members along the way, we're happy to do so.

Chairman D'AMATO. Yes.

Mr. YAGER. Of course, when the report is published, we frequently go out and brief not just the requesters but other interested parties as well.

Chairman D'AMATO. All right; thank you.

Cochair DREYER. I declare this session closed, and we will reconvene in five minutes to start Panel VI: Strategies for Intellectual Property Rights Enforcement.

[Recess.]

PANEL VI: STRATEGIES FOR ENFORCEMENT—INTELLECTUAL PROPERTY RIGHTS

Cochair DREYER. Ladies and gentlemen, our five minutes is up. I'd like to reconvene here.

I now declare open Panel VI, Strategies for Intellectual Property Rights Enforcement. We welcome first Eric Smith, who is the President of the International Intellectual Property Alliance. Welcome, Mr. Smith.

STATEMENT OF ERIC H. SMITH, PRESIDENT
INTERNATIONAL INTELLECTUAL PROPERTY ALLIANCE (IIPA)

Mr. SMITH. Thank you very much, Madam Chairman, Members of the Commission.

IIPA and its members, thank you for the opportunity to again appear before you to talk about an extremely important topic, namely, China's compliance with its WTO commitments in the intellectual property rights area. IIPA represents the U.S. copyright industries. It has six member trade associations representing over 1,300 companies, accounting for millions of U.S. jobs.

The copyright industries in 2002, for example, contributed over $625 billion to the GDP, 6 percent of the U.S. economy and 5.5 million jobs or 4 percent of U.S. employment. These companies and the individual creators that work with them are critically dependent on strong copyright laws in place around the world and having those laws effectively enforced. On average, the copyright industries generate over 50 percent of their revenue from outside the United States, and that will continue to grow.

First of all, let me apologize for not providing you prior to this hearing with an extensive written submission reviewing the entire copyright enforcement situation in China. I had told Commissioner Mulloy that this submission would be available, but USTR extended the original January 31 deadline, and our members are continuing to review their position on this, and so, we have not finalized our recommendations, but we hope to get you that document on Monday, which I think you will find helpful for your report and your deliberations.

I will focus primarily here today on film and entertainment, business and entertainment software and book publishing, where we have the honor to have with us, and you've invited him, the chairman and CEO of IFPI, Jay Berman, who will be speaking to the situation facing the global recording industry.

Before turning to your specific questions and to summarize, since China joined the WTO, it has fallen short of compliance with its international enforcement obligations under the WTO TRIPS agreement. It has done so in two respects. Piracy rates across all the copyright industries continue to hover around 90 percent of the market. An estimated nine out of 10 copies of our products are pirate copies in China. We do not have as yet a complete estimate of trade losses for 2004, but they have been running well over $2 billion a year and are likely to remain at that level.

Because of accompanying onerous and persistent market access restrictions, and it's important to note that these restrictions are even more onerous than those in place for many other economic sectors, it is difficult at best for any of these companies to do business profitably in the Chinese market, despite massive demand for our products.

The principal reason for this is high piracy rates and the failure of the Chinese enforcement system to meet TRIPS standards by providing meaningful deterrence that would result in a reduction of those rates. Therefore, in terms of WTO compliance, first, the Chinese enforcement system has yet to meet the standards set out in Article 41–61 of the TRIPS agreement when it comes to providing effective and deterrent enforcement in practice.

Second, the TRIPS agreement requires all WTO members to subject to criminal remedies all copyright piracy on a commercial scale. That's in quotes. China's current criminal law, which I will speak to in more detail shortly, fails on its face to meet that test. Many acts of commercial piracy are not subject to criminal remedies in China, rendering that part of its law in direct violation of its TRIPS obligations.

I must add, however, that China's copyright law is generally good, and China has, through amending its law periodically, sought to keep pace with modern technological developments. Over the last few years, the Chinese authorities have increased the number of actions taken to raid and seize pirate product in a good faith effort to improve the piracy situation.

Unfortunately, these activities, while laudable, have not yet had a significant impact in the marketplace. New pirate product, much of it produced on optical disks at pennies a unit, simply replaces that which is seized and destroyed. The low risk and high profits associated with pirate activities can only be countered with coordinated and effective and TRIPS-compatible criminal enforcement, including deterrent penalties that are, at present, not within the Chinese enforcement system.

Let me address your specific questions: the first question is what is the overall assessment of compliance with the WTO's IPR rules? What, if any, changes have occurred in the past year? As summarized above, China's enforcement regime has yet to be brought into compliance with its TRIPS obligations. Vice Premier Wu Yi's commitments to our government in the JCCT process last April gave reason for some hope, however. Raiding activities were increased, and total seizures of optical disk product by China Customs and by the national and provincial and local authorities reached the highest level of any country in the world, reported to have exceeded 240 million units, a two to fourfold increase in seizures from 2002 to 2003.

Our members report, however, that this has had only a minimal impact in the Chinese marketplace due to the lack of any meaningful deterrence, which I have mentioned earlier. Some of our members did conduct confidential market surveys, which show that there may be a positive trend at work, but it remains much too early to even predict that these rates may come down significantly, as Wu Yi promised.

Even though the Supreme People's Court new judicial interpretations of China's criminal law provisions in the IPR area were finally amended in December, as she promised, we have yet to see any criminal prosecutions for piracy per se. Administrative enforcement is up, but fines remain way too low to make a dent in the marketplace. As to the future, all will depend on the will of the Chinese political leadership to reorganize its enforcement machinery and begin a major round of very public piracy prosecutions, matched by unprecedented deterrent criminal penalties. We know this is the right formula, because it has worked in other countries, which have started from a base of excessively high piracy rates and an ingrown culture of piracy.

But there is a new threat: China now has 94 million Internet users, the highest in the entire world. Internet piracy is growing

in China, and it just recently became clear via the new judicial interpretations that certain infringements on the Internet could be dealt with criminally. China must also update its legal infrastructure again and organize its enforcement machinery much more rationally if it is to avoid being faced with traditional types of piracy plus massive new Internet piracy.

Your second question: at the April 2004 meeting of the U.S.-China JCCT, China made several commitments to improve IPR enforcement. What are the concrete results to date? As to, quote, significantly reducing piracy levels, which, is clearly the major commitment here, this has not yet happened. We hope it will, but for many reasons, we remain skeptical that the right actions will be taken to achieve this result.

Wu Yi also committed to lower the criminal thresholds contained in the 1998 Supreme People's Court interpretation of the criminal law. This was also promised, by the way, as part of China's commitment to the U.S. when it joined the WTO initially. IIPA has carefully reviewed these new interpretations, and while, again, political will has a way of jumping all hurdles, the changes made were minimal, and because the changes seem to have been so grudging and so long in coming, we all wonder whether they will make any real difference on the ground.

If the change is meaningful, then, we should see immediate criminal prosecutions of major pirates. So far, this hasn't happened. It should be noted also that criminal penalties were not increased, nor were administrative penalties increased. We do not view this as a good sign, either.

Finally, the new interpretations do subject online infringements to criminal remedies, something that was very important to us. However, because the criminal law requires infringements to be for profit, which, by the way, violates the TRIPS threshold I mentioned earlier, and because all the new thresholds must still be met, and it is even more difficult to meet those thresholds in the online environment, we also retain a healthy dose of skepticism that this will prove meaningful in provide. But we hope we are wrong.

What should the U.S. be doing to ensure compliance? Has technical assistance been provided? Is there a particular problem area that could be subject to a WTO dispute case? Commissioners, we have not yet finalized our recommendation to USTR, but we can say at this point that we are leaning in the direction of recommending that USTR commence consultations with China in the WTO and that they be moved to the priority watch list from the 306 monitoring category where they have resided quietly for the last eight years with a new out of cycle review to be conducted sometime this summer.

If significant progress is not made by the time USTR concludes this OCR, then the available bilateral and multilateral tools, Section 301 or establishing a panel for a dispute settlement case, remain options that the U.S. Government could take.

What is critical is that we want China to know how serious our community is about significantly improving the piracy situation there. We want to send a signal to them that is not more of the same that resolute action must be taken now.

Technical assistance—one of your questions, is being continually provided to the Chinese authorities at all levels by our members and by the U.S. Government. We do think that the Chinese can do what we are asking right now. Technical assistance is part of our ongoing program, but it should not be used as an excuse for further delay in taking immediate action.

Who should the U.S. be cooperating with in terms of trading partners? We would hope that if USTR agrees with our tentative recommendation that both the Europeans and the Japanese will join in these WTO consultations. If we all act together, we think the Chinese will get the message that this theft cannot continue unabated. Both Europe and Japan have now realized that they also have a huge stake in this issue. We hope we can all work together to this common end.

Finally, in our written submission to USTR, we will be setting out a series of benchmarks that we believe are essential to achieving the ultimate objective of significantly reducing piracy rates. That submission will provide great detail with statistics and anecdotes about what the market looks like for the movie industry, the entertainment video game industry, for record companies, for book and journal publishers and for publishers of all types of software. Right now, it is not a pretty picture.

We will also go into some detail on the range of market access restrictions that our companies face in the Chinese market. Market access and reducing piracy go hand in hand. It is difficult for piracy to be reduced when legal product is kept out of the market. We need our government to press further for major liberalization of market access for copyright-based industries.

I would be pleased to elaborate on any of these points in response to your questions. Thank you very much.

[The statement follows:]

Prepared Statement of Eric H. Smith, President
International Intellectual Property Alliance (IIPA)

Mr. Chairman and Members of the Commission, IIPA and its members thank you for the opportunity to appear today to review China's compliance with its WTO commitments in the intellectual property area. IIPA represents the U.S. copyright industries. Its six member trade associations consist of over 1,300 U.S. companies, accounting for millions of U.S. jobs. The copyright industries, in 2002 contributed over $625 billion to the GDP, or 6% of the U.S. economy and for almost 5.5 million jobs or 4% of U.S. employment. These companies and the individual creators that work with them are critically dependent on having strong copyright laws in place around the world and having those laws effectively enforced. On average, the copyright industries generate over 50% of their revenue from outside the U.S.

First of all, let me apologize for not providing you, prior to this hearing, with an extensive written submission reviewing the entire copyright and enforcement situation in China. I had told Mr. Mulloy that this submission would be available but, because USTR extended the original January 31 deadline for submission of recommendations in the out-of-cycle review of China under Special 301, we have not yet fully completed our filing or finally settled on our collective recommendations for action. We hope to have this submission to you early next week and we believe you will find it most useful for your deliberations and your report.

In this testimony I will be reflecting the views of Alliance members. I will focus primarily on the filmed entertainment, business and entertainment software and book publishing industries. The recording industry is a critical part of the Alliance and a key component of the overall copyright industries, but I am pleased that you have asked Jay Berman to testify today and he will speak to the situation facing the U.S. and the global record industry.

Before turning to your specific questions, and to summarize, since China joined the WTO, it has fallen short of compliance with its international *enforcement* obligations under the WTO/TRIPS Agreement. It has done so in two respects: Piracy rates across all copyright industries continue to hover around 90% of the market—an estimated 9 out of 10 copies of our products are pirate copies. We do not have as yet a complete estimate of trade losses for 2004 but they have been running well over $2 billion per year and are likely to remain at that level. Because of accompanying onerous and persistent market access restrictions—restrictions that are even more onerous than those still in place for many other economic sectors—it is difficult, at best, for any of these companies to do business profitably in the Chinese market, despite massive demand for our products. The principle reason for these high piracy rates is the failure to date of the Chinese enforcement system to meet TRIPS standards by providing meaningful deterrence that would result in a reduction of these piracy rates.

Therefore, in terms of WTO compliance, first, the Chinese enforcement system has yet to meet the standards set out in Articles 41–61 of the TRIPS Agreement when it comes to providing effective and deterrent enforcement in practice. Second, the TRIPS Agreement requires all WTO members to subject to "criminal" remedies all "copyright piracy on a commercial scale." China's current Criminal Law, which I will speak to in more detail shortly, fails, on its face, to meet this test. Many acts of commercial piracy are not subject to criminal action in China, rendering that part of its law in direct violation of the obligations in the TRIPS Agreement.

I must add, however, that China's copyright law is generally good and China has, through amending its law, sought to keep pace with modern technological developments. Over the last few years, the Chinese authorities have increased the number of actions taken to raid and seize pirate product in a good faith effort to improve the piracy situation. Unfortunately, these activities, while laudable, have not had a significant impact in the marketplace—new pirate product, much of it produced on optical discs at pennies a unit—simply replaces that which is seized and destroyed. The low risk and high profits associated with pirate activities can only be countered with coordinated and effective—and TRIPS-compatible—criminal enforcement, including deterrent penalties that are absent today from the Chinese enforcement system.

Let me now address your specific questions:

1. What is the overall assessment of compliance with the WTO's IPR rules? What if any, changes have occurred over the past year and what are the prospects for the future?

As summarized above, China's enforcement regime has not yet been brought into compliance with its TRIPS obligations. Vice Premier Wu Yi's commitments to our government in the JCCT process last April gave reason for some hope, however. Raiding activities were increased and total seizures of optical disc product, by Customs and by the national provincial and local authorities, reached the highest level of any country reported to have exceeded 240 million units, a 2 to 4 fold increase from seizures in 2002 and 2003. Our members report, however, that this has had only minimal impact in the Chinese marketplace due to the lack of any meaningful deterrence which I have mentioned earlier. Some of our members did undertake confidential market surveys which showed that there may be a positive trend at work but it remains much too early to even predict that these rates may come down "significantly" as Wu Yi promised they would.

Even though the Supreme People's Court new Judicial Interpretations of China's Criminal Law provisions in the IPR area were finally amended in December, we have yet to see any criminal prosecutions for piracy per se. Administrative enforcement is up, but fines remain way too low to make a dent in piracy in the marketplace.

As to the future, all will depend on the will of the Chinese political leadership to reorganize its enforcement machinery and begin a major round of very public piracy prosecutions matched by unprecedented deterrent criminal penalties. We know this is the right formula because it has worked in other countries which have started from a base of excessively high piracy rates and an ingrown culture of piracy. But there is a new threat: China now has 94 million Internet users, the highest in the entire world. Internet piracy is growing in China and it just recently became clear, via the new Judicial Interpretations, that certain infringements on the Internet could be dealt with criminally. China must also update its legal infrastructure again, and organize its enforcement machinery much more rationally if it is to avoid being faced with traditional types of piracy plus massive Internet piracy.

2. At the April 2004 meeting of the U.S.-China Joint Commission on Commerce and Trade (JCCT), China made several commitments to improve IPR enforcement. What are the concrete results to date?

As to "significantly reducing piracy levels"—the key commitment—this has not happened. We hope it will, but for many reasons, we remain skeptical that the right actions will be taken to achieve this result.

Wu Yi also committed to see lowered the criminal thresholds contained in a 1998 Supreme People's Court's interpretation of the Chinese Criminal Law. This was also promised as part of China's commitments to the U.S. when it joined the WTO. IIPA has carefully reviewed the new interpretations and while, again, political will has a way of jumping all hurdles, the changes made were minimal and because the changes seemed to have been so grudging and so long in coming, we all wonder whether they will make a real difference on the ground. If the change is meaningful, then we should see immediate criminal prosecutions of major pirates. So far this hasn't happened. It should be noted, also, that criminal penalties were not increased, nor were administrative penalties. We do not view this as a good sign either. Finally, the new Interpretations do subject online infringement to criminal remedies. However, because the criminal law requires that the infringement be "for profit" (which violates the TRIPS standard) and because all the new thresholds must still be met (and it is even more difficult to meet these thresholds with respect to Internet infringements), we also retain a healthy dose of skepticism that this will prove meaningful in practice. We hope we are wrong.

3. What should the U.S. be doing to ensure compliance? Has technical assistance been provided? Is there a particular problem area that could be the subject of a WTO dispute case?

We have not finalized our recommendation to USTR but we can say at this point that we are leaning in the direction of recommending that USTR commence consultations with China in the WTO and that they be moved to the Priority Watch List (from the 306 monitoring list where they have resided for the last 8 years) with a new out-of-cycle review to be conducted sometime this summer. If significant progress is not made by the time USTR concludes this OCR, then the available bilateral and multilateral tools—Section 301 or establishing a panel for a dispute settlement case—remain options that the U.S Government could take. What is critical is that we want China to know how serious our community is about significantly improving the piracy situation there. We want to send a signal to them that it is not "more of the same"—that resolute action must be taken now.

Technical assistance is being continually provided to the Chinese authorities at all levels by our members and by the U.S. Government. We do think that the Chinese can do what we are asking right now. Technical assistance is part of our ongoing program, but it should not be used as an excuse for further delay in taking action.

4. Who should the U.S. be cooperating with in terms of trading partners?

We would hope that if USTR agrees with our tentative recommendation that both the Europeans and the Japanese will join in these consultations. If we all act together, we think the Chinese will get the message that this theft cannot continue unabated. Both Europe and Japan have now realized that they also have a big stake in this issue. We hope we can all work together to this common end.

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In our written submission to USTR, we will be setting out a series of benchmarks that we believe are essential to achieving the ultimate objective of "significantly reducing piracy rates." That submission will provide great detail, with statistics and anecdotes, on what the market looks like for the movie industry, the entertainment or videogame industry, for record companies, for book and journal publishers and for publishers of all types of software. Right now, it is not a pretty picture.

We will also go into some detail on the range of market access restrictions that our companies face in the Chinese market. Market access and reducing piracy go hand in hand, it is difficult for piracy to be reduced when legal product is kept out of the market. We need our government to press for further and major liberalization of market access for copyright based companies. I would be pleased to elaborate on these points in response to your questions. Thank you.

Cochair DREYER. Thank you very much, Mr. Smith. That was very enlightening.

Our next witness will be Mr. Timothy Trainer, the President of the International AntiCounterfeiting Coalition. Thank you, Mr. Trainer.

STATEMENT OF TIMOTHY P. TRAINER, PRESIDENT INTERNATIONAL ANTICOUNTERFEITING COALITION, INC.

Mr. TRAINER. Madam Chairperson, Members of the Commission, on behalf of the members of the International AntiCounterfeiting Coalition, I thank you for the opportunity to provide you with our comments regarding intellectual property protection and enforcement in China.

The IACC is a Washington, D.C.-based nonprofit organization that represents intellectual property owners from diverse industries, including the auto industry, entertainment, consumer goods, apparel, pharmaceuticals and many other sectors. Because of the copyright industry representatives that are here today, most of what I will say represents, I hope, anyway, the trademark industries that are members of my organization.

We do focus our efforts on the protection and enforcement of intellectual property rights. I am happy to supplement our submission with the China section of our Special 301 once that is finalized. We are still working that, and as the due date is a week from today, hopefully, we will be able to provide that to you next week.

Let me begin by stating some of the recommendations first. The intellectual property enforcement challenges posed by China are in fact global challenges to the IP enforcement system. Our recommendations have both domestic and international components. Moreover, they are not limited to steps that target actions in China, simply because these are global problems that are posed by China.

Specifically, we recommend the following: strengthen Federal statutes against trafficking in counterfeit goods even here in the United States by making provisions of H.R. 32 the law of the land. Strengthen the enforcement provisions of our free trade agreements to obligate trading partners to improve protection and enforcement, which would include targeting goods from China. Support Interpol's effort to combat criminal trafficking in counterfeit goods, as this will include goods originating from China. Encourage the U.S. Government to be more creative and imaginative in developing IP training programs and tools for technical assistance and capacity-building and to instruct relevant U.S. agencies to consider whether the global threat of criminal counterfeiting and piracy can be adequately fought with an IP system that is grounded on principles of territoriality.

To assess WTO compliance, we start with the TRIPS agreement. And as Mr. Smith has mentioned, Articles 41 through 61 obligate China to implement effective enforcement procedures and provide remedies that have a deterrent effect. Our members report that many raids have been conducted. Significant quantities of counterfeit goods have been seized; criminal prosecutions have been initiated; shipments have been stopped by the Chinese Customs, and prison sentences have been imposed, although on the latter point, we never know if those prison sentences are really served. There is an issue of transparency when it comes to the penalties that

have been put forward. We don't know if fines are paid or prison sentences are served.

Despite a lot of enforcement activity, China continues to pose the greatest threat to IACC members' IP assets as compared to other countries in the world. We believe that China has no equal either as a source of counterfeit and pirated goods to the world or as a market in which fakes are produced and sold locally. Despite significant improvements in China's IP legal regime over the last few years, the enforcement system continues to be fraught with weaknesses and inefficiencies that facilitate massive counterfeiting and piracy.

To list just a few, these weaknesses would include the porous borders and, in this particular case, exports of counterfeit and pirate product; failure to make sure that guilty defendants are, in fact, paying fines, serving time; and the lack of referral of administrative cases for criminal investigation. Certainly, in our Special 301, we will list many, many more.

The exports of counterfeit and pirated products continue to flow from China to every corner of the world, and therefore, it actually imposes a burden on many countries, including the United States. For example, for fiscal year 2004, our Bureau of Customs and Border Protection seized 2,826 shipments from China containing counterfeit and pirated product, having a domestic value of over $87 million, accounting for 63 percent of the total monetary value of IP seizures in FY '04.

Recent legal developments in China that are relevant are the customs regulations, and, as Mr. Smith mentioned, the December judicial interpretations regarding criminal cases. Both are recent, and it is probably too soon to predict the overall long-term impact of the changes. But regarding the criminal enforcement system, the police, prosecutors and the courts will have to demonstrate a willingness to investigate, prosecute and impose higher-level penalties on counterfeiters and pirates.

The system must impose a level of penalty that will deprive the individuals involved of any economic benefit and impose a monetary fine or a prison sentence so that the penalty is greater than the rewards of returning to the illegal activity of counterfeiting and piracy. Thus, greater political will at all levels must be demonstrated to ensure IP crime is punished.

Turning to the JCCT, the IACC members' central concern was the judicial interpretations. The IACC welcomes the lowered criminal thresholds that have been announced by China, but despite the lower thresholds, a reasonable argument can be made that TRIPS rejects the use of numerical standards. TRIPS Article 61 requires that any counterfeiting or piracy on a commercial scale shall be eligible for criminal penalties.

Under the new interpretations, counterfeiters must still be caught with approximately $6,000 worth of counterfeit goods to be eligible for criminal penalties. For many products, counterfeit products, one would have to have a significant number of units, easily a commercial quantity, to reach the sum of $6,000.

The text of the new interpretation should not be the sole focus of our efforts. Whatever steps the Chinese take, whether it be new regulations and interpretations, increased training, more funding,

specialized IP units for the police, et cetera, such steps must result in a reduction of the overall counterfeiting levels. Additionally, the administrative enforcement bodies need to cooperate more closely with Chinese police and promptly transfer those cases that meet the standards for criminal investigation and prosecution.

Because of the divergent IACC membership, we have no member consensus concerning the support of a WTO case against China on the issue of enforcement at this time. There is no expectation that the current onslaught from China will ease in the near future. The IACC members' lack of consensus on the pursuit of a WTO case does not mean that there are no steps to take. In fact, the wave of Chinese counterfeit and pirated product has significant lessons for industry and government.

With regard to the U.S., we believe that the government should continue to strengthen its domestic laws to protect IP. For example, H.R. 32, the Stop Manufacturing Counterfeit Goods Act, which is currently being considered in the House of Representatives, is the type of legislation that should be part of U.S. law in order to close loopholes in our criminal laws. Once law, the provisions in H.R. 32 can then become a part of the bilateral free trade agreements.

With regard to free trade agreements, the U.S. should continue to include strong intellectual property enforcement provisions in these agreements. The challenge of combating the trade in counterfeit and pirated products can be in part met through effective implementation of the provisions of the FTAs, which now obligate trading partners to take actions at their borders against goods intended for export and goods in transit, including activities within free trade zones. Enhanced levels of criminal enforcement will also add to the IP owners' ability to protect their assets.

Successful single market companies in the United States must increase their awareness of the possible threats posed by counterfeiters and pirates. Those that may not be active in multiple global markets may still be victims of intellectual property theft simply due to their success. Because of today's technology and instant communication, a successful national enterprise can easily become a global target of counterfeiters.

Along these lines, the U.S. Government should increase its efforts to raise awareness among small and medium enterprises. Many successful SMEs may not be aware of the IP assets they have or how they might protect those assets. Thus, this requires a proactive education campaign.

With regard to the IP system, technology, communications and increased trade facilitation all contribute to jeopardizing the success of SMEs but also pose threats to larger multinational companies. The challenges posed by the massive quantities of counterfeit and pirated products made in China and elsewhere and exported throughout the world highlight a collision between borderless criminal activity and territorial IP rules.

Counterfeiters have flooded global markets with substandard and dangerous products with no regard for national borders and with no respect for the rule of law, placing law-abiding companies at an extreme disadvantage in combating IP crimes. The global IP system has rules. IP owners who are the victims are failing to make

much progress, in part because of the territorial nature of some IP rules, which help counterfeiters and pirates exploit an established IP system.

In view of the collision between the global counterfeiting and piracy and the territoriality of some types of intellectual property, it may be appropriate to reconsider and consider new rules in the IP system.

The IACC also encourages the government to consider a more systemic approach to IP training that expands the target audiences to include the local business communities who can become our allies. By improving the business community's awareness of the importance of IP to them and local economies, it may accelerate our efforts to engage both the business and law enforcement communities to advocate for better IP protection overall. We believe that increased efforts should be made to broaden the reach of intellectual property training in order to enlist a wider group to support our efforts and to meet our objectives.

I want to thank you again for the opportunity to provide you with these comments and welcome any questions you may have. Thank you very much.

[The statement follows:]

Prepared Statement of Timothy P. Trainer, President
International AntiCounterfeiting Coalition, Inc.

Chairman D'Amato and Members of the Commission, on behalf of the members of the International AntiCounterfeiting Coalition, Inc. (IACC), I thank you for the opportunity to provide you with our comments regarding intellectual property protection and enforcement in China.

The IACC is a Washington, D.C.-based non-profit organization that represents intellectual property owners from diverse industries, including auto, entertainment, consumer goods, apparel, luxury goods, pharmaceuticals and many others. In addition, our corporate rights holder companies are both U.S. and foreign-based multinational companies. The IACC focuses its efforts on the protection and enforcement of intellectual property rights. Our members' combined revenues exceed $650 billion.

The IACC, on behalf of its members, has been providing U.S. Government agencies with comments regarding China's intellectual property (IP) protection and enforcement activities for a number of years. Through official submissions related to Special 301, the annual WTO Review mechanism and informal meetings and discussions on China, the IACC has addressed this issue many times in different fora.

Through this submission, I will attempt to respond to the Commission's specific inquiries and to provide additional observations, comments and recommendations.

1. China: WTO Compliance

For purposes of assessing WTO compliance with intellectual property protection, we typically look to the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). TRIPS Articles 41 through 61 obligate China to implement ***effective*** enforcement procedures and provide remedies that have a ***deterrent*** effect. Our members report that:

- Many raids have been conducted;
- Significant quantities of counterfeit goods have been seized;
- Criminal prosecutions have been initiated;
- Shipments have been stopped by Chinese Customs; and
- Prison sentences have been imposed.

Despite a lot of enforcement activity, little has fundamentally changed in the market since the IACC's most recent submission in September 2004 concerning China's compliance with WTO commitments. China continues to pose the greatest threat to IACC members' intellectual property assets as compared to other countries in the world. Based on available statistics and reports from our members, China has no equal either as a source of counterfeit and pirated goods to the world or as a market in which fakes are produced and sold locally. Despite significant improvements in China's IP legal regime over the last few years, which the IACC has noted in pre-

vious filings, the enforcement system continues to be fraught with weaknesses and inefficiencies that facilitate massive counterfeiting and piracy.

The exports of counterfeit and pirated products continue to flow from China to every corner of the world causing lost sales and damage to brand image. China sourced counterfeits range from counterfeit medicines and auto parts to home electrical products to apparel and footwear.[1] In addition to the impact on IACC member companies, China's counterfeiting industry has a direct impact on foreign governments. For FY 2004, the U.S. Department of Homeland Security's Bureau of Customs and Border Protection (CBP) reported the seizure of 2,826 shipments from China containing counterfeit and pirated product, having a domestic value of over $87 million dollars.[2] Based on these statistics, China accounted for 63% of the total monetary value of intellectual property seizures in FY 2004. The types of products coming from China seized by the Bureau of Customs and Border Protection included, but were not limited to, wearing apparel, cigarettes, consumer electronics, toys, batteries, watches, sunglasses, and automotive components. Thus, the export of counterfeit and pirate product places significant pressures on foreign customs administrations and law enforcement entities to combat China's counterfeit exports.

While China's counterfeiting industry churns out massive amounts of counterfeit goods, the government has made changes to the legal regime. Two sets of changes involve the customs regulations and the recently issued judicial interpretations regarding criminal cases, the latter being issued in late December 2004. Both are recent and it is too soon to predict the overall long term impact of the changes.

The most recent amendments to the Customs regulations went into effect on March 1, 2004, and replaced earlier regulations from 1995 on the protection of IP rights by local customs offices. As a result of the regulatory changes, Customs issued new implementing rules that took effect July 1, 2004. While we commend the effort, several issues remain problematic. The issues that continue to cause right owners problems are:

- The monetary range of the value of the bonds that can be required when ex officio action is taken (0% to 100% of the value of the counterfeits);
- Long term storage costs of the goods during the pendency of legal actions, which right holders believe should be paid by the infringers; and
- Auctioning of counterfeit goods rather than destruction of counterfeits as the routine remedy.

The result of some of the procedures now in place can deter right holders from using the enforcement system because it ties up valuable revenues. Given some of the expenses involved, e.g., storage, the right holder, not the infringer, continues to be subjected to additional further damage as the result of its effort to protect its rights.

Turning to the judicial interpretations concerning criminal thresholds, these were recently issued by the judicial authorities. It is far too early to say whether they will have any real deterrent effect on the levels of counterfeiting and piracy. The criminal enforcement system—police, prosecutors and the courts—will have to demonstrate a willingness to impose higher level penalties on counterfeiters and pirates. Any assessment of the future effectiveness of the new judicial interpretations should be accompanied by greater transparency of the judicial process so that right holders can more easily learn whether defendants receiving prison terms do, in fact, serve the prison sentences or pay monetary fines that are imposed.

While the problems in China's enforcement system are many, a basic starting point should be a consistent application of the enforcement mechanisms at all levels, city, provincial, and national. At these levels, the system must impose a level of penalty that will deprive the individuals involved of any economic benefit and impose a monetary fine or prison sentence so that the penalty is greater than the rewards of returning to the illegal activity of counterfeiting and piracy.

In order for the system to have the desired effect, the national government will have to ensure that its stated policy is implemented at all levels. Thus, greater political will should be demonstrated to ensure that IP crime is punished.

2. JCCT: Results?

Central to the concern of IACC members was the judicial interpretations involving criminal counterfeiting and piracy. The IACC welcomes the lowered criminal thresholds that have been announced by China. This was one of the hoped for results of

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[1] The most recent media piece underscoring this point appears in the February 7, 2005 issue of *Business Week*. *See Fakes!* at p. 54.

[2] Both of these statistical measures were increases over FY 2003 when CBP seized 2,056 shipments with a domestic value of over $62 million.

the 2004 JCCT. However, because it has only been a matter of weeks since the announcement of the new thresholds for criminal liability, we can not yet assess whether they will lead to reduced rates of counterfeiting and piracy. Rather than a wholesale review of the interpretations, only a couple of points are made below.

Based on an unofficial translation, we provide initial observations regarding the judicial interpretations. Initially, it should be noted that the 2001 joint prosecution guidelines, issued by the Supreme People's Procuratorate and the Ministry of Public Security were hopelessly ambiguous, illogical and provided little practical guidance, which led to the issuance of the December 2004 judicial interpretations.

In view of the new December 2004 judicial interpretations, it is difficult to say that improvement occurred. The new judicial interpretations still leave many previous questions unanswered and contain vague, ambiguous and undefined terms.

A reasonable argument can be made that TRIPS outlaws the use of numerical standards. TRIPS Article 61 requires that any counterfeiting or piracy on a commercial scale shall be eligible for criminal penalties. Under the new interpretations, counterfeiters must still be caught with approximately $6,000 worth of counterfeit goods to be eligible for criminal penalties. For many products, one would have to have a significant number of units, easily a commercial quantity, to reach the sum of $6,000. As a practical matter, such numerical thresholds are likely to impede enforcement efforts. Chinese police are often unwilling to commence investigations until the trademark owner and/or admin authorities have provided convincing evidence that the necessary numerical thresholds have been met. Police should be permitted to investigate based on mere suspicion of "serious" infringements and then investigate themselves to build the necessary evidence. If they are already allowed to do this, then this should have been made clear in the guidelines.

In the first three articles of the new interpretations, the Court attempts to define and clarify what specific circumstances will qualify as "serious" under Articles 213 and 215 of the Criminal Code and what illegal sales amounts will qualify as a "relatively large" under Article 214 of the Criminal Code. In addition, with respect to the language in the interpretations, the IACC notes that the vague phrases such as "other circumstances of a serious nature" and "other circumstances of an especially large nature" used in Articles one and three are left wholly undefined.

Articles one through three of the new interpretations appear to take a significant step backwards with respect to violations committed by repeat offenders. Articles 61 and 63 of the 2001 guidelines, (implementing Articles 213 and 215 of the Criminal Code, respectively), provided that where an alleged infringer had received administrative punishment on two or more prior occasions, the accused was eligible for criminal investigation and penalties regardless of the value of the counterfeit products sold/manufactured/possessed. Although these older provisions left certain questions unanswered, they represented one of the stronger provisions of the guidelines.[3] The repeat offender provisions were removed from the new interpretations in their entirety.

At first glance, the new judicial interpretations (Article 12) appear to do away with the requirement of having prior sales in counterfeiting cases. The IACC welcomes removal of this cumbersome method. Article 12, however, is still somewhat confusing and ambiguous regarding exactly how the value of finished and unfinished products and sold and unsold products will be calculated. It appears to provide that for items actually sold, the value of such goods, (for purposes of determining if the new threshold is met), shall be calculated according to the actual sales price of the counterfeiter. This method of calculation fails to impose any real penalty because by using the sale price of a counterfeit product, the courts will use a deflated number that may not meet the minimum thresholds in many cases. Problems also arise with respect to how the infringer's price will actually be determined—e.g., what types of evidence will be used or permitted to be used? Will mere declarations by the infringer be accepted?

For unsold products, Article 12 provides that the value shall be calculated according to the "indicated prices." Unfortunately, the term "indicated prices" is not defined. Does the term refer to the actual price appearing on the packaging or price tags attached to the goods? (Counterfeiters could obviously "indicate" an extremely low price on all the products they store in warehouses for future sales as a means to avoid criminal liability). What if the products contain no indicated price? Will they be valued at zero?

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[3] For instance they failed to clarify whether all three violations had to involve the same trademark or whether two or all three of the offenses could have involved different trademarks. The provisions also failed to explain what would happen when the required three administrative actions were brought by a combination of different administrative enforcement agencies (e.g., AICs and TSBs).

If the products have no "indicated price" or the actual sales price cannot be verified then Article 12 provides that their value will be calculated according to the "median market prices of the infringed goods." Unfortunately, this term is also not defined. Does this term refer to the price of legitimate goods in the same market? Trademark owners have no idea how Article 12 will work in practice.

Article 15 provides higher monetary criminal thresholds for enterprise operations, as opposed to individual natural persons. To qualify for criminal penalties, an enterprise operation must engage in counterfeit operations at least three times greater than the value/threshold required for individual persons. The IACC has long held that this distinction is arbitrary, makes little sense and hinders effective enforcement. The damage done to IPR owners is the same regardless of who commits the crime. Enterprise standards should be lowered to meet the lower monetary thresholds used for individuals or eliminated entirely.

Another significant gap in the interpretations is the absence of language addressing the problems caused by counterfeiters who operate underground factories/facilities without the necessary business/commercial licenses from the government. There should be no minimum monetary standard required for criminally pursuing counterfeiters who operate these types of underground facilities. Article 225 of the Criminal Code provides up to five years imprisonment for engaging in "illegal operations." It is the understanding of the IACC; however, that Article 225 only applies to parties that deal in products specially regulated by the government (such as cigarettes, telecommunications and publishing).

The text of the new interpretations, while important, should not be the sole focus of our efforts. Whatever steps the Chinese take—new regulations/interpretations, increased training, more funding, IP specialized PSB divisions, etc.—such steps must result in more criminal prosecutions, heavier fines, more jail sentences and a reduction in the overall counterfeiting levels. The natural solution is for Chinese police to take a leading role in the investigation of counterfeiting cases. Additionally, the AICs, Customs, TSBs and other administrative enforcement bodies need to cooperate more closely with Chinese police and Public Security Bureaus (PSBs) and promptly transfer those cases that meet the standards for criminal investigation and prosecution.

3. WTO: Dispute?

Because of the divergent membership of the IACC, we have no member consensus supporting a WTO case. The different intellectual property communities, i.e., copyright, trademarks and patents and the types of industries in each of these IP communities have different viewpoints. Our members have indicated that they have differing opinions. While counterfeiting and piracy continue to plague many companies, some companies point to the slow, but forward steps toward criminal prosecutions for counterfeiting, reflecting China's positive efforts.

4. What Next?

There is no expectation that the current onslaught from China will ease in the near future. In addition, the IACC members' lack of consensus on the pursuit of a WTO case should not be interpreted to mean that there are no steps to take. In fact, the wave of Chinese counterfeit and pirated product has significant lessons for industry and government.

a. *Strengthen U.S. Laws*

The U.S. Government should continue to look at ways to strengthen its domestic laws to protect IP. For example, H.R. 32,[4] which is currently being considered in the House of Representatives, is the type of legislation that should be part of U.S. law in order to close loopholes in our criminal laws that punish those who traffic in counterfeit goods.

Once law, the provisions in H.R. 32 can then become a part of the bilateral free trade agreements so that trading partners can be encouraged to adopt stronger criminal provisions in their domestic legislation.

b. *Free Trade Agreements*

Having previously recognized TRIPS as the international minimum level of IP protection, the U.S. should continue to seek strong IP protection through negotiations of free trade agreements with trading partners. The challenge of combating the international trade in counterfeit and pirated products can be, in part, met through effective implementation of the provisions of FTAs, which now seek to have trading partners take actions at their borders against goods intended for export and

[4] H.R. 32 was introduced in the House of Representatives on January 4, 2005 and is known as the "Stop Counterfeiting in Manufactured Goods Act."

goods in-transit. Moreover, it must be made clear to our trading partners that the activities within free trade zones are also subject to enforcement action in order to seize counterfeit and pirate products in these areas. Enhanced levels of criminal enforcement will also add to the IP owners' abilities to protect their assets.

c. *National Success/Global Problems*

Companies that have any great national success within an industry and have risen to be a leader within an industry must increase their awareness of the possible threats posed by counterfeiters and pirates. Those that may not be active in multiple global markets may still be victims of IP theft simply due to their success. Thus, a U.S. company that may not view itself as a global "player" can still have parts of its IP portfolio stolen and its future market taken.

Along these lines, the U.S. Government should increase its efforts to raise awareness among small and medium enterprises. Many successful SMEs may not be aware of the IP assets they have or how they might protect those assets. Thus, this requires a proactive education program. Because of today's technology and instant communication, a successful national enterprise can easily become a global target of counterfeiters.

d. *IP System Exposed*

The technology and communications that jeopardize the success of SMEs also pose threats to larger enterprises. The challenges posed by the massive quantities of counterfeit and pirated products made in China and elsewhere and exported throughout the world expose the IP system to a collision that has occurred. Counterfeiters and pirates operating in China have swamped markets with substandard and dangerous products with no regard for national borders and with no respect for the rule of law. The speed with which IP criminals can be on the market has placed law abiding companies at an extreme disadvantage in combating IP crimes.

Because the global IP system has rules, legitimate IP owners who are the victims are also failing to make progress in this battle because of the territorial nature of some IP rules,[5] which help counterfeiters and pirates exploit an established system. In view of the current system where criminals make, trade and sell in practically every country, IP owners are disadvantaged because they can only protect their rights where governments have granted rights. In view of the collision between the global scourge of counterfeiting and piracy and the territoriality of some types of intellectual property, perhaps it may be appropriate to consider how a distinction can be made between the acquisition of rights and the ability of IP owners to protect and enforce their rights so that protection and enforcement can be obtained in more countries in a timely fashion even absent the grant of rights in all the countries where one is victimized by counterfeiters.

e. *IP Capacity Building/Technical Assistance*

The IACC encourages the U.S. Government to consider a more systemic approach to IP training. IP enforcement training is often aimed at law enforcement officials (customs officers, police, and prosecutors). In view of the importance of having "allies" in our efforts to combat IP crime, the approach to IP training that is aimed wholly at enforcement officials seems to ignore a critical element of the population that could be enlisted to benefit our overall objectives. Technical assistance/capacity building should also target the business community of the countries where we seek to improve IP enforcement. By improving the business community's awareness of the importance of IP to their businesses and local economies, it may accelerate our efforts to engage both the business and law enforcement communities to advocate for better IP protection overall.

The IACC has been involved in such efforts and believes that increased efforts should be made to broaden the reach of IP training in order to enlist a wider group to support our efforts and to meet our objectives.

Cochair DREYER. We very much appreciate this, and we will get back to you with lots of questions.

Our next witness is Mr. Jason Berman, the former Chairman and CEO of International Federation of Phonographic Industries. Mr. Berman.

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[5] The territoriality of some types of intellectual property, e.g., patents and trademarks, hinder the ability of owners to seek protection and enforcement against counterfeiters.

STATEMENT OF JASON BERMAN
FORMER CHAIRMAN AND CHIEF EXECUTIVE OFFICER
INTERNATIONAL FEDERATION OF THE PHONOGRAPHIC INDUSTRIES

Mr. BERMAN. Thank you. Madam Chairperson and Members of the Commission, thank you for the opportunity to appear before you today to discuss the longstanding issue of how to assess China's intellectual property regime and most importantly its current enforcement policies and to explore possible strategies for positively impacting both China's WTO compliance and its bilateral trade obligations with the United States.

I have responded to the specific questions raised by the Commission in my written statement. Eric Smith has addressed them in some detail in his statement. So I will start by summing up in the hope that we will not lose sight of the forest for concentrating on the trees.

The situation is not good. The first point to make is while there has been progress in dealing with pirate exports, enforcement issues within China remain a problem. There has been progress in terms of the legal structure and numerous improvements in the copyright law. Unfortunately but not surprisingly, this has produced very little in the way of expanded commercial opportunities for legitimate foreign record companies.

The reason, simply, is the lack of a credible deterrent policy in enforcement, and I say that notwithstanding the marked increase in sporadic raiding and the actual seizure of hundreds of millions of pirate disks, which turn out to be, in a very profitable business, a cost of doing business.

The second point I want to emphasize is the continued existence of market access barriers and the actual operation of these trading restrictions in conjunction with the lack of effective enforcement, which combine to deny U.S. and other foreign record companies the opportunity to develop the marketplace. This is the current situation despite the growing number of foreign titles that have been sanctioned for release in China.

These trading barriers are too often overlooked as a reason for the inability of American entertainment companies to truly realize the commercial potential of the Chinese market, and this is most definitely an underdeveloped and underserved market, and it may well be by design of the Chinese authorities.

How do these market access barriers work? First, censorship. Chinese government censors are required to review the content of all foreign-produced sound records before release. Domestically produced recordings go through no such review. But, then again, neither do pirate releases, and so, they, as a matter of course, are always available before the official release, even if that official release has been denied a publication number.

The censorship office itself is understaffed, and there are delays. There has been some improvement recently, but the average is now a two-week delay, which means in two weeks, massive numbers of pirate disks are available in the marketplace.

Producing and publishing sound records in China: U.S. record companies are the most skilled at developing, creating, producing, distributing and promoting sound recordings and not just of U.S. artists but for artists the world. They could do exactly the same

thing in China: find a talented Chinese performer, determine the appropriate material, record it with technical skill, produce the recording and its associated materials, distribute it and promote it.

We could do it all, except for the fact that we are not permitted to do it. For example, for a record company to put on the market in China a recording, it must be released through a government-approved publishing company, and surprise, surprise, only Chinese state-owned firms are approved to publish sound recordings. That is a market access barrier. In addition, production companies, even Chinese wholly owned firms, are not permitted to engage in the replication, distribution or retailing of sound records.

The integrated process of bringing a recording to market is seriously hampered as a result, and it is extraordinarily difficult to develop the total marketplace when the government arbitrarily apportions these economic functions. That is a market access barrier.

Finally, U.S. record companies can market non-Chinese recordings in only two ways: by licensing a Chinese company to produce the recording in China or by importing the finished product through the China National Publications Import and Export Control Company. U.S. record companies should be permitted to produce, publish, market their recordings in China and to import directly any finished product.

And the final step, the distribution of sound recordings: foreign record companies are restricted to owning no more than 49 percent of any distribution company joint venture with a Chinese firm. But as a result of the closer economic partnership agreement recently concluded between China and Hong Kong, Hong Kong companies can own 70 percent of such joint ventures. There is no reason in the world why U.S. companies should not be granted the same privilege.

Thank you.

[The statement follows:]

Prepared Statement of Jason Berman
Former Chairman and Chief Executive Officer
International Federation of the Phonographic Industries

Mr. Chairman and Members of the Commission, thank you for the opportunity to appear before you today to discuss the longstanding issue of how to assess China's intellectual property regime and, most importantly, its current enforcement policy, and to explore possible strategies for positively impacting both China's WTO compliance and its bilateral obligations with the United States.

If I had to characterize the last decade in terms of these issues, the first point I would make is that while there has been significant progress in dealing with the production for export, that local enforcement issues have remained relatively constant. There has been some progress, most notably improvement in the legal structure itself, but this has done little to expand the commercial opportunities for U.S. record companies in China. Enforcement remains a serious problem and, as a result, China continues to be a marketplace dominated by pirated recordings despite a sporadic increase in the number of raids undertaken and the hundreds of millions of discs seized. Secondly, there continues to be a number of market access barriers that prevent timely entry for many U.S. and other foreign recordings—again, despite an increase in the number of titles that are officially sanctioned for release.

I will return to my conclusions in greater detail but I want to address directly the questions raised by the Commission's letter of invitation.

1. What is the overall assessment of compliance with WTO's IPR rules? What, if any, changes have occurred over the past year and what are the prospects for the future?

There has been some improvement, particularly with long-awaited issuance of the new Judicial Interpretations governing criminal actions, but a definite verdict over whether this will have meaningful results will have to await actual implementation—the real litmus test is effective enforcement and it is one China has historically failed to meet.

As you know, the TRIPS Agreement is basically divided into two parts: the substantive standards (e.g. what rules must be in a copyright law) and effective enforcement. For the most part, China is now in compliance with the standards test. However, it is not in compliance on a number of counts in regard to effective enforcement.

For example, the enforcement section of TRIPS sets out a general set of obligations, beginning with the following from Article 41: "members shall ensure that enforcement procedures ... are available under their law so as to permit effective actions against any infringement ... covered by this Agreement, including expeditious remedies ... which constitute a deterrent to further infringements." China's failure, in terms of effective enforcement, centers on its historic and continued reluctance to apply the necessary measures to deter piracy. Simply put, episodic raids and seizures, no matter how successful, will not result in any notable declines in pirate production. Pirates, without facing serious penalties, will simply view raids and seizures as a cost of doing business—and piracy is a very profitable business.

Another and related example, is China's failure to comply with Article 61, which specifically requires criminal penalties "in cases of willful trademark, counterfeiting or copyright piracy on a commercial scale." As I noted earlier, China has enacted the necessary laws—the appropriate remedies are on the books. Yet, with very, very rare exceptions, there have been extremely few prosecutions and convictions for copyright piracy. China has persisted in defining "commercial scale" in such a way as to make it highly unlikely any pirate with common sense will be caught in its net as a punishable criminal offense. Even with the recent Judicial Interpretations, the thresholds for a criminal prosecution are likely to continue to prove difficult to meet. Thresholds may be an appropriate test in determining the level of punishment, but they are an inappropriate test in determining whether a criminal offense has been committed.

Moreover, China requires that its criminal code remedies are only available in those instances where the pirate is making a profit. Ironic, isn't it, that the concern is the pirate's profitability and not the fate of the legitimate business. In addition, the profit test is actually more difficult to meet than the commercial scale requirement. For example, someone intentionally posting online a single copy of a copyrighted recording, without authorization, will cause serious economic harm on a commercial scale if that recording is downloaded over and over again. It would not, however, meet the for profit test.

2. At the April 2004 meeting of the U.S.-China Joint Commission on Commerce and Trade (JCCT), China made several commitments to improve IPR enforcement. What are the concrete results to date?

First and foremost, China committed to significantly reduce the level of piracy. Again, the commitment was to significantly reduce piracy. To date, that has not happened.

While there has been some reduction in the overall level of piracy, it is far from a significant reduction. The legitimate market, while it has improved in the last year, is still under siege. Piracy is down from an astounding 90% to about 85%—progress, yes, but a significant reduction, no.

One important aspect of this is that China committed to revise the judicial interpretation governing application of its criminal code so that criminal prosecutions would occur for copyright piracy. It is true that this promise, at least in theory, has been fulfilled. Whether the thresholds are sufficiently low to prove effective and how they will be implemented in criminal prosecutions is still an open question.

Other JCCT commitments included:

- To increase penalties for IPR violations by taking the following actions by the end of the year:
  - —increase the scope of IPR violations subject to criminal investigation and criminal penalties;
  - —apply criminal sanctions to the import, export, storage and distribution of pirate product;
  - —apply criminal sanctions to online piracy.

Some of these were addressed by the recently published "Judicial Interpretations." The Interpretations have a number of useful elements and if China has the political will to apply them conscientiously and strictly, then China might be able to meet these commitments. Given China's history, a healthy dose of skepticism is merited until things actually change. While it is very likely that Vice Premier Wu Yi, who is responsible for IPR and led the Chinese JCCT delegation, is serious about bringing about a reduction in piracy, the police still seem to regard IPR violations as not really a criminal activity that merits their attention in a serious way.

- Conduct a major crackdown on pirates to demonstrate China's intentions by mounting a nationwide enforcement campaign to stop the production of pirate product and punish violators.

  It is clear that a one year campaign was launched last September and that this effort has resulted in noticeable increases in the number of raids and product seizures. However, the usual remedies are being applied—product is seized and modest administrative fines are levied. This is not effective enforcement and it will not result in a significant reduction in piracy.

- Improve the protection of electronic data by ratifying the WIPO Internet Treaties as quickly as possible. To date, while there have been some promising public announcements about China's intention to ratify the Treaties, there has been no demonstrable progress on this, and this legal issue must be viewed against a background that has witnessed a proliferation of sites offering unauthorized recordings.

- Increase customs enforcement actions against imports and exports of pirate products and provide easier remedies for rights holders to secure effective enforcement at the border. Again, there is no indication that is underway.

3. What should the U.S. be doing to ensure compliance? Has technical assistance been provided? Is there a particular problem area that could be the subject of a WTO dispute case?

To ensure compliance the U.S. Government is conducting a Special 301 "out-of-cycle review" at this time. The results of this review are expected in mid March. Options available to the U.S. include initiating a WTO dispute case; placing China on one of the Special 301 lists (priority foreign country, priority watch list, watch list); impose some form of trade sanction that is consistent with our WTO obligations. These options are not mutually exclusive.

The U.S. and its IPR industries have been providing a considerable amount of technical assistance. The international recording industry, for example, has been conducting extensive training of Chinese judges. The U.S. Government has also been training police, prosecutors, and judges and this is likely to increase in 2005. On a related point, our own ability as an industry to assist in the process of fighting piracy is severely restricted in most provinces in China—in contrast to other countries where our investigative resources are welcomed. It is only very recently, for example, that in some jurisdictions the local enforcement authorities have permitted IFPI anti-piracy personnel to accompany them on raids.

In regard to a possible WTO dispute case, I would refer back to the issue of deterrent penalties—a WTO requirement. Currently, China does not provide deterrent penalties, not because it requires legislative changes to its legal system but because it seems to lack the political will to do so.

4. Who should the U.S. be cooperating with in terms of trading partners?

We should be reaching out to the European Commission and to Japan, where there seems to have been recently a renewed interest in fighting piracy. In truth, the U.S. has attempted to involve both in its efforts to seek improvements in China's IPR regime—mostly to no avail when it has become clear that some form of pressure is what it takes to prompt China to respond affirmatively. However, I would not abandon the effort, particularly in regard to any potential WTO actions. Both the EU and Japan were invited to and participated in this year's Roundtable in Beijing. It is interesting to note that the EU representative pointed out that 67% of the counterfeit goods stopped at the borders were from China.

In December, at the EU-China Summit, a Customs Cooperation agreement was signed and it also appears as if copyright enforcement was raised by the EU as an issue to be addressed. In January of this year, the EU and Japan held a joint meeting on The Information Society and, again, IPR and its enforcement was a major issue in regard to China.

Market Access Restrictions

Before I close, there is a very important related topic that I would like to address. This is China's refusal to permit U.S. record companies to participate fully in the Chinese economy. This is what we call denial of "market access."

U.S. record companies' possess great expertise the world over in developing and recording new artists, and distributing, promoting, and advertising their recordings so that the public is aware of them. U.S. record companies must be permitted to undertake the full range of the services they are skilled at providing. Today China severely limits the ability of American record companies to engage in developing, recording and distributing the music of Chinese performers, and in fully participating in developing the Chinese marketplace.

This is done in a number of ways:

Censorship:

(1) Chinese government censors are required to review the content of *foreign-produced* sound recordings before their release, but domestically-produced Chinese sound recordings are NOT censored. Of course, pirated product is not censored either. China should terminate this discriminatory process between imported and domestically-produced product.

(2) Censorship offices are understaffed, causing long delays in approving new recordings. In recent months, we have seen some improvement and a new recording takes an average of two weeks to be approved which still gives the pirates a crucial headstart. The best result would be for censorship to be industry-administered, as in other countries. If this is not possible, steps must be taken to expedite the process so that legitimate music can be promptly marketed, preventing pirates from getting there first.

Producing and publishing sound recordings in China:

U.S. record companies are skilled at and desirous of developing, creating, producing, distributing and promoting sound recordings by Chinese artists, for the Chinese market and for export from China. However, onerous Chinese restrictions prevent this from occurring. For example, for a sound recording to be brought to market, it must be released through an approved "publishing" company. Currently only state-owned firms are approved to publish sound recordings. China should end this discrimination and approve foreign-owned record publishing companies.

Further, production companies (even wholly-owned Chinese ones) may not engage in replicating, distributing or retailing sound recordings. This needlessly cripples the process of producing and marketing legitimate product in an integrated manner. China should permit the integrated publishing, production and marketing of sound recordings and allow such companies to have foreign investors.

U.S. record companies may market non-Chinese sound recordings only by (1) licensing a Chinese company to produce the recordings in China or (2) importing finished sound recording carriers (CDs) through the China National Publications Import and Export Control (CNPIEC). China should permit U.S. companies to produce, publish and market their own recordings in China and to import directly finished products.

Distributing sound recordings:

Foreign sound recording companies may own no more than 49% of a joint venture with a Chinese company. However, the recently concluded "Closer Economic Partnership Agreement" (CEPA) between China and Hong Kong permits Hong Kong companies to own up to 70% of joint ventures with Chinese companies engaged in distributing audiovisual products. China should grant at least MFN status to U.S. record producers per the terms of the CEPA.

Panel VI: Discussion, Questions and Answers

Cochair DREYER. Thank you very much.

I have first on my list of questioners Commissioner Wessel.

Commissioner WESSEL. Thank you, Madam Chairman, Chairwoman, excuse me.

Cochair DREYER. Chair.

Commissioner WESSEL. Chair, Madam Chair.

I apologize, Mr. Trainer, since I do not know you well. Let me direct my comments quickly to our two gentlemen, Mr. Smith and Mr. Berman, who I have probably a 20-year relationship with.

Mr. BERMAN. And we're saying the same things today, are we not?

Commissioner WESSEL. Well, you are patient men. You have been saying many of these things for quite some time, and we have all been doing this a long time, so long that this weekend, in preparation for this hearing, Jay, I was looking at your current title and mentioned it to one of my children and had the unpleasant response, they wanted to know what a phonograph was.

So we've all been doing this far too long.

Mr. BERMAN. That's a terrible thing, a phonogram.

Commissioner WESSEL. But I did hear a greater level of frustration than I think I've heard from either of you in the many years we have worked thing, and Eric, I have to tell you, your comments, I think, should be taken as a real shot across the bow in terms of the Chinese, the seriousness with which the industry now looks at these issues. To contemplate a case shows a level of frustration that I think really should be taken seriously by the Chinese, and there is not a lot of time left for them to really start putting in place not only the laws, as we've talked about, but the infrastructure necessary to make real changes.

Mr. Trainer, though, I want to understand something, and actually, the whole panel in terms of the economic impact. If I remember, and I haven't looked at the trade data recently, that copyright-based industries generally rank as either one or two in terms of exports and their value that they provide in trade: aerospace, copyright-based industries, it goes back and forth, and so, it is a very important industry for America.

This is not just Hollywood; this is not the paparazzi. This is what we heard in terms of the counterfeiting of the dials that are used in Humvees, their equipment; it's GM losing rights to their product. It's movies, it's books, it's sound recordings, et cetera.

You indicated, I think, Eric, that there were 240 million seizures last year, products that were seized. Yet you estimated the trade loss at only $2 billion. Mr. Trainer, I believe you indicated in your testimony, and I'm quoting, that as part of the enforcement effort that China should apply the retail value of the legitimate item as the basis for the valuation of the counterfeit goods.

Does that mean that the $2 billion estimate you're giving is the cost of the product itself, meaning just the equipment rather than the lost profits, the lost sales? I mean, 240 million, I don't know what CDs sell for in their market, but here, they're $12, $13, $14. Simple math, $16, simple math would indicate that we're talking about billions of dollars in piracy, counterfeiting, not $2 billion.

What estimate, in terms of how public views this, of the lost profits, lost total retail sales, are we looking at?

Mr. SMITH. This is a very tough question you're asking. Jay was talking about what are really, really significant market access barriers. If the Chinese market were fully exploitable for U.S. copyright-based industries, we would be looking at numbers far, far higher than the numbers we're giving you.

But we can't be in the market as a practical matter for the most part. So in generating what we consider to be our losses, first of all, most industries in the IIPA conservatively estimate their losses at pirate prices, not always, but this particularly in China is a

very, very difficult exercise, and all of our industries have sought to try to measure what some dollar figure.

So we've really sort of moved over to look at piracy rates as an aspect. But I think your question is quite correct. If you look at the overall potential of the Chinese market if we were to be able to fully exploit it, it would be monstrous, because just to give you a number, 244 million seizures; the Chinese OD plants, 83 of them, have the capacity to produce 2.6 billion units a year.

So you can see that is just but a fraction of what's going on in China is being captured through their enforcement system.

Mr. BERMAN. I'm sorry, I'll amplify that just a little bit. First of all, the massive amount of product that's being seized, the fact is that not all of it is of U.S. records or U.S. films or whatever. There's a large international component to it.

I think it's a little difficult, certainly in my mind; I've never been satisfied that there is a displacement number that is verifiable. So how many pirate disks would it take if you were denied the opportunity to purchase them, you would purchase one? We don't know the answer to it. All I would say is first of all; I'm hearing it myself for the first time today. There are 83 plants, optical disk plants in China. I have to tell you, when the U.S. imposed sanctions on China in 1996 and immediately after the publication in the Federal Register, we were invited to go to China with Ambassador Barshefsky to negotiate what it would take to remove those sanctions, we, through our own investigative resources, were able to pinpoint something between 28 and 30 plants.

So since 1996, there has been the most extraordinary explosion. Now, I remember the former Chairman of the Federal Communications Commission, Charles Ferris, talking about recorders have to record, birds have to sing and so on and so forth. Optical disk plants have to produce, and I can only imagine what it is they're producing. And as Eric said, the true value of the loss to U.S.-based companies is not measured because of the inability of those U.S. companies to actually perform in the marketplace.

I won't speak for the U.S. film industry, but it's interesting to note that U.S. films are part of a quota system, which restricts to 20 the number of foreign titles available in China.

Commissioner BECKER. Which China gets to choose the titles as well.

Mr. BERMAN. Well, as they used to choose out of the 100 foreign records that were permitted. Now, that number has been vastly exceeded for records, but still, if you can't be in the marketplace and do the things that you as an industry and as a business know how to do to develop that marketplace, then, there's no way to measure the true loss. It's not just about the pirate product in the marketplace.

Commissioner BECKER. It's billions in lost opportunities.

Mr. BERMAN. It is billions of dollars, yes.

Commissioner BECKER. Okay; thank you.

Cochair DREYER. Commissioner D'Amato.

Chairman D'AMATO. Thank you, Madam Chair.

Thank you very much, all three of you, for coming and your testimony. I must say that this testimony really ranks with the most infuriating testimony we have ever had before this Commission in

four years; not that it's bad; it's just infuriating in its content for us.

There is no other area, in my opinion, in the U.S.-China relationship that more completely defines the actual situation that we face with China, and there's no other area in my opinion that demonstrates how completely the Chinese government has contempt for the rule of law and the United States as this area. And I think you're all right; the problem is political will on the part of the United States and on the part of the Chinese.

The question is how are we going to start moving in the right direction in this area, and in looking through your testimony, obviously, the Chinese don't feel any kind of pressure, and it may well be that there's so much corruption and so much enrichment on the part of the Chinese leadership from this particular illegal behavior that we'll never be able to get them to move on it.

But the question is what is sufficient pressure on this government to start moving in this area? What is it? It seems to me that there are only two areas that they care about. All this stuff with the JCCT and this nonsense about more enforcement, rules, and so on, we've been down that road for years with the Chinese. It seems to me there are only two areas that the Chinese care about: one, access to our market, and secondly, their reputation in the WTO. Fortunately, they do care about their reputation in the WTO. They don't want any cases brought before the WTO against them. They've only had one by the United States.

I don't think there's any disagreement that we do not now have a regime of sufficient pressure on the Chinese to move them. After all, if the Chinese wanted to do something, they could just call on that group that eradicated the Falun Gong in one year and say go on out and see what you can do about IPR.

Mr. BERMAN. It is both the benefit and curse of totalitarian governments.

Chairman D'AMATO. It is a totalitarian government, and it has complete contempt for us in this area, and it is very damaging to our relationship, and it is damaging to our businesses.

Let me ask you: I do notice, and I've been looking for reference to the WTO. I see in your testimony, Mr. Smith, you do refer to going to a panel for a dispute settlement but only after going through various other hoops. My question is why don't we cut to the chase right now and figure out what kind of cases we ought to bring before the WTO? There must be 20 or 25 good ones we could do right now. Anybody can answer that.

Mr. SMITH. I'll speak only about the IPR case. The TRIPS enforcement text is rather general in the requirements that it places upon a country. Now, we have said for many years that a 90 percent piracy rate is prima facie a violation of the TRIPS agreement, and I can't imagine anything that would counter that.

But going before a three-person panel in the WTO with an enforcement case is something that can't be taken lightly. You must win that case. Now, we do have the good fortune of having the Chinese give us a case that is a slam-dunk, as I would say; their criminal law is on its face not compliant.

But I think that yes, pressure needs to be ratcheted up against China, but we also have to take into account that ultimately, coun-

tries don't do things until they feel it's in their interest. And I think the whole point of our recommendation is to engage the Chinese in a consultation process hopefully with the Japanese and Europeans joining us, which will get them to do many of the things we're recommending that would ultimately bring us to where we want to be.

Just a panel is one of the alternatives, but hopefully, we don't have to go to that point. Hopefully, the Chinese will see the light that they're going to lose this case if it's ever brought and do the things they need to do.

Chairman D'AMATO. Mr. Trainer?

Mr. TRAINER. Just simply, I would agree with Mr. Smith that one of the big hurdles is when one looks at the TRIPS enforcement provisions, Articles 41 to 61, it is ambiguous. One doesn't really know how you define effective enforcement, and one doesn't really look at—there's no definition for what constitutes effective deterrence as well.

I don't think that for most of my member companies, we have a 90 percent rate; it's less. We do have situations where companies report that globally, 50 percent of the counterfeits they find in the world market originates in China, but the challenge in my organization with my companies is that when we're talking about branded products bearing trademarks, we talk about everything, practically, that one thinks of in the store, no matter what kind of store it is.

So it is everything from what you wear to what you buy at the auto parts store and everything else: electrical appliances and so on. So it's a bit more difficult when you're talking about such a huge range of industries and products to get them to agree whether they should get together and support a WTO case.

I would probably think that there are companies within the trademark community where trademark is their primary concern where there are some companies that would support it. I just can't say that I have the endorsement of my group as a whole to say yes, we support a WTO case. I think there are companies within the trademark community who would say yes, but when I have to go to my members as a group, that's a different story.

So that's what complicates it for us, and that's also because of the range of products. It's everything.

Chairman D'AMATO. Yes, did you want to add anything to that, Mr. Berman?

Mr. BERMAN. I think you've said everything that I would have said.

Chairman D'AMATO. Let me ask you this, and I'll save some of my other questions for later. To what extent do we as a market accept Chinese videos, movies, and other kinds of products of that kind? Why don't we just cut it all off until they start complying with their agreements? What kind of access do they have to our market with their intellectual products in terms of the movie industry, films, books, CDs and so on? Is it substantial or not?

Mr. SMITH. It's totally duty free access for virtually all the products in our category. They can bring in everything.

Chairman D'AMATO. Yes, so we have——

Mr. SMITH. Unfortunately, the way the WTO works, you just can't close them off. You can only do it pursuant to a dispute settlement decision under the WTO. The way that system works, of course, is the remedies that are available to us have to be WTO-consistent so——

Mr. BERMAN. Can I add one other point to that, because I think that won't take us very far because of the total imbalance——

Mr. SMITH. Right.

Mr. BERMAN. —between the nature of the products that we would be exporting and that the Chinese in theory would want and the nature of those copyrighted—and I don't speak for the trademark industry—but for those copyrighted products that might be coming out of China to gain access to the U.S. market would be apples and oranges. One would be worth billions and billions, and one would be worth thousands.

So I think we have to find some other venue or avenue for, in effect, imposing the pain.

Chairman D'AMATO. Yes.

Mr. SMITH. Commissioner D'Amato, let me just add that back in 1995–1996, when China was not in the WTO, and Mr. Berman mentioned the special 301 action that was taken to stop the exports of pirate optical disk product, there, the U.S. targeted key businesses in the province that was producing all this product, Guandong Province, and eventually, the Chinese blinked. And those products were textiles, everything that was important to China.

And now that they're in the WTO, that's still a possibility. But you have to go through this process to get there.

Chairman D'AMATO. It seems to me we are going to have to do something to stop this. There is no jawboning that's going to work here. That's very obvious to everybody, at least to me. So we're going to have to think of something, and we've got creative lawyers stacked up like cordwood from here to the White House; figure out a few cases to start bringing them to heel on this. Thank you.

Cochair DREYER. If I could just introduce a slight corrective, the Chinese government is not a totalitarian government and has not been since the time of Mao Zedong. It is an authoritarian government, and it is furthermore occasionally a very sloppy authoritarian, very inefficient authoritarian government.

As for the question of why the government can be so efficient against Falun Gong, which it is pretty much, and any dissident, and not with regard to IPR, one reason is corruption, which is endemic in the system. People from the lowest to the highest levels profit from these IPR violations. Another reason is something suggested to me by Chinese journalists, who really are not champions of their own government; they are independent thinkers, and they say that what they feel is the Party and government have withdrawn from censorship on the risqué and the pornographic and the purely entertaining, and in that way, they can concentrate their resources on dissidents and new publications that say bad things about the government.

I'm sure my Chinese journalist friends don't know about the Roman emperors and bread and circuses, but that is essentially their argument. The average person's attention is diverted from

thinking about the more serious problems of society to thinking about sports and sit-coms. As Chairman D'Amato says, the only way to do it is to get our cordwood stacks of lawyers busy on this and stop thinking that negotiation is going to solve the problem.

Commissioner Mulloy.

Cochair MULLOY. Let me understand: IPR has three components, I understood: copyrights, and we have two gentlemen representing copyrights, trademarks, and we have one; patents. Are patents a big problem here as well? Who represents them, and what's going on there?

Mr. SMITH. In general, the problem in China has been a problem faced by the pharmaceutical industry with counterfeit drugs, and Mr. Trainer can speak to this much better than I, but there are problems in that area as well.

Mr. TRAINER. Yes, I think that from the Chinese perspective, it's probably the illegal production of copies, patented pharmaceuticals and then the export of counterfeited pharmaceuticals, and there certainly have been a number of reports, media reports, certainly through Africa and other places where they are finding a lot of counterfeit pharmaceutical products from China entering their markets.

It's certainly not as bad here in the United States, but they are certainly producing in large volume and shipping to other parts of the world where it more easily enters the market.

Cochair MULLOY. Okay; I want to get through a couple of things very quickly. First, is this problem mainly with our products? Are we concerned about the China market and what we're losing there, or are we concerned with the stuff that's violating IPR rights that's out of China into third markets, including our own? What is the principal issue that you folks want us to think about?

Mr. TRAINER. From the trademark perspective, it's both. There's no doubt that a massive amount of counterfeit goods made in China flood markets around the world.

Cochair MULLOY. There are safety problems associated—you mentioned——

Mr. TRAINER. Absolutely.

Cochair MULLOY. —medicine and auto parts.

Mr. TRAINER. Yes.

Cochair MULLOY. If there are counterfeit auto parts coming in here, they may not meet our standards, right?

Mr. TRAINER. Absolutely, they don't meet the genuine automakers standards.

Cochair MULLOY. And that's airplane parts, too, is it not?

Mr. TRAINER. Well, we haven't had in recent years an explicit report on airplane parts.

Cochair MULLOY. Okay.

Mr. TRAINER. But certainly in the auto industry, this is a problem, and just in last week's Business Week, the fine article about counterfeits and complete motorcycles and everything.

Cochair MULLOY. I'm sorry, Mr. Berman; did you want to comment about——

Mr. BERMAN. I would say we face somewhat of a different problem, and principally because of the success associated with the imposition of trade sanctions in 1996, one outcome of that negotiation

when we were there with Ambassador Barshefsky had to do with the export of pirate product into third marketplaces.

And for the recording industry, the problem basically is in the domestic market.

Cochair MULLOY. In China.

Mr. BERMAN. In China.

Cochair MULLOY. Okay.

Mr. BERMAN. They have to a large extent ceased the export of pirate product. They have a large enough market that they can produce for the domestic market.

Cochair MULLOY. Okay.

Mr. SMITH. Let me just add to that, Mr. Commissioner. For the movie industry, for a period of seven or eight years, exports of pirate products stopped. About two years ago, Chinese DVDs were being seized, began to show up all over the world. Video games are being exported in massive quantities out of China, and counterfeit software, the Chinese are the best in the world at counterfeiting software, making it look exactly like the original.

And there have been seizures in Los Angeles of $100 million of counterfeited software originating in China which took the company involved at least a couple of years just to figure out it was not their own.

Cochair MULLOY. That's a copyright issue.

Mr. SMITH. Yes, well, it's also a trademark issue, too.

Cochair MULLOY. Both.

Mr. SMITH. Yes.

Cochair MULLOY. Yes; now, you, on page 5 of your testimony, Mr. Smith, tell us about maybe getting China on the priority watch list. Taiwan was on the priority watch list, isn't that correct? And they're coming off. Why is it, if these massive violations—why isn't China already on the priority watch list?

Mr. SMITH. It was subject to a trade action in 1996, and what, under the statute, you put them on what's called Section 306, monitoring, which, by the way, permits the U.S. to immediately retaliate under that section. So it is kind of the highest place. The problem is they've been there for eight years, and it hasn't done anything.

Cochair MULLOY. We can't immediately retaliate now because we're in the WTO.

Mr. SMITH. That's right.

Cochair MULLOY. So we've got to go through that WTO process.

Mr. SMITH. That's right, but you could start that immediately.

Cochair MULLOY. Now, that brings us to the next issue. You say we should commence consultations in the WTO. That means you file a case, because consultations are the first 60 days of a WTO case; you consult, and then, you ask for a panel if you can't resolve the matter. Is that where you are? You're ready to file.

Mr. SMITH. Well, as I say, our members are leaning in the direction of urging the United States to commence consultations immediately.

Cochair MULLOY. That means filing a case; is that right?

Mr. BERMAN. We are within the alliance, and we are one of the parties to this discussion and negotiation. I don't have to be more explicit about where we are in this process.

Cochair MULLOY. One last point I want to make, because this came up yesterday when we were talking about a currency case: Dr. Bergsten made very clear that if you were going to bring such a case, and we had a lawyer lay out how you would bring a currency case. He said you want to make sure that you've got multilateral support.

Mr. BERMAN. Right.

Cochair MULLOY. I note that in your testimony and Mr. Smith, you and Berman both say you've got to reach out and get the Japanese and the EU involved. Are we reaching out to get them involved?

Mr. BERMAN. I think I can respond to that, having just spent six years in London.

Cochair MULLOY. Yes.

Mr. BERMAN. It is a very difficult task to engage the European Commission in trade negotiations that look toward a concrete result. They tend to be very delicate in their approach.

Now, I think we have an enormous opportunity, quite frankly, as a result of changes in the Commission, and we have a new Trade Commissioner in the EC in Peter Mandelson. He's expressed an interest in what's happened within China. Whether or not the Commission itself would permit something to go forward, I honestly don't know. But there is an effort being made, I know, on behalf of the international recording industry in the coming week to reach out to Commissioner Mandelson to talk a little bit about China and where the Commission might be.

In the last year or so, the Japanese have woken up to the fact that they are a victim in this process. Now, again, it's hard to know about how they view the trade process and the remedies procedure. Now, the Japanese have been involved in a lot of WTO actions; it shouldn't come as a great surprise to them. Whether the effort would be successful, I don't know, but I think we really do, within the context of something going forward within the WTO, really need to be creative about how we involve the EU and the Japanese.

And I do think we're probably at the best possible moment in terms of the European Commission.

Cochair MULLOY. Thank you very much, and thank you, Madam Chair.

Cochair DREYER. You're also at a good moment with the Japanese, believe me.

Chairman D'AMATO. Can I just make one comment?

Cochair DREYER. Commissioner D'Amato.

Chairman D'AMATO. As you said, Mr. Berman, we've been over to the WTO every year, and we talk to them all, EU, Japan and so on. It is absolutely obvious that they will not move unless we move; but if we move, they will move with us. That's our judgment. We've seen that on the semiconductor case. Everybody says——

Mr. BERMAN. That's the one great, shining victory, Mr. D'Amato, yes.

Chairman D'AMATO. And they joined us, but we had to take the lead first.

Cochair DREYER. We have four minutes and four Commissioners. Talk fast, please. Commissioner Bartholomew.

Commissioner BARTHOLOMEW. Thank you very much and thank you to our witnesses. I particularly want to acknowledge the presence of Jay Berman. Although I don't have the 20 years of working with him under my belt that Commissioner Wessel does, it's certainly been 10 years. It's always a pleasure to see you, Jay.

Mr. BERMAN. Thank you, Carolyn.

Commissioner BARTHOLOMEW. It would be more of a pleasure, of course, if you could come and say to us we've made significant progress, and the problems are under control but——

Mr. BERMAN. In the 10 years I've been saying it, I've never been able to say that.

Commissioner BARTHOLOMEW. In some ways, this issue makes me speechless. For those who know me, that's really saying something, because my level of frustration, hearing essentially the same story year in and year out for over 10 years must be nothing compared to the level of frustration that you all are experiencing.

The fact, Mr. Smith, that you come here and say 90 percent of the product is pirated; nothing has changed.

Mr. SMITH. And has been for 10 years at least.

Commissioner BARTHOLOMEW. And has been for 10 years. It is just amazing to me. We have gone through four MOUs on this issue in the past 12 years, and yesterday, we were talking a about a general orientation in this government where people somehow proclaim that negotiations are progress and talk is success, but when you look at what this has all accomplished, there really aren't any results that we can point to.

A couple of facts, of course. I always think it's a lack of will in both places. We know that the Chinese government employs 30,000 people to monitor Internet usage. If they can have that kind of control, then, it's really difficult to understand why they don't have the kind of control over piracy. I suspect the answer is there are no incentives for them to comply, and there are plenty of disincentives for them to do so.

I'm frustrated with our own government about the unwillingness to move forward sometimes more strenuously, and frankly, sometimes, I'm frustrated when I hear splits within the industry. I understand that there are costs to standing up and that a lot of companies do it and a lot of other countries do it. It is part of what I think of as the long arm of Chinese censorship: everybody else wants somebody else to take the risk so that they get the benefits if it works, and they don't get any of the costs if it doesn't.

So I really commend you all for your courage in speaking out on these issues and hope that people will stand up and do more. This is such a cost to our economy in so many different ways. Jay, you talk again about market access barriers. We were told when we went through the whole WTO debate, PNTR, this was going to be bringing down market access barriers for U.S. companies.

I don't even know what to ask in the sense of you come here with very compelling information, but I don't know what we do.

Mr. BERMAN. The one thing I would say in regard to market access in the context of the WTO is there is a serious problem, because, of course, the Chinese made no commitments in this area in regard to the WTO when it negotiated with the U.S.

So if your view is that we are confined to a WTO forum, then. I think we're also restricted to the questions raised by Articles 41 through 61 about enforcement and not, unfortunately, in regard to market access, which we would have to deal with the Chinese on a bilateral basis. In that respect, I would say if one were to go back and look at this historically, there is a single moment in time in the trade relationship between the United States and China when the U.S. succeeded, absolutely succeeded, in achieving a concrete result.

It announced the imposition of trade sanctions on over $1 billion worth of Chinese exports to the United States. It was published in the Federal Register, and the date, in order to accommodate goods in transit, was 30 days hence from whatever was. As that date approached, the Chinese figured out that they had to do something, and we were there with Ambassador Barshefsky, and we actually entered into what amounted to a commercial negotiation over how many plants would be closed and principally those plants that were doing exports. That is a singular moment when actually something was achieved.

I will say one other thing: unless we can figure out what it is we're actually asking for, we will get another round of improvements in the copyright law; we will get another round of these episodic outbursts of people being executed for piracy and whatever, and of course, nothing will change. I think we have to figure out—and I'm not creative enough to do this—what is it—to be closing 12 plants was a big deal. What is it that's a big deal now that's achievable?

We will be piecemealed to death, and we will be doing this every year henceforth unless we can figure out the answer to that question.

Cochair MULLOY. Mr. Berman, what was the date of that?

Cochair DREYER. Commissioner Mulloy?

Mr. BERMAN. June 1996.

Cochair DREYER. We have three more minutes and four more people on the list, Commissioner Mulloy.

Commissioner Reinsch.

Commissioner REINSCH. Thank you. If it will make you feel better, Jay, my 21-year-old son, who's an aspiring hip hop performer, has his own set of turntables and does parties.

Mr. BERMAN. Thank you, Bill.

Commissioner REINSCH. He knows phonographs very well and has——

Mr. BERMAN. Thank you, Bill.

Commissioner REINSCH. —a great selection.

Mr. BERMAN. Thank you for remembering.

Commissioner REINSCH. The technology is not dead, and he didn't learn it from us.

Mr. BERMAN. Thank you.

Commissioner BARTHOLOMEW. Or the hip hop.

Commissioner REINSCH. No, he didn't learn that from me, either. I think every generation produces music that their parents don't understand, but I'm used to that.

I also share my colleagues' indignation about what's going on here completely, but I'm not going to take up June's time to be in-

dignant. Let me just ask a couple questions: Mr. Berman, with respect to the market access limitations that you find in China, the difficulties in getting licensed and being able to market your own product there, do you think that's a function of commercial or corruption considerations or a function of censorship control considerations by the Chinese government?

Mr. BERMAN. If I were to venture a personal guess based on experience, I would say it is a function of the cultural issues, not trade issues. Our experience over the years in direct negotiations with the Chinese were that you could talk to—aside from the time that Wu Yi assumed the leadership role in this, that you could talk to the Commerce Minister, the Trade Minister, and everything else, but the guy who controlled the process was the Propaganda Ministry.

So it's all about what they're prepared to permit in terms of access for the Chinese population to basically Western ideas. I believe that still is the defining characteristic behind the censorship market access barrier.

Mr. SMITH. Bill, if I could add——

Commissioner REINSCH. Yes, I was going to ask you to comment on that.

Mr. SMITH. The software industry, for example, which is part of our group, are facing a new procurement regulation which will require all state-owned enterprises and government entities to purchase only Chinese software. Now, that's not cultural, and I agree with Jay: I think there is a combination here of things: there's protectionism I think in all of these areas.

With the movie industry and the record industry in particular, I think there's a major cultural issue. But with many of the other industries, it's pure out and out protectionism, and we need to realize that in these other areas.

Commissioner REINSCH. It's interesting you say that, because I had thought in the software issue, it was much more related to their ongoing desire to control the Internet than it was to any commercial purposes.

Mr. SMITH. Well, that's certainly part of it, but there is a lot of software out there that has nothing to do with the Internet.

Commissioner REINSCH. Helpful. Thank you both very much on that score.

Final question: it has also seemed to me over the years that countries really get interested in doing something about this when they have IP of their own to protect. That may be truer on the industrial patent side than it is on the recording/movie side. But, A, do you share that view, and B, do you see signs of that happening in China, i.e., their developing their own property and that then creating internal domestic pressures for their government to do a better job on enforcement?

Mr. SMITH. Yes and yes. Unfortunately, the Chinese creative industries who are being savaged by these piracy rates even worse than we are, China is not a place where people can speak their minds easily, and you don't criticize the government. You talk privately to these people across all our industries, and they will tell you we're in trouble.

Mr. TRAINER. And I would say that's similar in the trademark areas, where companies are having branded products, and there's counterfeiting of the Chinese home-branded products as well.

Commissioner REINSCH. Thank you.

Cochair DREYER. Commissioner Robinson?

Commissioner REINSCH. I yield back my time, Madam Chair.

Vice Chairman ROBINSON. I will cede my time as well. We are tight on time, but I want to associate myself with the remarks, which I thought were particularly eloquent, of Commissioner Bartholomew. I let her download on my behalf, in a sense, and those comments of Chairman D'Amato as well.

This is a litmus test of the destiny of the U.S.-China economic relationship. We have to look at this as the most egregious circumstance that I think has come before this Commission in its existence, not to mention the fact that this is an instant replay, seemingly, annually for now a decade or more.

All I can say is that it's going to receive urgent treatment by this Commission. There's no question about it. And we're not going to be, frankly, walking on eggshells to the extent that some of you have to. We're going to test the limits of what can be done within the WTO and more importantly what we can do as a nation.

The idea that the WTO is going to staunch this effort so that we're having this discussion three or five years from now—we feel very strongly that's not going to happen. One way or another, even if we have to choose another venue, like that proposed by Senator Schumer with an across-the-board 27 percent tariff to combat currency manipulation; if that's the way we have to go, then, that's what we're inclined to do. This is an outrage, and we can't abide by it for another year, much less for another five or 10, and that's the extent of my remarks. With that, I'll turn things over to my——

Cochair DREYER. Commissioner Becker.

Vice Chairman ROBINSON. Thank you.

Commissioner BECKER. Thank you.

There's the old story that everything that has been said. The problem is everybody hasn't said it, and I just want a shot at it here.

I missed a lot of your testimony, and I apologize for that. I had to take care of some of my own problems on that.

But the thing that I think is happening is it's not the same every year. They become emboldened and it is worse every year. We had a recent hearing in Seattle, and we were talking about exports. We had two gentlemen who talked to us, each one of them involving copyrighted material. One was lumber, where they were processing the lumber in China into plywood.

This carries a certification if it's coming into the U.S. market or anywhere in the world, because we have a certain standard, and it was being counterfeited. They were taking lumber that was not up to grade, and they were putting the U.S. certification stamp on it. They've protested this, and nobody gets very excited in this country about it.

The other is the gauges that Mr. Wessel mentioned. Those carry a U.S. certification. Now, they've not only duplicated, counterfeited the gauges, but they've also counterfeited the stamp and the type

of certification that goes on there. I think this speaks more of just somebody running off some cheap copies of something; this is a plan. This is a business that they're in.

This is not the United States but the Business Week; you talked about that with the Japanese Honda bike. To duplicate that is incredible, to actually construct another whole machine, this takes a factory, and this takes a lot of planning and a lot of money being put in there, and it also takes assurance that they're going to be able to continue in business, and this is the part that bothers me.

I saw a picture the other day in a newspaper or a magazine, I forget which, in which the police, it says cracking down, and it showed the police cracking down on this huge outdoor clothing market.

Mr. BERMAN. Silk Alley.

Commissioner BECKER. At the end of the paragraph, it said the police were directing them up the hill to a mall that they were moving them to. So they were shutting this down, but the police were helping move them.

Now, this is not some people sneaking around, criminal types. Again, this gets into some kind of organized business. I think you had the answer to it, Mr. Berman, when you said this one bright spot was when you and Ambassador Barshefsky were engaged in it. How did this come about? If this was done every time on every occurrence, it would shut them down.

Now, the real scary part that I wanted to hold off here till the last that really bothers me is that I'm very concerned when the United States agreed that China could do preclinical testing for drugs here in this country, because I don't think their system is tight enough; I think it's too—well, the counterfeiting and everything else, it just shows a much more loose society.

And now, they're doing clinical testing, which means when it comes out of China, it's going to be certified for use in the United States and through that throughout the rest of the world. I don't have the confidence in that, particularly when I see where drugs are being counterfeited over there.

Now, one of the reasons I believe that employers or businesspeople are somewhat hesitant to kick up too much fuss is because they still have an ongoing worldwide business, and if it's featured in magazines or news articles that their product is being counterfeited, what does it do in the confidence of their regular business?

Now, we don't talk about that but I look at this picture in here of Pfizer with the drugs, and it says which is which? I bet they had spasms when they saw that, because all across the world, people who use that drug are going to be questioning whether they should do it or not. These are just my own remarks. It's a horrendous job, but I really believe that what Barshefsky did under that administration and yourself in engaging them head on, that has to be the answer to it.

Thank you.

Cochair DREYER. Thank you very much. We very much appreciate this. We'll take a very, very short break, and the next panel will begin in five minutes. Thank you.

[Recess.]

PANEL VII: STRATEGIES FOR ENFORCEMENT—AGRICULTURE

Cochair DREYER. Let me call to order our seventh and final panel on Strategies for Enforcement in Agriculture. I would like to go by how this appears on my schedule, and we will start with Nancy Foster, who is the President and CEO of the United States Apple Association.

Ms. Foster, thank you.

STATEMENT OF NANCY E. FOSTER
PRESIDENT AND CHIEF EXECUTIVE OFFICER
U.S. APPLE ASSOCIATION

Ms. FOSTER. Yes, thank you for the opportunity to testify today on U.S.-China trade on WTO issues. The U.S. Apple Association represents all segments of the U.S. apple industry, from growers to processors, packers and marketers. Our members span the 40 states where apples are grown in this country.

In the past decade and a half, China has experienced unprecedented expansion in apple production. Massive plantings of apples in China during the 1990s resulted in tremendous growth in the Chinese apple industry. Between 1990 and 2003, Chinese apple production increased almost 400 percent.

In 1990, the U.S. was the leading apple producing country in the world. At that time, China produced almost as many apples as we did. In 2003, the WTO produced almost 4 million metric tonnes of apples and was the second leading country in world production after China's tremendous production of 21 million metric tonnes. Chinese production now amounts for almost half of the world's production of apples.

China is a challenge for our industry because of its exports of apple juice concentrate, processed products and potential fresh apple exports to the U.S. We also face intellectual property theft and are concerned about currency imbalance and unequal market access between the U.S. and China.

In the mid to late 1990s, China invested heavily in its apple juice concentrate industry and increased its share of world apple juice concentrate trade. China increased its market share by offering substantially lower prices, especially in the U.S. In our opinion, Chinese exporters demonstrated classic dumping behavior by offering prices significantly lower than market competitors, with the hope of gaining market share at the expense of short-term profitability, and this strategy worked.

Between 1995 and 1998, Chinese apple juice concentrate imports increased by more than 12,000 percent, while the average price of Chinese concentrate imports into this country fell 53 percent. As a result, U.S. concentrate producers were forced to slash their prices and drastically reduce the price they paid for U.S. juice apples to American growers. U.S. apple producers lost millions of dollars.

In 1999, the U.S. apple industry filed an antidumping case against Chinese apple juice concentrate exporters for offering concentrate in the U.S. below its cost of production. Despite the overwhelming cost of filing, the U.S. apple industry decided to seek the protection this might provide. When the Commerce Department initially assessed dumping duties, several Chinese companies appealed. In 2003, the Commerce Department determined that sev-

eral large exporters were not dumping. Meanwhile, U.S. imports of Chinese apple juice concentrate have continued to grow to now 40 percent of total concentrate imports. U.S. growers continue to receive lower prices for juice apples, which means lost revenue for American producers.

While this antidumping case provided some temporary relief to the domestic apple juice concentrate producers and growers in this country, our industry presently derives little or no relief from current trade remedies. In addition, the extraordinary costs of participating in an antidumping suit and its lengthy legal process are also serious constraints to small growers and other industry members spread across the nation. This discourages realistic access to available trade remedies.

Now, another challenge looms on the horizon for the U.S. apple industry from China. Chinese exports of applesauce, canned, sliced and dried apples are starting to gain market share here. Domestic apples grown for processing represent about 38 percent of total U.S. apple production, with the rest going to fresh apples.

There are some states in this country that are more heavily dependent on processing apple markets than fresh. States including Michigan, Pennsylvania, New York, North Carolina and others; the apple industries in these states and others would be threatened with significant economic dislocation of imports of low-priced Chinese processed apple products continues to increase. However, antidumping law requires us to wait for the Chinese or other competitors to cause significant harm to our industry before any action can be taken to alleviate the damage.

Moving along, we're also very concerned about potential negative impacts from fresh apple imports into this country from China. China has requested access into the U.S. for their fresh market apples and is working with USDA now to secure needed approvals. USDA requires that fresh produce imports must be cleared through a scientific technical process to ensure that produce and apples in particular do not inadvertently introduced an exotic insect or plant disease into our country.

Introduction of damaging pests could wreak havoc on the U.S. apple industry and other tree fruit industries, as evidenced by several quarantined pests that have already invaded agriculture from China, for example, the emerald ash bore and the Asian longhorn beetle.

U.S. Apple believes that our bilateral trading relationship with China must conform to the scientific standards and principles set forth in WTO sanitary and phytosanitary measures. We believe that this process should not be politicized, nor should negotiators accelerate or exchange market access for certain U.S. goods into China for access to the U.S. market for Chinese apples.

There is a substantial difference in labor costs between the U.S. and China, and we believe that may well translate into a substantial price difference between U.S. apples and Chinese apples if those Chinese apples arrive in the U.S. market. About half the cost of producing apples is attributed to labor. It's a very labor-intensive process because of thinning, pruning, tree trimming and harvesting. China's labor rate is almost $500 an acre, compared to almost $2,000 an acre in the U.S. to produce apples. In China, each

apple is touched on average 15 times by hand for optimum care and sunlight and pest control.

Should Chinese producers gain access to the U.S. market, major segments of the apple industry could be forced out of business by extremely low prices. U.S. apple exports are already being displaced by Chinese apple exports in third country markets. China is expected to have tripled its exports based on 2004 forecasts over the last four years and is now a major competitor with the U.S. in the Pacific Rim countries as well as Canada and the EU.

But as we monitor China's exports, we seriously question whether China has the capability to reliably prevent exports of exotic pests and diseases that could threaten our industry, even if there is an agreed upon mitigation and control work plan. Examples include recent shipments of Yah pears into the U.S., where the shipments were suspended because China could not comply with the agreed-upon work plan. Alternaria was discovered, which is an exotic pest not present in this country. Also, exports of Chinese apples from a province in China were suspended in 2004 in Canada because of multiple interceptions of pests.

The panel before us talked about intellectual property, and I have some visual examples at the end of our testimony which I hope you have, and we're concerned that there are numerous instances of pirating of intellectual property through the unauthorized use of trademarked brands and logos by apple exporters. This is the Washington Apple Commission trademarked logo. If you turn the page to the next one, you will see a remarkably similar logo that showed up in Thailand that was supplied by a Chinese exporter. And I have additional examples that I would be glad to provide you from U.S. apple exporters.

If you turn to the next page, you will see a specific U.S. brand called Top Red. This has been trademarked for 35 years in this country. If you turn to the next page, you will see an amazingly similar brand that was photographed in China. Now, this country, the trademarked Top Red in the U.S., this U.S. apple producer, does not export to China, and it's amazing to find this in China.

The last one is actually a double infringement, because you have the Top Red infringement, and you have the Washington Apple Commission logo infringement. And we would be delighted to provide additional examples if this Commission wanted them.

We're also concerned about currency exchange issues. As you know, the Chinese yuan is pegged to the U.S. dollar. We would encourage the Chinese currency to more accurately reflect market forces. We believe that our exports would be more competitive with Chinese products in China and in other markets if this occurred.

I also want to stress that we do export some apples to China at a much greater reduced rate than certainly they export. But we feel that it is unfair to have an unequal duty structure between the U.S. and China, where China still imposes an effective 24.3 percent import duty on incoming apples. The U.S. has no duty on fresh apple imports.

In closing, we would be better prepared to compete with China if more were known about the structure and function of China's apple industry. U.S. policy makers such as you would be in a better position to everything China's impact on the U.S. economy if Chi-

na's invisible hand in its economic policies and institutions were more transparent. We think this Commission can play an important role in helping to do this.

We appreciate this opportunity to be here with you today, and I would welcome any questions you would have. I thank you.

[The statement follows:]

Prepared Statement of Nancy E. Foster
President and Chief Executive Officer
U.S. Apple Association

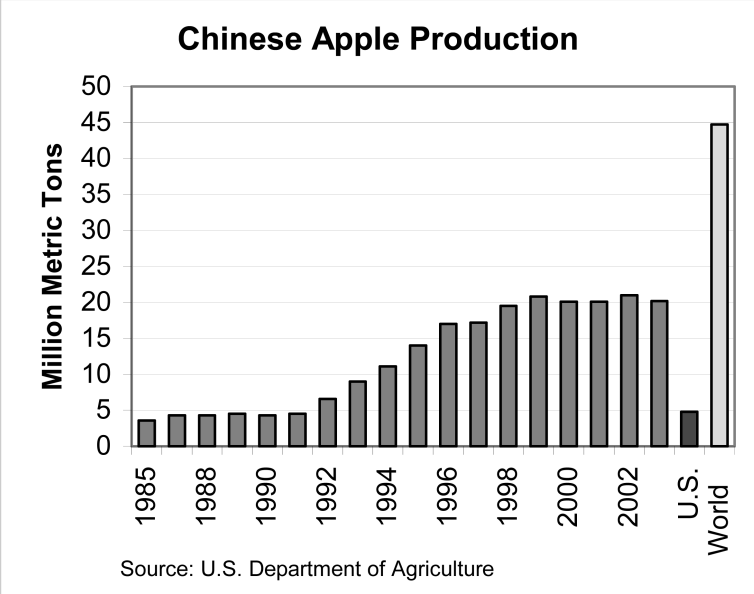
The U.S. Apple Association (USApple) is the national trade association representing all segments of the apple industry. Our members include 40 state apple associations representing 7,500 apple growers throughout the country, as well as over 400 individual firms involved in the apple business.

Thank you for this opportunity to testify on U.S.-China trade issues, legal U.S. trade remedies to address import concerns, and the implications of Chinese production of apples and apple products for the U.S. apple industry.

China's Unprecedented Expansion in Apple Production

The U.S. apple industry produced 3.9 million metric tons of apples in 2003, and was the second leading country in world production after China's tremendous production of 21 million metric tons. With total world apple production reaching 44.7 million metric tons in 2003, Chinese production accounted for 47 percent of total world production.

While China is now the world's largest apple-producing nation, its emergence as the world leader is a recent phenomenon. In 1990, the United States was the leading apple producing country in the world. At that time China produced 4.3 million metric tons, nearly as many apples as the United States. However, massive planting of apples in China during the 1990s resulted in tremendous growth in the Chinese apple industry. Between 1990 and 2003, Chinese apple production increased 388 percent.



China Expands U.S. Apple Juice Concentrate Market Share

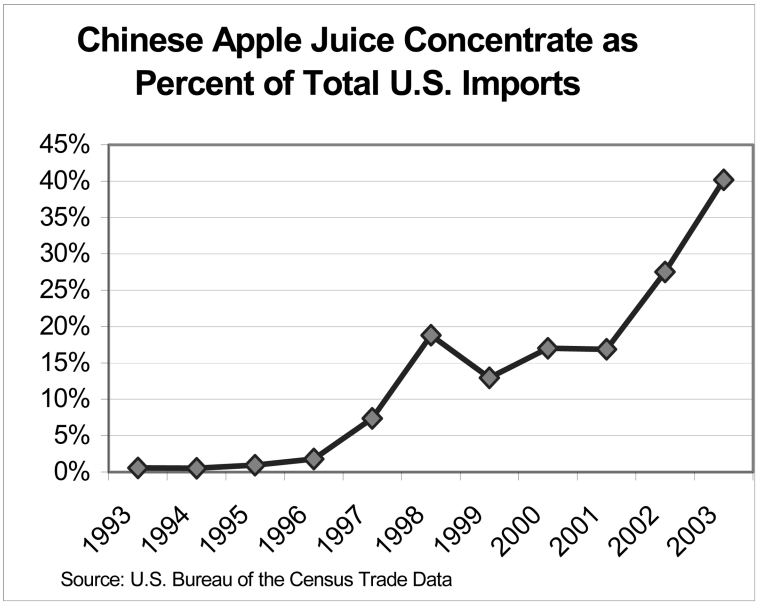
In the mid- to late-1990s China invested heavily in its apple juice concentrate industry. With the help of provincial governments and foreign equipment manufacturing interests, China began a campaign to increase its share of the world apple juice concentrate trade. However, when China entered the market there were

already adequate supplies of apple juice concentrate to satisfy demand. China increased its market share by offering substantially lower prices than its South American and European competitors, especially in the United States, which is one of the world's largest apple juice concentrate markets.

In this entry phase, USApple believes that Chinese apple juice concentrate exporters demonstrated classic dumping behavior by offering prices significantly lower than market competitors with the hope of gaining market share at the expense of short term profitability, and the strategy worked.

Chinese apple juice concentrate imports increased by more than 1200 percent between 1995 and 1998. During that same period, the average price of Chinese concentrate imports declined by 53 percent, from $7.65 per gallon in 1995 to $3.57 per gallon in 1998.

U.S. concentrate producers consequently were forced to slash their prices, and to drastically reduce the price they paid for U.S. juice apples. The average price received by U.S. growers for juice apples fell from $153 per ton in 1995 to $55 per ton in 1998. U.S. apple growers lost more than $135 million in revenue from the decline in juice apple prices during those three years, according to U.S. Department of Agriculture data.



In 1999, the U.S. apple industry initiated an antidumping case against Chinese apple juice concentrate exporters for offering apple juice concentrate in the United States below its cost of production. At that time the apple industry felt it had a strong case against Chinese concentrate exporters and despite the overwhelming cost of filing an antidumping case, the U.S. apple industry decided to avail itself of the protection it was intended to provide.

When the Commerce Department initially assessed dumping duties ranging from zero to 52 percent, several Chinese firms appealed the decision. In 2003, the Commerce Department determined that several large exporters were not dumping. Meanwhile, U.S. imports of Chinese apple juice concentrate have grown to 40 percent of total U.S. apple juice concentrate imports, and U.S. apple growers continue to receive lower prices for juice apples, which means lost revenue for American growers.

While the U.S. apple industry's antidumping case provided some temporary relief to domestic apple juice concentrate producers and apple growers, the U.S. apple industry presently derives little or no relief from current trade remedies.

In addition, the extraordinary cost of participating in such a case and a lengthy legal process are also serious constraints to small growers and other industry members spread across the nation. These factors also discourage realistic access to available trade remedies.

U.S. Apple Industry Challenged by Chinese Processed Product Imports

Another challenge now looms on the horizon for the U.S. apple industry. Chinese apple processors have recently entered the U.S. applesauce, canned, sliced and dried apple markets, and Chinese exports of these products are starting to gain market share in the United States. U.S. growers and apple processors are monitoring U.S. imports, which demonstrate a pattern similar to the Chinese apple juice concentrate statistics just before Chinese apple juice concentrate flooded the U.S. market in the late 1990s.

According to U.S. Department of Agriculture statistics, domestic fresh apple production represents 62 percent of total apple production. Conversely, apples grown for processing utilization in the United States represent approximately 38 percent of total U.S. apple production. The total farm gate value of processing apples was $206 million in 2003. However, some apple producing states are more heavily dependant on processing apple markets. In 2003, Pennsylvania processing apple production accounted for 79 percent of total apple production; Michigan's processing production represented 65 percent of total production and New York's processing production was 49 percent of total production. These states represent a substantial portion of total U.S. apple production. The apple industries in these states and others would be threatened with significant economic dislocation if imports of low price Chinese processed apple products are allowed to increase. Despite our industry's awareness that China is ramping up exports to the U.S. market, antidumping law requires our industry wait for the Chinese, or other competitors, to cause significant harm to our industry before any action may be taken to remove the threat.

U.S. Imports of Processed Apple Products by Country
(Applesauce and Sliced Apples)

	1999	2000	2001	2002	2003
	---------- Metric Tons ----------				
Canada	12,477	16,018	16,599	18,240	21,728
% of total	91%	94%	90%	82%	72%
China	936	834	1,736	2,352	8,077
% of total	7%	5%	9%	11%	27%
South Africa	0	0	0	1,205	257
% of total	0%	0%	0%	5%	1%
Mexico	0	3	73	152	95
% of total	0%	0%	0%	1%	0%
Other	225	111	105	149	89
%of total	2%	1%	1%	1%	0%
Total U.S. Imports	13,638	16,966	18,513	22,098	30,246

Source: U.S. Bureau of the Census Trade Data

U.S. Facing Possible Fresh Apple Imports from China

The U.S. apple industry is deeply concerned about the potential negative impact of fresh apple imports from China. China has requested access to the U.S. market for Chinese fresh apples. Chinese government officials are now working directly with the U.S. Department of Agriculture's (USDA) Animal and Plant Health Inspection Service to secure permission to export Chinese fresh apples to the United

States. The U.S. apple industry's future economic well-being may be challenged by Chinese fresh apple imports.

Unlike processed agricultural imports, USDA fresh produce imports must be cleared through a scientific technical process to ensure that imports do not inadvertently introduce an exotic insect or plant disease into U.S. growing regions. Introduction of damaging pests could wreak havoc on the U.S. apple industry, as evidenced by several quarantine pests that have invaded U.S. agriculture from China. For example, USDA has spent millions of dollars in attempts to control and eradicate the emerald ash border and the Asian longhorn beetle.

The U.S.-China bilateral trade relationship must conform to the scientific standards and principles set forth in the Sanitary and Phytosanitary Measures (SPS) in the WTO. The U.S. apple industry believes that this process should not be politicized, nor should negotiators accelerate or exchange market access for certain U.S. goods into China for access to the U.S. market for Chinese apples.

A substantial difference in labor cost between the U.S. and China may well translate into a substantial price difference between U.S. apples and Chinese apples in the U.S. market. Apple production is extremely labor-intensive because thinning, pruning, tree training and harvesting are performed by hand almost year-round. According to a recent study on global apple production competitiveness, China's labor rate is approximately $472 per acre as compared to $2,052 per acre in the United States. (In China the labor rate is only $0.28/hour, or about $2.00/day.) At a minimum, the U.S. apple industry expects Chinese fresh apple imports to add significant downward pressure on fresh apple prices. Should Chinese producers gain access to the U.S. market, major segments of the apple industry could be forced out of business by low apple prices.

Costs of Production for Major Apple Producing Countries

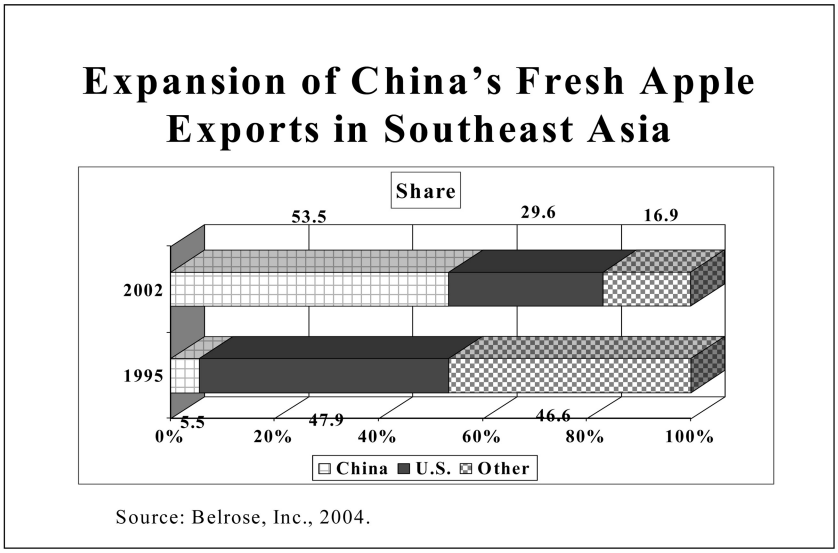
Country	Labor ($/acre)	Materials ($/acre)	Total Dir. Costs ($/acre)	Overhead & Invest. ($/acre)	Total COP ($/acre)	Yield (bins/acre)
Italy	2,753	736	3,489	4,298	7,787	55.0
France	2,288	492	2,780	2,615	5,395	42.0
Germany	1,760	568	2,328	2,773	5,101	36.0
USA	2,052	450	2,502	2,502	5,004	42.0
Chile	1,045	406	1,450	1,179	2,629	50.0
Brazil	586	506	1,092	760	1,853	35.0
Poland	325	348	672	1,169	1,842	34.0
China	374	587	1,369	584	1,953	16.0
China-30	**477**	**587**	**1,472**	**584**	**2,056**	**30.0**

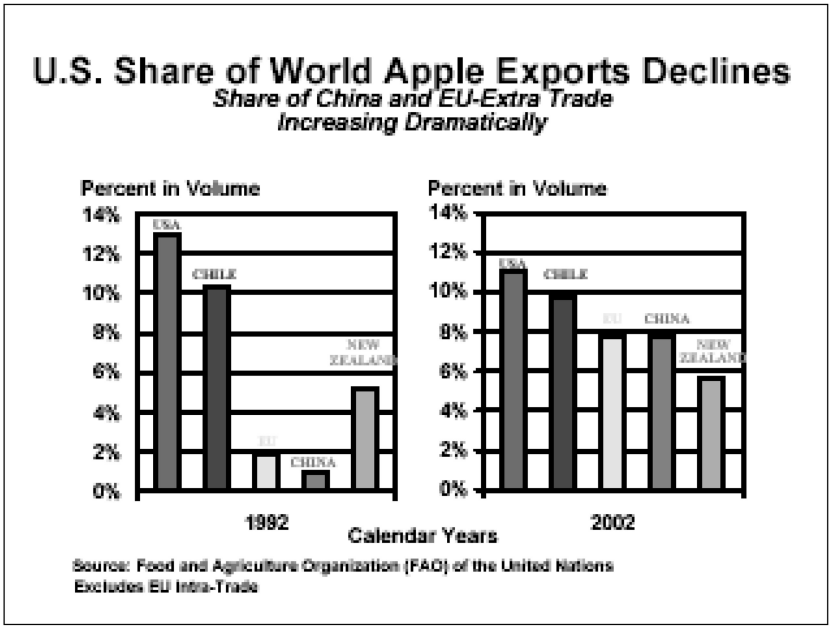
China 30 = Yield target to be achieved in the near future in China
Source: Global Apple Study, Jim Du Bruille, Wenatchee Valley College, 2004.

Chinese Fresh Apple Exports Displace U.S. Exports in Third Country Markets

As the Chinese apple industry expanded in the 1990s, fresh apple exports remained relatively constant at approximately 180,000 metric tons. However, as the Chinese industry improved its fresh apple quality and invested in improved infrastructure, exports grew at an impressive rate. Chinese fresh apple exports are expected to more than have tripled from 2004 to 2004 forecast levels, growing from 281,851 to 850,000 metric tons. This is equal to the combined total apple production in states of Michigan and New York.

China has increased its export capability and is now a major competitor with the United States in many South East Asian markets. Additionally, China has gained access to the Canadian and EU markets where Chinese apples are competing successfully with domestic fresh apples in those countries.





China's Phytosanitary Compliance is Unreliable

In 2004, shipments of Ya pears to the U.S. and Canadian markets were suspended because of interceptions of an exotic species of *Alternaria*, which is not present in the United States or Canada. Additionally, exports of Chinese apples from Shaanxi Province were suspended in 2004 because of multiple interceptions of mites and a lepidoptera pupa. These examples indicate that China does not have the capability to reliably prevent export of exotic pests and diseases that can threaten the U.S. apple industry.

Chinese Intellectual Property Infringement

U.S. apple exporters report examples of pirating of intellectual property through the unauthorized use of trademarked brands and logos by Chinese apple exporters. This practice intentionally misleads customers, places U.S. apple exporters at a disadvantage in important markets and must be stopped. Several examples are attached which compare the trademarked Washington Apple logo to several trademark infringements, and a U.S. "Top Red" boxed logo (trademarked 35 years ago) to a pirated "Top Red/Whole World" label. Intellectual property rights must be enforced to halt this practice. Additional examples are available if the Commission would like to examine them.

Currency Exchange

The Chinese yuan is pegged to the U.S. dollar and currently valued at 8.28 yuan per dollar. If allowed to float, it is reasonable to expect the U.S. dollar to weaken compared to the yuan, given the substantial U.S. trade imbalance with China and the robust strength of the Chinese economy. Exports from the U.S. would be more competitive with Chinese products in China and other markets, and U.S. imports of Chinese apple juice concentrate and processed apple products would be relatively more expensive. Consequently, Chinese exports enjoy a de facto export subsidy into overseas markets. A freer-moving yuan should be instituted that reflects market forces and China's robust economy.

U.S. Apple Exports to China

The U.S. apple industry also exports fresh apples to China. In 2002, U.S. apple exports were 21,655 metric tons, and in 2003, 18,517 metric tons, according to USDA.

An unequal duty structure between the U.S. and China is of concern to the U.S. apple industry. China is in the last year of its scheduled tariff reductions that began with the nation's 2001 WTO accession. Under 2004 tariff rates, China imposes an effective 24.3 percent duty on imported apples resulting from a 10 percent duty and an added 13 percent value added tax (VAT). Fresh apples entering the U.S. from all foreign countries are assessed no duty.

Enhancing U.S. Industry Competitiveness

The U.S. apple industry recognizes the threat China poses to apple growers, apple processors and apple packers. In response to this competitive threat, the apple industry is working with the U.S. Department of Agriculture to develop and implement a national research initiative to improve the competitiveness of the domestic industry by decreasing costs and improving fruit quality. This effort seeks to identify new technologies to automate orchards and fruit handling operations, optimize fruit quality, nutritional value and safety.

The industry has identified investment in automation of fruit handling and harvesting systems, and plant breeding, genomics and genetics programs as its highest priorities for this initiative. USApple suggests that the apple industry could improve its competitiveness if the Federal Government provided greater investment in apple technology research.

China's "Invisible Hand"

The U.S. apple industry would be better prepared to compete with China if more were known about the structure and function of China's apple industry. However, attempts to find this information in China have not been fruitful. Likewise, U.S. policymakers would be in a better position to evaluate China's impact on the U.S. economy if China's economic policies and institutions were more transparent.

USApple has heard anecdotal evidence that China's apple industry benefits heavily from indirect subsidies, such as access to 1 percent interest, and favorable government policies. These allegations are difficult to prove, but equally difficult to dispel, given the general lack of transparency in China.

USApple believes the Commission could play an important role in helping define, qualify and quantify the involvement of China's government in the Chinese apple industry or how its apple industry benefits from China's unreformed banking system or currency policies.

More information about these issues will lead to a greater understanding of how well China lives up to its World Trade Organization responsibilities and where the playing field is tipped steeply in favor of Chinese industries.

USApple appreciates this opportunity to share our experiences about trade with China and looks forward to working with the Commission in the future.

U.S. Trademarked Material

Chinese Version

U.S. Trademarked Material

Chinese Version

Cochair DREYER. Thank you very much, Ms. Foster.

Gary Martin, who is the President and CEO of the North American Export Grain Association. Welcome, Mr. Martin.

STATEMENT OF GARY C. MARTIN
PRESIDENT AND CHIEF EXECUTIVE OFFICER
NORTH AMERICAN EXPORT GRAIN ASSOCIATION

Mr. MARTIN. Thank you and thank you for again having the opportunity to address the Commission, and thank you for accepting my written submission. I will try to be brief and get to the point.

From the perspective of the U.S. grain and oil seed export industry, the bulk trade, if you will, China is one of our top priority growth markets, and because its population and economic growth is so significant, it is a major influence on many related areas and markets that we're concerned with. We see a successful Chinese effort to meet its WTO commitment as critical to the future of the WTO and to the U.S. grain and oil seed export industry.

In many ways, many would measure U.S. agricultural export trade to China as a success. In five years, a move from around $2 billion worth of trade to well over $6 billion, almost $7 billion worth of trade is quite significant. Just in this past year, we've seen some significant numbers in new commodities or relatively new commodities like wheat and expansion in cotton.

However, China is now more than halfway through its commitment phase-in period, and at this time, China should have graduated from early implementation period efforts. China has made progress in important areas, particularly in tariff reduction and revising existing laws and drafting and passing new ones to comply with its WTO requirements. It has also moved forward in educating its officials and companies about WTO obligations, and we should recognize China for these efforts, and they have resulted, again, in tangible increases in market access for U.S. agricultural products. Given the sweeping nature of the Chinese commitments in December of 2001, this sort of progress was expected.

I want to point out that the elevated meetings between U.S. and Chinese officials have made significant progress in several lagging areas of implementation. However, U.S. agriculture interests have expressed and should continue to express growing concern regarding progress of Chinese WTO implementation.

Today, I want to focus on two specific areas where China fails to meet it obligations: first, while China has eliminated and reduced tariff barriers, the benefits from these actions can be quickly offset by continued expansion and use of nontariff barriers that restrict trade into China, create significant marketplace uncertainty and discourage foreign investment. And second, we are very concerned with the failure of China to eliminate practices that result in significant export subsidies for agricultural products, particularly corn.

With regard to nontariff trade barriers, among the agricultural restrictions that China imposes are additional standards and actions on imports of agricultural products, all, I think, intended to manage trade that are first applied without prior notice or geographic consistency; second, fail to provide for comment period and time provisions for trading partners to institute practices to readily comply; third, encourage and support Chinese firms to avoid con-

tractual commitments; fourth, inappropriately discriminate against specific private entities through broad-based imposition of company specific trading bans, blacklisting; and finally, fifth, result in unjustified management and delay of issuance of permits for quarantine inspections, essentially import permits. And they do this all for political or other economic reasons, again, to manage trade.

The soybean trade, in particular, has noted significant restrictions on export products to China. Now, I should note that our soybean trade is one of our real highlights in expansion. China needs soybeans. In the growth in their protein consumption; their population improves its diet is quite significant: $1 billion to $2.5 billion or more worth of trade in just four or five years.

However, after the quotas were removed in 1999, we think the Chinese government continues to control and manage import volume through what we think are WTO-inconsistent methods such as AQSIQ; that's the Agricultural Administration of Quality Supervision, Inspection and Quarantine of China. AQSIQ issuance of permits has resulted in significant commercial uncertainty and, in some cases, has placed U.S. foreign investment in the Chinese agriculture sector at risk.

I think we should acknowledge the impacts of such inappropriate governmental action. My association along with the National Oil Seed Processors Association here in the United States and similar associations in Argentina and Brazil are very concerned about the regulatory and enforcement actions of Chinese authorities like AQSIQ.

We are ultimately concerned that the uncertainty that results from the enforcement by these officials results in a lack of contract sanctity and greatly reduces the predictability of trade with China. Contract integrity and predictability prior to shipment of commercial and official acceptance of commodities upon arrival are overarching prerequisites to successful agricultural commodity trade.

It is obvious that a number of factors influence defaults and predictability of trade. In the case of China, practices that appear to be put in place to manage trade flows that are not consistent with WTO obligations are a major contributor to the lack of predictability and lead, in some cases, to that lack of contract performance.

While the precise mechanism used by the government of China to manage imports has a tendency to change quickly, last year, I was talking about a different method, I want to point out a recent notice from AQSIQ that articulates and codifies inappropriate regulatory authority; in fact, in my experience, it codifies regulatory actions that were taken 25 years ago.

AQSIQ Decree 73 unilaterally imposes new and additional standards to imports of all plant and animal agricultural products and expressly rejects the sanctity of international sampling and testing procedures that have been developed and respected over time. Chinese issuance of this new measure, items on handling and the review and approval for entry of animal and plant quarantine, was not notified to the WTO and maintains the requirement that quarantine import permits, QIPs, be approved prior to signing contracts.

This is of significant concern to all U.S. agricultural exporters. The measure provides AQSIQ with blanket authority to annul or void import permits in the case of a government-issued warning or ban that also requires quarantine requirements specified in these quarantine import permits be written into contracts.

AQSIQ's Decree 73 further requires exporters to assume the risk of noncompliance with Chinese laws of Chinese importers. It also creates a zero tolerance level for genetically modified organisms. The quarantine import permit applications require identification of supplier, and in some cases, that's an impossibility, particularly in the bulk fungible commodity trade.

And finally, I would repeat: the arbitrary revocation of import permits at any time in the logistic stream is a serious problem. It is very difficult to estimate the costs and other implications of these sorts of official actions, and it should be made clear that trade continues as well as investment continues under these uncertain conditions.

It is, however, occurring at higher risk premiums built into existing contracts. Just for example, the potential holdup costs from such circumstances are substantial. My industry in particular relies on bulk cargo shipments, 50,000 ton vessels at a time. The redirecting of such a vessel or charges on such a vessel at port can easily add up to millions of dollars; that's per shipment.

It's also important to recognize the impact of increases in market volatility that result in even short-term disruptions of trade. The recent problems with shipments of soybeans from South America have had considerable secondary effects on our markets in the United States. Rejection of products from Brazil and Argentina sent the U.S. market into a tailspin in terms of price declines, $7-plus soybeans to $5 soybeans and created an unexpected glut of additional product in the world market.

Our consistent experience is that contrary to assurances by the Chinese government, the short-term disruption of trade that results from a combination of interest in managing trade and the authority described in measures like Decree 73 is not only expensive but can result in serious impact on the reputation of the market as being unreliable.

The remedy for these AQSIQ and other administrative related problems, we believe China should provide immediately provide for changes in activities that restricts actions to import quarantine procedures, so they are science-based and compliant with WTO as well as other international conventions and should not impose delays, uncertainties or commercially discriminatory or commercially unrealistic requirements that inhibit free trade.

We further think the approvals and the import requests should be made in a timely and commercially realistic manner and a process and communication that assures that all formalities transparent should be implemented immediately.

The second area, export subsidies, I think, is something we have also been talking about for several years. Since China joined the WTO, we've continued to see reluctance by Chinese officials to comply with WTO rules and abide by the obligations set forth in the accession agreement as it applies to subsidies and preferences to agricultural product exports.

The WTO illegal use of export subsidies and discrimination against imports continued to adversely affect, in particular, U.S. feed grain producers and exporters. Chinese administrative control over pricing and other nontransparent practices often make it difficult to identify and track subsidy practices; nevertheless, today, there exist two distinct areas of export subsidy for corn that can be identified: first, applying a value added tax to imports and then rebating it for exports, and second, price management on acquisition costs to entities that do export, and that's even added to by additional measures that provide for subsidies. We just heard of last week a subsidy where the exports of corn were not charged construction fees on railroad rates to move it to port.

It is in the best interests of China as a major agricultural importer and global trader of agricultural goods to meet its WTO obligations and improve the quarantine import process as well as eliminate agricultural product export subsidies. An absence of product in this regard will lead the need for WTO dispute settlement cases. Recognizing that much has been accomplished to date, I would urge the governments of China and the United States to press aggressively forward in their efforts to work collaboratively to reduce unjustified barriers to agricultural imports and identify subsidies that can be eliminated.

I also want to point out the importance of working with other nations, in particular with respect to the technical measures and the phytosanitary barriers that China erects. With a market that is as large and influential as China, an internationally consistent approach to technical issues that are addressed by the WTO sanitary and phytosanitary agreement and that impacts all suppliers will greatly enhance the success of our efforts.

China's entry into the WTO brings with it a reciprocal responsibility of adhering to its contractual responsibilities, given the extraordinary market privileges inherent in WTO membership. China's WTO membership provides for new and expanded trading opportunities that result in a significant and immediate market growth for China in much of the world's developed markets. I want to urge our joint actions continue and we work to expand common understanding and improve conditions of trade.

In the event of disputes, we should all work to assure commercial arbitration awards are honored. In China, regulatory measures must meet WTO standards; necessary financial controls must exist; financing must be provided to allow private industry in particular to perform on contracts and export subsidies must be identified and eliminated.

Thank you. I look forward to our conversation.

[The statement follows:]

Prepared Statement of Gary C. Martin
President and Chief Executive Officer
North American Export Grain Association

Thank you for the opportunity to again address the Commission with regard to China's compliance with the commitments made in connection with its accession to the World Trade Organization (WTO). NAEGA, established in 1912, is a not-for-profit trade association comprised of private and publicly owned companies and farmer-owned cooperatives involved in and providing services to the bulk grain and oilseed exporting industry. NAEGA member companies ship practically all of the bulk grains and oilseeds exported each year from the United States. For the North

American Export Grain Association, my primary responsibility is to achieve a mission that seeks to promote and sustain the export of grain and oilseeds from the United States. Our objective of working jointly to foster a grain and oilseed export industry that provides the best environment for all stakeholders—from producer to consumer, guides our activity. Importantly our mission and this objective are founded in NAEGA Membership's commitment:

> "to integrity in a commercial environment supported by free trade and competition in commerce involving grain and other agricultural products; to eliminate abuses relative thereto; to eliminate or secure freedom from unjust, unlawful and oppressive exactions in commerce; to promote certainty in the customs and usages of trade and commerce; to promote a more enlarged and friendly exchange among persons engaged in business; and to cooperate to the fullest extent practicable with all governments, governmental departments, governmental and private corporations, partnerships, associations and groups with an interest in providing for global food security and efficient international commerce."

NAEGA acts from offices in Washington D.C., and in markets throughout the world.

From the perspective of the U.S. grain and oilseed export industry, China is one of our top priority growth markets and because its population and economic growth is a major influence in many related markets. We see a successful Chinese effort to meet its WTO commitments as critical to the future of the WTO and the U.S. grain and oilseed export industry.

China is now more than half-way through its commitment phase-in period. At this time China should have graduated from the early period of its implementation efforts. China has made progress in important areas, particularly in tariff reduction; revising existing laws and drafting and passing new ones to comply with its WTO requirements; and educating its officials and companies about its WTO obligations. China should be recognized for its efforts that have resulted in tangible improvements in market access. Given the sweeping nature of China's December 2001 market access commitments, this progress was to be expected.

The elevated meetings of the U.S. and Chinese officials have made significant progress in several lagging areas of implementation. However, U.S. agricultural interests have expressed and should continue to express growing concern regarding the progress of China's WTO implementation efforts.

China's WTO commitments to reduce both tariff and non-tariff barriers in the agricultural sector have met with mixed results. There has been welcome progress in some key areas such as tariff reductions. Unfortunately, however, many non-tariff barriers continue to limit the progress anticipated from China's WTO membership.

China has made some progress in addressing a range of problems with the implementation of the promised TRQ system, including a lack of transparency, delay in the announcement of quotas, granting of insignificant and uneconomic quotas, imposition of restrictions that are not required of domestic producers or merchants, and other unnecessary restrictions.

China has also removed, to a degree, uncertainty regarding biotech regulations and the issuance of permanent safety certificates for biotech products. The progress on certification of U.S. genetically modified agricultural exports included a political commitment by the Chinese to not disrupt U.S. soybean exports.

Today I would like to focus on two specific areas where China fails to meet its WTO obligations. First, while China has eliminated or reduced some tariff barriers, the benefits from these actions can be quickly offset by continued non-tariff barriers that restrict trade into China, create significant marketplace uncertainty, and discourage further foreign investment. Second, we are concerned with the failure of China to eliminate practices that result in significant export subsidies for agricultural products, particularly corn.

Non-Tariff Trade Barriers

Among the agricultural product restrictions that China imposes are additional standards and actions on imports of agricultural products that:

1. Are applied without prior notice and geographic consistency;
2. Fail to provide for comment period and time provisions for trading partners to institute practices to readily comply;
3. Encourage and support Chinese firms to avoid contractual commitments;
4. Inappropriately discriminate against specific private entities through the broad-based imposition of company-specific trading bans (blacklisting); and
5. Result in unjustified management and delay of the issuance of Permits for Quarantine Inspections to control imports for political or economic reasons.

Soybean traders in particular have reported significant restrictions on exports of products to China stemming from the General Administration of Quality Supervision, Inspection and Quarantine of the People's Republic (AQSIQ). Although China removed soybean import quota control in 1999, we believe the Chinese government continues to control import volume through WTO-inconsistent methods such as the use of the AQISQ import permits. AQSIQ issuance of permits has resulted in significant commercial uncertainty and, in some cases, has placed U.S. foreign investment in the Chinese agricultural sector at risk.

We should acknowledge the likely impacts of such inappropriate governmental actions. As I hope you are aware, NAEGA, the National Oilseeds Processors Association and similar trade associations representing from Brazil and Argentina are very concerned about the regulatory and enforcement actions of the Chinese authorities. We are ultimately concerned by the uncertainty that results from enforcement of official requirements that: do not recognize the need to facilitate trade; are not based on science; and lack necessary transparency and advance notice, encourage a lack of contract sanctity and greatly reduce the predictability of trade. Contract integrity and predictability, prior to shipment, of the commercial and official acceptance of commodities upon arrival are overarching prerequisites to successful international agricultural commodity trade.

It is obvious that a number of factors influence defaults and the predictability of trade. These include cultural and ethical issues ingrained in business practices or customs regarding contractual obligations. Other problems include restrictive currency regulations that inhibit hedging and in some cases outright prohibitions against hedging, and lack of familiarity with international trading rules and arbitration procedures along with the consequences of failing to comply with these universally acceptable precepts. Importantly all trade participants must be adequately financed to insure contract integrity can be maintained. Further, since the Chinese government determines the credit policy of China any denial of credit to a private sector has a direct impact on the efforts to perpetuate sound commercial practice and contract sanctity. In the case of China, practices that appear to put in place to manage trade flows and that are not consistent with WTO obligations are a major contributor to a lack of predictability and lead, in some cases, to a lack of contract performance.

While the precise mechanism used by the Government of China to manage imports has a tendency to change quickly, I would like to point out a recent notice from AQSIQ that articulates and codifies inappropriate regulatory authority.

AQSIQ Decree 73, we fear, unilaterally imposes new and additional standards to imports of all plant and animal agricultural products and expressly rejects the sanctity of international sampling and testing procedures that have been developed and respected over time. China's issuance of the new measure, "*Items on Handling the Review and Approval for Entry Animal and Plant Quarantine*," was not notified to the WTO and maintains the requirement that Quarantine Import Permits (QIP's) be approved prior to signing contracts. This is of significant concern to all U.S. agricultural exporters. The measure provides AQSIQ with blanket authority to annul or void import permits in the case of a government issued warning or ban and also requires quarantine requirements specified in QIP's be written into contracts.

On June 16, 2004, China's quarantine and inspection agency, the General Administration of Quality Supervision, Inspection, and Quarantine (AQSIQ), issued revised regulations for importation of soybeans and other products subject to the quarantine process. The decree became effective on July 1, 2004. The new regulations, known as Decree 73 (Items on Handling the Review and Approval for Animal and Plant Entry Quarantine), were not properly notified to the World Trade Organization (WTO). To date, China has yet to properly identify, as well as support scientifically, the phytosanitary risks that require implementation of such regulations. In our estimation, Decree 73 places exporters in an unfavorable commercial position relative to domestic producers in China.

While Decree 73 extended the validity of quarantine import permits (QIP) from 3 months to six months in accordance with an agreement reached during the April 2004 meetings of the U.S.-China Joint Commission on Commerce and Trade (JCCT), Decree 73 included additional burdensome requirements that constrain U.S. exporters' ability to export grain and oilseeds to China, and that create uncertainty for U.S. producers.

Following are the specifics of our concerns with AQSIQ Decree 73:

1. *Requires exporters to assume the risk of non-compliance with Chinese laws.* Decree 73 requires all contracts for importation of soybeans and other products to include Chinese inspection and quarantine requirements as a contract term. Further, the contract must stipulate that entry of goods is dependent on

whether the goods comply with relevant Chinese laws and food safety regulations. Such requirements are inconsistent with standard international trading practices in that exporters of agricultural products are forced to assume the risk of non-compliance with foreign standards. Even Chinese exporters do not face those requirements in export markets. Under an international commercial sale, the quality, condition, and specification of the goods are determined when the goods are shipped, and therefore, the risk is transferred from the exporter to the importer upon shipment of the product, not upon discharge in the foreign port. Under these requirements, the importer can reject shipments if the Chinese authorities determine the product does not comply with Chinese laws, creating a great deal of uncertainty for U.S. suppliers.

2. *Creates zero tolerance level for GMO presence.* Decree 73 requires that a safety certificate issued by the Ministry of Agriculture in China accompany all products of Genetically Modified Organisms. The Ministry only makes certificates available for GMO products that are approved by the Chinese government. The requirement in essence creates a zero-tolerance requirement for any shipments that contain trace elements of non-approved GMO products. Zero-tolerance standards that apply to many commercially produced agricultural commodities are impossible to meet. The failure to provide for the adventitious presence of GMO events in any shipment results in the strong possibility that trade will be prohibited.
3. *QIP applications require identification of supplier.* It is not practical to require the importer to list the supplier at the time of application because often the supplier is changed after the QIP is issued. The exporter is the contracting party with the Chinese importer, not the supplier.
4. *Allows for arbitrary revocation of QIPs.* Chinese authorities can, at any time, invalidate an import permit in the event of any announcement by the government that forbids entry of the product. Basically, this regulation provides Chinese authorities the license to issue scientifically unfounded bans on U.S. exports of agricultural products, which runs counter to China's obligations under the WTO SPS Agreement and the GATT 1994.

While it is difficult to estimate the costs and other implications of these sort of official actions it should be made clear that while trade and investment is occurring under more uncertain conditions, it is occurring with higher risk premiums built into the existing contracts. I think most of us are aware of one of the most obvious costs when regulations prevent vessel discharge. The potential hold-up costs from such circumstances would be substantial. Depending on the size of cargo and port of import, demurrage charges from re-directing a vessel to an alternative destination, quality deterioration and other costs could add up to millions of dollars per held-up vessel.

It is also important to recognize the impact of increases in market volatility that result in even short term disruptions of trade due to inappropriate official enforcement actions. In the U.S. we certainly appreciate the assurances that Chinese officials have provided to our senior U.S. trade officials that Decree 73 will not disrupt U.S. soybean exports to China. However assurances do not remove the risk created by the existence of regulations like Decree 73. For example, the recent problems with shipments of soybeans from South America have had secondary effects on our marketing. Rejection of products from Brazil and Argentina send the U.S. market into a tailspin in terms of price declines created by an unsuspected glut of additional product in the world market. Our consistent experience is that, contrary to such assurances, the short term disruption of trade that results from the combination of an interest in managing trade and the authority described in Decree 73 is not only expensive but can result in the reputation that a market is unreliable. As I discussed earlier, the avoidance of this reputation is important to all market participants.

In addition to the concerns with Decree 73, U.S. interests are harmed by the failure of China to utilize the International Plant Protection Convention and China's use of "zero tolerance" standards that are neither science based nor practical. Fundamentally, China needs to adhere to the WTO Agreement on the Application of Sanitary and Phytosanitary Measures. These various non-WTO complaint measures are causing serious interruptions in cargo contracting and delivery thereby adding unnecessary risk to doing business with Chinese customers and limiting sales of many U.S. agricultural products. The near and long term costs of such actions directly impact U.S. farm income.

As a remedy for these AQSIQ related problems, China should provide for:

- Changes in activities that restrict actions to import quarantine procedures that are science based and compliant with WTO and international conventions and

should not impose delays, uncertainties, or commercially discriminatory or commercially unrealistic requirements that inhibit free trade.
- The approvals of import permit requests in a timely and commercially realistic manner.
- Process and communication that ensures that all formalities are transparent, with clear timelines openly promulgated.

Export Subsidies

Since China joined the WTO, we have continued to see reluctance by Chinese officials to comply with WTO rules and abide by the obligations set forth in China's Accession Agreement as they apply to subsidies and preference to agricultural product exports. The WTO-illegal use of export subsidies and discrimination against imports continues to adversely affect U.S. feed grain producers and exporters. Chinese administrative control over pricing and other non-transparent practices often make it difficult to identify and track subsidy practices. Nevertheless two distinct areas of export subsidy for corn can be identified:

Applying the Value Added Tax (VAT) to Imports

It is assumed that upon importation, a VAT of 13% will be applied to the C&F value of corn (approximately $20/mt). However, PRC domestic corn that ends up in the feed channel has no VAT directly applied (some argue it is applied in the form of VAT on commodity). Recent information from China confirms the VAT is refunded on corn exports. These tax refunds vary but it is clear they often exceed the applied VAT. The fact that traders believe this tax will be applied decreases the likelihood of filling the import TRQ unless world prices are correspondingly lower. And, if the 13% VAT actually is applied, it would certainly be at least a partial violation of WTO principles, if not completely a violation. (In July, 2004, the United States resolved a similar dispute with China in the WTO over semiconductors.)

Additionally, if the Chinese private trade is assessed the VAT on grain imports while state trade imports are VAT-exempt, the private trade clearly would be at a significant price disadvantage in the market. In fact, the state trade which is likely further supported by administratively determined price preferences can completely crowd out any private sector importing activity and act in a non-transparent manner to export allocated amounts of corn.

Direct Export Subsidies

Due to China's export policy in 2003, it was able to ship a record 16.4 million metric tons of corn into the international market, with much of that volume displacing U.S. sales. While a reduced crop lead to a significant reduction in corn exports in 2004, we anticipate a return in 2005 to an export regime that provides for export prices that are lower than domestic price. Further there again is strong evidence that China will export corn on a non-commercial basis with the aid of export subsidies. China's explanation of lowering the price of corn for export through the practice of rebating the VAT is not consistent with what is actually happening given that the VAT is not collected to begin with, or collected fully, as outlined above. However, the overt use of export subsidies has been widely published in the Chinese press and is common knowledge among traders. Again, this is a direct violation of China's obligations under the Accession Agreement.

Recent reports confirm the expectation that China's corn exports will experience a partial revival this year thanks to the central government's policy adjustment. While USDA is estimating 4 million metric tons of Chinese corn exports this year, recent projections from China indicate an export program of 5 million tons. That would be double last year's total corn exports of 2.32 million tons. The China National Grain and Oils Information Centre predicted China's corn harvest to rise 14 percent to 131.7 million tons in 2004 from 2003, after the area sown with the crop expanded 6 percent to 25.6 million hectares. China's demand for corn is projected at 126 million tons for the crop year through September 2005, which means this marketing year will be the first time in five years that production exceeds demand.

The situation means China must increase its exports; doing so with the high domestic price level established to support farm income is impossible without government support. Reports from late last week said the government is considering more policies to boost exports in the wake of a recent tax rebate increase. Indications are the Chinese government has increased the base price for calculating a rebate of a 13% value added tax to 1,100 yuan (US$133) per ton, from the former base price of 860 yuan (US$104). In China, the value on which the 13 percent is refunded is not based on actual FOB (free-on-board) prices but on fixed prices set by the government, which are usually lower than the FOB prices. The policy change meant exporters tax rebates would be increased by US$3.77 per ton.

Additional reports indicate that in order to encourage exports and increase farmers' incomes, the government may introduce more measures to support corn exports, including increasing export quotas and waiving railway construction funds in corn transportation charges. Waiving the railway construction charge will lower delivery costs from production bases to ports by 30 percent, for example 23 yuan (US$2.78) per ton in Jilin and 30 yuan (US$3.61) in Heilongiang.

The exemption of construction funds and the administrative practice of providing for acquisition costs at well below market values are a direct subsidy to corn exports.

Japan and South Korea, two of our best customers for U.S. corn are the main export destinations of subsidized Chinese corn.

Working Together to Improve Trade

In the best interest of China and international commerce, China must meet its WTO obligations and improve the import quarantine process and eliminate agricultural product export subsidies. An absence of progress in this regard will lead to the need for WTO dispute settlement cases.

Recognizing that much has been accomplished to date, I would like to urge the governments of China and the United States to press aggressively forward in their efforts to work collaboratively to reduce unjustified barriers to agricultural imports and identify subsidies so they can be eliminated.

The importance of working with other nations that serve the Chinese market for agricultural products should also be emphasized. The U.S. competes for the Chinese market in many agricultural products including soybeans. However, with a market as large and influential as China, an internationally consistent approach to technical issues that are addressed by the WTO Sanitary and Phytosanitary Agreement and that impact all suppliers will greatly enhance the success of our efforts. For products like soybeans, a multi-national strategy that adds to the joint efforts of the governments of China and the U.S. will help to ensure sufficient progress. Ultimately working to achieve international consistency on health and safety issues will support the maintenance of a level playing field for U.S. agricultural products in the Chinese market.

Market participants must acknowledge and address each of these factors. Further, the individual merchants or their trade organizations should consider undertaking a comprehensive and large-scale educational effort to familiarize the market participants and government officials with the prevailing trade rules, the protections and expectations of those rules. Governments in particular must be educated to understand the impact of regulation on trade.

China's entry into the World Trade Organization (WTO) brings with it the reciprocal responsibility of adhering to its contractual responsibilities given the extraordinary market privileges inherent in WTO membership. China's WTO membership provides for new and expanded trading opportunities that result in immediate and significant market growth in much of the developed world's consuming markets.

I want to urge our joint actions to work to expand our common understanding and improve conditions of trade. In the event of disputes, we should all work to ensure commercial arbitration awards are honored. In China, regulatory measures must meet WTO standards, necessary financial controls must exist, financing must be provided to allow industry to perform on contracts and export subsides must be identified and eliminated.

Thank you. I look forward to our ongoing discussion and any questions you may have.

Cochair DREYER. Thank you very much. That is very interesting. Lastly, we welcome Mr. Michael Coursey, member of the International Trade and Customs Law, Collier Shannon Scott. Mr. Collier, could I ask you to tell me what PLLC stands for?

STATEMENT OF MICHAEL J. COURSEY
MEMBER, INTERNATIONAL TRADE AND CUSTOMS LAW
COLLIER SHANNON SCOTT PLLC

Mr. COURSEY. Yes, it refers to a limited liability corporation.

Cochair DREYER. Thank you.

Mr. COURSEY. Thank you for inviting me here to testify today, and I have a treat for you to start out with: I this morning honed

down my 10 minute statement to seven minutes, so I think we'll be able to get right to your questions shortly.

I think I'm here to address primarily what remedies are available to U.S. agricultural producers against unfairly traded Chinese products. There are only two such laws. The first is the Section 421 action, the so-called China Safeguard Action, which authorizes the President to impose restraints on Chinese imports that are causing market disruption.

Because the President or the ITC has denied all requests to date for Section 421 relief, that law is currently viewed as a dead letter for domestic producers being injured by Chinese imports, including all agricultural producers. We are not going to see 421 cases probably in our lifetime.

The second potential remedy is the antidumping law. Virtually all Chinese agricultural products are sold here at prices that are far below what it would cost to produce the same products in a comparable market economy country such as India. This activity constitutes dumping under our law. Nevertheless, the dumping remedy is not available at this time to U.S. agricultural producers. This is because many Chinese exporters are exploiting a huge loophole in the dumping law that allows them to ship enormous amounts of product to this country and to sell them here at ruinous prices without paying any duty.

This loophole is buried in the procedures Commerce uses to conduct so-called new shipper administrative reviews of existing dumping orders. Normally, a U.S importer of a product subject to a dumping order must post with Customs a cash deposit equal to the import's declared value times the dumping rate of the foreign exporter. For example, if an import had a value of $100, and the exporter's dumping margin were 50 percent, the importer would have to post a deposit of $50 in cash with Customs before Customs would release the import.

One or two years later, sometimes more, Commerce would determine, in a regular administrative review, the exact amount by which the import was dumped. If the amount of duties calculated by Commerce equaled $50, Customs would take the deposited $50 as full payment for the duties. If the amount were greater than $50, Commerce would bill the importer for the difference or send it a refund.

The point is that a cash deposit serves as security for the government against an importer's inability or unwillingness to pay assessed dumping duties. However, an importer is not required to post cash deposits on imports from any exporter that qualifies as a new shipper. The importer, instead, may post a single entry bond equal to the cash deposit that otherwise would be required.

There currently are five dumping orders against Chinese agricultural products: fresh garlic, honey, canned mushrooms, fresh crawfish tail meat, and as we heard earlier, frozen concentrated apple juice. My firm represents the domestic producers of the first three products. Our clients uniformly believe that the orders that they fought for currently offer them zero protection against dumped Chinese imports. These orders have been eviscerated by the new shipper bonding privilege.

Here is what happens: a newly-created exporter in China makes a single, low-quantity, high-price sale to the United States and then asks Commerce to subject that sale to a new shipper administrative review. During the 10 to 18 month pendency of the review, the new shipper exports huge amounts to the United States, where its U.S. importers don't have to post any cash deposits. While the importers are instead supposed to post bonds, Customs for years did not require importers to do so, and it is still not clear whether Customs is doing so today.

The bonding privilege ends when Commerce completes the new shipper review, but Commerce will not calculate the amount of duties owed on imports that entered during the review for two or three or sometimes more years. When Customs finally issues a huge bill for the duties, it finds that the importer has disappeared. Where Customs has obtained a bond, the issuing surety company typically balks at fulfilling its staggering obligation and begins an extended litigation process designed to forever postpone its day of reckoning.

The bottom line is that millions of pounds of dumped Chinese agricultural product have been dumped into the U.S. market, but dumping duties owed on those imports are never paid. Consider the dumping order on fresh garlic from China, one of the garlic producers in California are my firm's clients and have been so for 12 years. The first chart attached to my testimony shows that Chinese imports, and I don't know if everyone has the last two pages, Chinese imports spiked from virtually nothing in the early 1990s to 54 million pounds in 1993.

Commerce initiated a dumping investigation at that time and entered a final dumping order in November of 1994. Imports quickly fell back to less than a million pounds a year through the year 2000. In January 2001, Commerce initiated its first new shipper review under the Chinese garlic order. The exporter in that review shipped over 7 million pounds of garlic to the United States in that year, 2001. You can see that from the chart.

In 2002, there were three new shipper reviews in progress. Those three exporters shipped 42 million pounds of garlic to the United States. Imports increased to 54 million pounds in 2003 and to an incredible 80 million pounds last year. This surge of Chinese garlic imports keeps increasing, despite, ironically, Customs' continued finding in their reviews that the Chinese exporters are engaging in massive dumping.

The new shipper bonding privilege is also allowing importers to avoid paying huge amounts of dumping duties. Not only is product coming in, but duties aren't being paid. According to Customs FY 2004 Byrd Amendment report, came out in early January, Customs last year failed to collect $24.6 million in final dumping duties that were billed under the China Garlic Order, $24.6 million. Customs collected in the last fiscal year $175,000.

The upshot here is that for every dollar Customs should have collected, they collected less than a penny. The same distressing pattern exists for the canned mushroom and crawfish tail meat dumping orders, as chart two to my testimony shows. In FY '04, Customs collected only $353,000 in duties under the canned mushroom order, but it failed to collect $18.1 million.

Get ready for the next one: crawfish tail meat. Customs did collect $8.2 million in duties, but it failed to collect a staggering $170 million. Adding the $2 million Customs failed to collect under the honey from China order and the apple juice order brings the total amount of uncollected duties for agriculture products from China to $215 million last year. This is 95 percent of all of the uncollected duties under all of the dumping orders against China for last year and 83 percent of all the uncollected duties for all dumping orders on all countries.

When Congress added the new shipper bonding privilege to the dumping law in 1995, it mistakenly believed that this was required by the WTO. This means that the bonding privilege can now be repealed without fear of China successfully prosecuting the United States at the WTO. Ironically, China itself does not offer the bonding privilege in new shipper reviews under its dumping laws. China instead requires that all security against potential dumping liability be posted in cash. China, thus, would be in no position to pursue a WTO claim against the United States for repeal of the bonding privilege.

Late last year, Congress almost succeeded in harnessing the new shipper bonding privilege. After the election, the Senate passed a bill by unanimous consent that would have suspended the bonding privilege for three years while the administration studied what should be done after that. The bill died, however, when the House Ways and Means Committee failed to move it to the floor.

In sum, let me say no domestic producer will get meaningful relief under the dumping law from Chinese agricultural imports until the new shipper bonding privilege is repealed. My extremely discouraged clients will likely walk away from their hard-won dumping orders unless Congress corrects this problem.

Thank you.

Cochair DREYER. Thank you very much. We appreciate that. Your statement is really interesting. I think I will go over it carefully and find where the missing three minutes are.

Mr. COURSEY. I guess I spoke a little too slowly or a little too quickly this morning when I was doing the math.

[The statement follows:]

Prepared Statement of Michael J. Coursey
Member, International Trade and Customs Law
Collier Shannon Scott PLLC

Good morning. My name is Michael Coursey, and I am a partner with Collier Shannon Scott, where I specialize in representing U.S. agricultural producers in international trade disputes. I have over 20 years experience in trade matters, including my service in the second term of the Reagan Administration as the head of Commerce's office of antidumping and countervailing duty investigations. I am honored to be testifying before the Commission.

There are only two trade laws U.S. producers can use to fight unfairly traded agricultural imports from China. The first is the Section 421 action, which authorizes the President to impose quotas or other remedies on Chinese imports that are causing market disruption. All but one of the domestic industries that have tried to win relief under Section 421 have been turned down by the President, and the one industry that was not was turned down by the International Trade Commission. Section 421 is currently viewed as a dead letter for *all* domestic producers being injured by Chinese imports, including all agricultural producers.

The second potential remedy is the antidumping law. Virtually all Chinese agricultural imports to this country are sold here at prices that are far below what it

would cost to produce the same products in a comparable market economy country, such as India. Such activity constitutes dumping.

Nevertheless, the dumping remedy is *not* available at this time to U.S. agricultural producers. This is because many Chinese exporters are exploiting an unfortunate loophole in the dumping law that allows them to ship enormous amounts of products to this country, and to sell them at ruinous prices, without ever paying any dumping duty. This is the case even where Commerce has found the exporters to be dumping at huge margins.

This destructive loophole is buried in the procedures Commerce uses to conduct so-called "new shipper" administrative reviews of existing dumping orders. Normally, a U.S. importer of a product subject to a dumping order must post with U.S. Customs a cash deposit equal to the declared value of the import times the dumping rate of the relevant foreign exporter. For example, if a covered import had a value of $100, and the exporter's dumping margin were 50%, the importer would have to deposit $50 in cash with Customs before Customs would release the import.

One or two years later, Commerce would determine in a regular administrative review of the dumping order the exact amount by which the import was dumped. If the amount of duties calculated by Commerce equaled $50, Customs would take the previously deposited $50 as full payment. If the amount were greater or less than $50, Customs would either bill the importer for the difference, or send it a refund.

The point is that a cash duty deposit serves as security for the U.S. Government against an importer's potential inability or unwillingness to pay the assessed dumping duty.

However, an importer is not required to post cash deposits on imports from any exporter that qualifies as a "new shipper." The importer instead may post a bond equal to the cash deposit that otherwise would be required.

There currently are five dumping orders against Chinese agricultural products—fresh garlic, honey, canned mushrooms, fresh crawfish tailmeat, and frozen concentrated apple juice. My firm represents the domestic producers of the first three products. Our clients uniformly believe that the orders they fought for and won currently offer them zero protection against dumped Chinese imports. These orders have been eviscerated by the new shipper bonding privilege.

Here is what happens. A newly-created exporter in China makes a single low quantity, high priced sale to the United States, and then asks Commerce to subject that sale to a "new shipper" administrative review. During the pendency of the review, which typically lasts from 10 to 18 months, the new shipper exports millions of pounds of product to the United States, where its U.S. importers don't have to post any cash deposits on these imports. While the importers are instead supposed to post bonds, Customs for years did not require importers to do so. It is still not clear whether Customs is doing so today.

The bonding privilege ends when Commerce completes the new shipper review. But Commerce will not calculate the amount of dumping duties owed on the imports that entered during the review for two to three years. When Customs finally issues the bill for the dumping duties calculated by Commerce, it typically finds that the importer has disappeared. Where Customs has, in fact, obtained a bond, the issuing surety company typically balks at fulfilling its obligation, given the huge amount at stake, and begins an extended protest and litigation process designed to forever postpone its day of reckoning.

The bottom line is that millions of pounds of dumped Chinese agricultural product have been sold into the U.S. market, but the dumping duties owed on those imports are never paid.

Consider the dumping order on fresh garlic from China. My first chart shows that Chinese imports spiked from virtually nothing in the early '90s to 54 million pounds in 1993. Commerce initiated its dumping investigation in January '94; imposed a 376% duty on all Chinese exporters in May of that year; and entered a final order against the imports in November '94. Imports quickly fell back to less than a million pounds a year through 2000.

In January 2001, Commerce initiated its first new shipper review under the Chinese garlic order. That exporter by itself shipped over seven million pounds of garlic to the United States that year. In 2002, there were three new shipper reviews in process. Those three exporters collectively shipped 42 million pounds of fresh garlic to the United States.

Imports increased to 54 million pounds in 2003—the same amount that was shipped ten years earlier, that then caused the domestic producers to seek protection under the dumping law. Imports in 2004 are estimated to have been an incredible 80 million pounds. This surge of imports keeps increasing despite Commerce's continued findings that the Chinese exporters are engaging in massive dumping.

The new shipper bonding privilege is also allowing unscrupulous importers to avoid paying the huge amounts of dumping duties that Commerce ultimately determines are owed on imports from new shippers. According to Customs' report on its Byrd Amendment activities for FY '04, Customs last year failed to collect $24.6 million in assessed dumping duties billed to importers under the China garlic order. Further, Customs actually collected only $175,000 in assessed duties under that order. In other words, for every dollar of assessed duties Customs failed to collect, it collected only one-seventh of one cent.

The same distressing pattern exists for the canned mushroom and crawfish tailmeat dumping orders, as my Chart 2 demonstrates. In FY '04, Customs collected only $353,000 in duties under the canned mushroom order, but failed to collect $18.1 million. For crawfish tailmeat, Customs last year collected $8.2 million in duties, but failed to collect a staggering $170.1 million. Adding in the $2 million Customs failed to collect on the honey and apple juice orders brings last year's uncollected duties total for the five dumping orders on Chinese agricultural imports to $215 million. This is 95% of the $244 million in uncollected duties on all China orders, and 83% of the $260 million in uncollected duties on all trade orders from all countries.

When Congress added the new shipper bonding privilege to the dumping law in 1995, it mistakenly believed that this was required by the WTO. This means that the bonding privilege now can be repealed without fear of China successfully prosecuting the United States at the WTO. The supreme irony is that China itself does not offer the bonding privilege in new shipper reviews under its dumping law; China instead requires that all security against potential dumping liability be posted in cash. China thus would be in no position to pursue a WTO claim against the United States for repeal of the bonding privilege.

During the past year, the domestic agricultural industries mentioned above almost succeeded in convincing Congress to harness the new shipper bonding privilege. Late in the session, the Senate passed by unanimous consent a bill which would have suspended the bonding privilege for three years while Commerce, Customs and the USTR prepared a report on the issue for Congress. The bill, however, died when the House Ways and Means Committee failed to move it to the floor.

The bottom line is that no domestic producer will get meaningful relief under the dumping law from unfairly-traded agricultural imports from China until the new shipper bonding privilege is repealed. My extremely discouraged clients have all but given up on their hard-won dumping orders, which they will likely walk away from unless a legislative correction is made very soon.

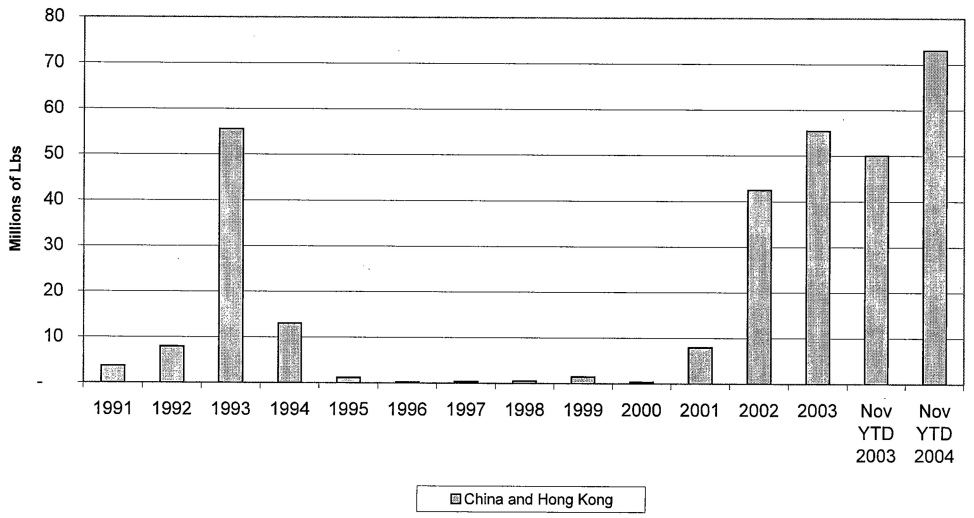
Thank you.

CHART 1

U.S. Imports of All Fresh or Chilled Garlic

Annual 1991-2003 and November Year-to-Date 2003, 2004

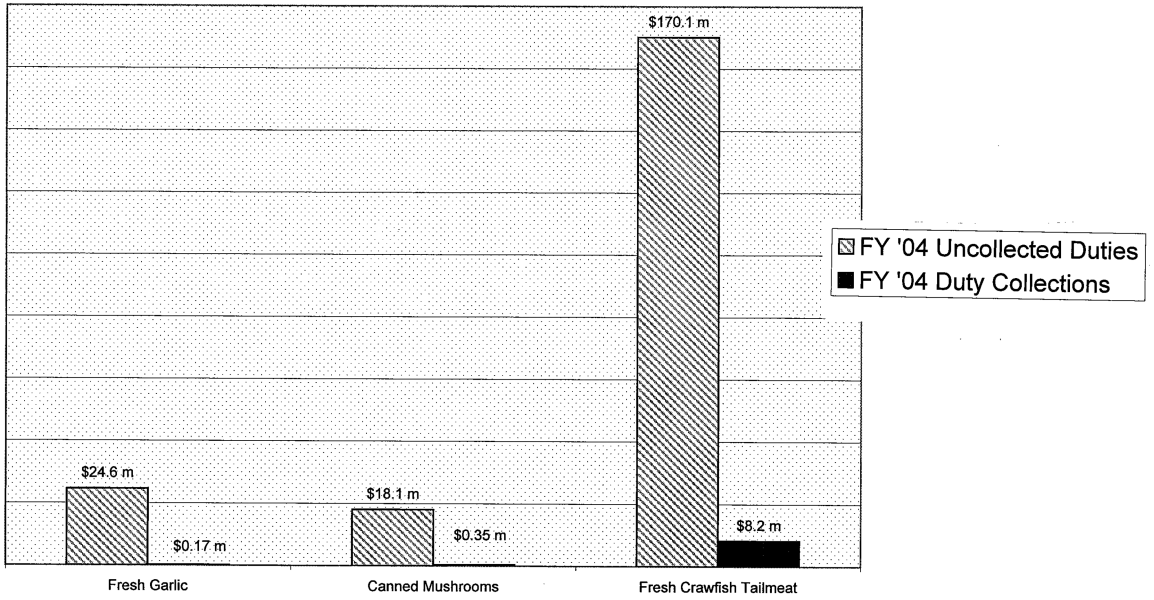
Quantity in Millions of Pounds



Source: U.S. Commerce Department Import Statistics

CHART 2

FY' 04: CUSTOMS COLLECTED AND UNCOLLECTED DUTIES ON CHINA ANTIDUMPING ORDERS (millions of dollars)



Source: U.S. Customs & Border Protection, CDSOA FY '04 Annual Report, Sections I and II

Cochair DREYER. No, really very interesting.

Okay, questions? The first person on the list is Chairman D'Amato.

Panel VII: Discussion, Questions and Answers

Chairman D'AMATO. Thank you, Madam Chair. This is not the best kind of way to start the weekend is to listen to this testimony, but I guess we've got to.

We were just in Seattle a month ago, had a hearing in Seattle, and a number of these issues, all of your commodities came up in those hearings. Let me ask you a question, a series of quick questions: Mr. Coursey, it's my understanding that this situation has led to almost a complete destruction of the American garlic industry; is that right?

Mr. COURSEY. It has not been completely destroyed. This year, the fresh garlic producers—their profits going in will be close to half of what it was three years ago. It is moving into a niche market.

Chairman D'AMATO. Yes.

Mr. COURSEY. We also have, in addition to the fresh garlic industry, a dehydrated garlic industry, which is twice the size of the fresh producers. They also are just totally embattled by Chinese imports. But what you heard out in Seattle from all the other producers out there, I think you will see no one is going to file a dumping case.

Chairman D'AMATO. Why not?

Mr. COURSEY. Because of this problem: you put hundreds of thousands of dollars into an action. You win a dumping case. You win high duties, and then, nothing happens. You get—the imports continue to come in. In the case of garlic and honey, all the products we're talking about here, they keep coming. Customs doesn't collect duties. It's a waste of money. I know many of you are businesspeople. If you look at this graph, what would you do? Would you put any money in this order?

If you basically had your lawyer saying in order to fight the Chinese who are coming forward to win low margins procedurally in Washington through the administration, and it's going to cost a half million dollars, $1 million, to fight them all. Are you going to put any money in this? No. You're going to figure out how to grow something else or—so that's what's happening.

Chairman D'AMATO. Well, then, the result, the conclusion one would draw from that is that Chinese unfair trading practices can go forward and destroy American businesses without any kind of reaction.

Mr. COURSEY. Absolutely. This is a real scandal.

Chairman D'AMATO. That obviously is not the right answer. So we've got to figure out how we can do something. We'd like to work with you to figure out how to do this because it is just a completely outrageous situation.

Let me ask you, Ms. Foster: we were out in Seattle, and our understanding was that the Chinese are subsidizing their horticultural industry, heavily subsidizing their horticultural industry, and are going to be exporting apples more and more in larger and larger quantities as we go forward. Have you done any kind of pro-

jections as to what could happen, what is going to happen, say, five years down the road in terms of your business, your apple business in the United States as a result of this kind of assault, in a sense, by Chinese exporting of apples and apple products five years down the road? Do you know where you're going to be?

Ms. FOSTER. That is an excellent question, and our organization is embarking on strategic planning to help our industry answer that question, but that is probably the single most important question facing the apple industry.

There are a number of different options that people are considering, but it really goes to whether you are a large producer, packer; whether you are a small grower; and there is no sort of uniform type of producer in this country. So I can't answer you specifically, but it is a very sobering question, because we've seen what's happened with concentrate; now, we see the additional processed products entering the market, applesauce, slices in cans, dried apple products, and then, so much hinges on the prospects of fresh apple imports into this country.

Chairman D'AMATO. Yes, now, let me suggest, at the hearing we had in Seattle, I did make a proposal to both the labor organization and the business organization that testified that we would be prepared to work with them and help subsidize a study as to where the region was going to be going in the next five to 10 years. So I think that would be of some interest to you, and we should talk about that. And we haven't got a reaction from them yet about that, but we think projections as to what's going to happen in that region over the next five to 10 years right now are not available, and we ought to start think about where we're going.

Ms. FOSTER. Well, thank you, and the Northwest Horticultural Council, who I believe testified before you, is a regional member of U.S. Apple and a sister organization. Thank you.

Chairman D'AMATO. Thank you.

Cochair DREYER. Commissioner Wessel.

Commissioner WESSEL. Thank you, Madam Chair. It only took me a hearing to learn that. I appreciate everyone being here.

Mr. Coursey, I am a great fan of your work in town. You are an effective litigator who has aggressively pursued your clients' interests, and I know that they are well counseled by you for all that you have done, so I know that they appreciate it, we appreciate it as well.

Let me understand: the new shipper bill, which I believe Senator Byrd and Senator Cochran, if I remember, were the leading proponents of that last year. That passed by UC in the Senate. What held it up in the House? You have the interests; you've talked about garlic, canned mushrooms, crawfish, all well represented. Was it a question of timing or a question of energy, shall we say?

Mr. COURSEY. Commissioner, first, let me say that's the nicest thing I've heard in a couple of years, so I hope I can quote you on it.

Commissioner WESSEL. On the record.

Mr. COURSEY. Actually, the bill initially introduced by Senators Byrd and Cochran was an absolute repeal.

Commissioner WESSEL. Right.

Mr. COURSEY. On the House side, there was a bill introduced that would have a three-year suspension and charge Commerce, Customs and the USTR with a study and a report to Congress. The going forward thinking, I'm told, was that the Senate agreed to recede on their bill and pass the House version, which it was the House version that passed by unanimous consent at the Senate.

Commissioner WESSEL. Okay.

Mr. COURSEY. But then, there was a problem at the Ways and Means Committee in terms of getting it out as to what happened.

Commissioner WESSEL. I assume there's going to be some early energy put into try and get this done again this year.

Mr. COURSEY. Yes, and in fact, Chairman Thomas' office has given an indication that they are looking again at the issue.

Commissioner WESSEL. Right; garlic is a California product primarily, isn't it?

Mr. COURSEY. Absolutely, 90 percent of all commercially grown garlic is grown in California. It's a very complex product. I could go on for hours but I won't.

Commissioner WESSEL. I understand.

Mr. COURSEY. It's a California industry.

Cochair DREYER. Gilroy?

Commissioner WESSEL. Gilroy Garlic is one.

Mr. COURSEY. Gilroy is the mythic; it's sort of the Terra of garlic, but actually, it's grown from Sacramento down to the Mexican border.

Commissioner WESSEL. Right.

Ms. Foster, let me ask a question, if I could, of you. I didn't hear a lot of positive comments about trade with China as it relates to apple growers. If I could ask, what was the position of your industry on passage of PNTR when it was before Congress?

Ms. FOSTER. That was before I worked at the U.S. Apple Association, but having done some research, I understand that the U.S. Apple Association endorsed passage of PNTR. However, at that time, I don't believe the U.S. apple industry realized the great potential and role that the Chinese apple industry could play in the world market and in our market, notably, especially, with the prospect of potential fresh apple imports from China coming into this country.

Commissioner WESSEL. Not to mention canned applesauce and all the various other products.

Ms. FOSTER. Definitely.

Commissioner WESSEL. Okay. As we look at the upcoming negotiations in the Doha Round, we heard from several different panels yesterday about threats to our trade laws; clearly, we need to not only need to preserve the trade laws we have on the books but potentially remedy those issues or alter those issues where the remedies are not necessarily effectively available.

Are there issues any of the three of you have concerns with? Is there coming up in the Doha Round the possibility that remedies may, in fact, be further whittled away? We had been led to believe that trade laws were not on the negotiating table, but they are now. Ambassador Zoellick had agreed to discussions. What are your views of what the remedies are and what the threats might be for all three of the panelists, if I can.

Mr. MARTIN. I'm going to make a general comment, and please recognize that my opinion is that the WTO process with respect to China is working; it just needs to work faster, and from a U.S. agriculture standpoint, an increase from $2 billion to nearly $7 billion worth of sales in just four and a half, five years, is quite significant. It is indeed one of our biggest markets.

Commissioner WESSEL. Are we not facing, though, a potential trade deficit in agriculture for last year now?

Mr. MARTIN. Not with China.

Commissioner WESSEL. Not with China but globally for the first time since the fifties, if I remember; is that correct?

Mr. MARTIN. The U.S. consumer is enjoying more and more variety of product imported all the time. I think that—I don't see a fundamental shift in the economics. We're still very competitive in base agricultural production, the commodities that I principally am involved in, as I spoke of earlier, the feed grains, oil seeds, cotton. We have some considerable capacity globally. And we're there. We're a competitor. So these markets have been very important to us, Chinese market in particular. The WTO has opened up markets.

The key for us is accelerating Chinese compliance activities and enforcement activities. So I won't speak to the actions you discussed, because I see them sort of lost in the bigger picture, if you will, and the bigger picture is Chinese trade has been good for U.S. agriculture.

Commissioner WESSEL. I understand, but in terms of the potential impact on remedies, are there any concerns you have about the discussions going on about issues that may affect your members?

Mr. MARTIN. No, we would, from our perspective, we would encourage even more aggressive WTO action with respect to trade remedies around the world, including U.S. law.

Commissioner WESSEL. Ms. Foster?

Ms. FOSTER. I would agree with Gary's comments. The apple industry is a supporter of the WTO. We would like to see stronger market access provisions than are in the framework, because for the apple industry, we want the opportunity to compete in the world market. And we are supportive of a number of free trade agreements and an opportunity to do that.

We believe it's important for the U.S. grower to be able to have standing in cases, which has not always been the case, and I'd like to associate myself with Mike's comments as well in terms of the needed reviews here. But if anything, I think U.S. trade law should be strengthened so that U.S. industries can have an easier time of coming forth.

For our industry, we are not a large corporate sector. Coming up with the money, frankly, to file cases is a significant issue and really represents a barrier to us.

Commissioner WESSEL. Thank you.

Mr. Coursey?

Mr. COURSEY. Yes. Whether the WTO has been a good or a bad thing for agriculture depends on where you stand in agriculture. The industries I work with in agriculture tend to be on the West Coast. They tend to be small cash crop producers that have never

been subsidized at all on the level that farm subsidies have been given to other industries in this country.

They used to have good export markets. Garlic used to be shipped around the world. It's not shipped anywhere anymore. The Chinese have wrecked the world market for it. So has the WTO been good for the cash crop producers in California? My off the cuff would be no, it hasn't been. It has to be looked at again.

Trade remedies, part of the deal, we were told, well, we were told back in the Uruguay Round was that all the changes in negotiation of rules was going to be it. We were going to go through this once, get it all down. It was a long, torturous process; it was a balancing act; it came out, we were shocked two years ago to find out that this was back on the table. And what is happening is the same thing that happened in the Uruguay Round: the other countries are bombarding the agenda with rules, with proposals, all designed to eviscerate the U.S. dumping law.

And that is where it is going right now. I think it's not good.

Commissioner WESSEL. Thank you.

Cochair DREYER. Commissioner Bartholomew?

Commissioner BARTHOLOMEW. Thank you very much and thank you to our panelists.

I guess my theme for the day seems to be frustration as I listen both to the earlier panelists and to you. Ms. Foster, thanks in particular also for including the examples of trademark violations. I think it's important that people understand that these are not discrete problems but cross over a number of the different topics.

Yesterday, I asked some of our panelists essentially why did American workers believe that the U.S. Government is going to do anything to help them or is able to do anything to help them, and Mr. Coursey, particularly today, as I listened to you say there are two remedies out there, neither of which work, I guess I would just ask the same question, which is do the industries that you represent believe that the U.S. Government will do anything to help them, and if not, what do we do?

It is simply not as simple for people to just change crops. We're seeing the kinds of problems that you're describing across a number of different crops. When we were in Seattle, we heard from the spearmint oil producers, a product, frankly, that most of us hadn't given any thought to before, but they're under attack.

So, what are people supposed to do? And are they losing faith in their government and the ability to help? I'd offer this to anybody to answer.

Mr. COURSEY. Well, I'll speak up, because my clients are a little desperate, which means I'm a little desperate. We have been going through this. If you look at this chart, I spent four years, professional years, working on this problem, and my clients have done their best to stay on this side of cynicism, but I'm at the end of the road, and I'm sort of thinking about bankruptcy law, something else, because it is amazing.

We have trotted people in for four years. They're continuing—they've held it this long. But there is real desperation, discouragement, and once it gets to cynicism, it's over. And we won't be here any more. That's basically the business people say no, no more money; we'll do something else.

Commissioner BARTHOLOMEW. How much does it cost for a company or an industry to go through this in the first place?

Mr. COURSEY. To file an antidumping case, a vanilla commodity product antidumping case against China, $1 million.

Commissioner BARTHOLOMEW. And these are industries that are struggling in the first place having to come up with that money.

Mr. COURSEY. Correct. You can do it cheaper, but, it's like, do you want it right? It used to be you could do it a lot cheaper, because the Chinese didn't hire top flight legal counsel. And they had a reputation for not paying, so they had trouble. That's over. They get first line; they pay top dollar at this point.

And it's very expensive; it's extremely expensive. I wish it weren't so. It's not going to be solved by having the Commerce Department self-initiate cases. They've become, rightly or wrongly, they've become judges now, and it just doesn't work that way. But look at the cases that you hear the same industries complaining; they look at the dollar, and they say if you can't—when I go out and do presentations, I can't tell industries anymore to, yes, hire me to file a dumping case, because when you have this, you know that two years from now, three years from now, they'll be saying why didn't you tell us about this?

Commissioner BARTHOLOMEW. Ms. Foster, any comments?

Ms. FOSTER. Yes; first of all, I'd like to say that the U.S. apple industry does not receive any domestic subsidies at this time, and we are working very closely with the Department of Agriculture that we approached on a major research initiative to try and enhance our competitiveness to reduce production and packing, processing costs by at least 30 percent over the next decade, and USDA has been a great partner in this and is starting to fund some grants with us to do that. So we're trying not to come up with our hand out but be proactive.

But I would like to also emphasize, you say what to do about it. It is extremely frustrating for our industry when they see unequal standards and levels of support from the Chinese government and their industry with our industry, and as I mentioned, China's invisible hand, where it is not transparent, and it is hard to get the facts about what is really happening and what isn't, but you mentioned subsidies earlier; I think Gary mentioned the VAT tax is a back door subsidy.

There are core issues; for example, the difference in labor supply and labor costs which is fundamental to both economies: issues in access and cost to inputs, such as pesticides and fertilizer; worker safety standards; the cost of regulations and requirements that our industry works under that are simply not present or are present in different ways in China.

So our growers believe that they can compete if the so-called playing field were much more fair and level, but it's not, and we want to work to change that. That's a massive undertaking, and we are embarking on this planning process I mentioned to try and prepare ourselves for what may come, but it's not a simple solution at all, and frankly, we'd like to understand more about China so that we could do a better job of planning and running our businesses.

And the last point I want to make is that this is an exciting time to be in the apple business, because new dietary guidelines are out;

McDonald's is selling fresh, sliced apples; there will be more apple products brought into the fast food market; consumers are eating fruits and vegetables, so demand is—this is a great time to be in produce. With a healthy product, we're part of the obesity solution in this country, and the question is who is going to be supplying those apples?

Commissioner BARTHOLOMEW. Thank you.

Mr. Martin, any comment?

Mr. MARTIN. Yes, my perspective, given the nature of the Chinese government, which I know you discussed in your IPR discussion and their propensity to manage trade to solve problems, and in a very big way, they're trying to manage a massive rural population and provide them with some sort of capacity to transition, given that plus this inclination towards a lack of transparency, a lack of advance notice, it's clear that the WTO rules, the facts are in. U.S. agriculture has benefited from an export perspective. The numbers are quite extraordinary. There's no doubt about it.

It's also clear to me that aggressive action by the U.S. Government in many forms, primarily in the negotiation side but ultimately at the highest level of the U.S. Government, the President himself has accelerated the Chinese move towards opening its market through the WTO process. So it would be hard to deny that we haven't, because of the numbers, $2 billion to $6 billion plus in a short period of time, it would be hard to deny that there hasn't been some successful activity, and looking at what's happened particularly with soybeans and some of the other commodities, the pressure that's been put on the Chinese to open their market has worked.

It can be accelerated more. Pressure needs to be retained, and some firm commitments need to be made on transparency, advance notice, all of the WTO rules that they have agreed to comply with, voluntarily agreed to comply with, by the way.

Commissioner BARTHOLOMEW. Thank you.

Mr. COURSEY. Could I just add one comment to my answer? You've heard—and I'll be brief—reference to Chinese subsidies repeatedly on this panel. Well, guess what? You can't bring a subsidy case against China. And you know what? If you could bring a subsidy case against China, it wouldn't work. You know why? The subsidy law to work requires transparency.

The reason we can maintain a subsidy case against Canada soft wood lumber is because that country operates under a rule of law where laws are published, they're public, they're made available for lawyers, economists, others to read them. It is just impossible to get your hands around what happens in China. So I have cautioned people who have said, well, let's go get the subsidy law changed so we can apply it to China.

That is going to be very—I've worked on many, many subsidy cases, and I hate to even think about trying to demonstrate subsidies to the level that the Commerce Department and our law requires them to be demonstrated in a case against China. Virtually impossible.

Cochair DREYER. Thank you.

Commissioner Mulloy.

Cochair MULLOY. Well, I want to thank this panel. You have really offered us most interesting, I think, valuable testimony, so thank you very much, each of you.

Mr. Coursey, on page 4, where you talk about this law that was passed in 1995, is that the problem with the noncollection of the dumping duties, this 1995 law?

Mr. COURSEY. Yes, sir.

Cochair MULLOY. Well, you tell us that almost—well, it got UC'd through the Senate last year and then went over to the House. Now, you mention that the Chinese now hire major U.S. law firms to represent them in these dumping cases.

Mr. COURSEY. Yes.

Cochair MULLOY. That makes the cost of bringing a dumping case much more expensive. Is the Chinese government hiring these firms, or is it Chinese interests? Or how much money is—we don't know that? Okay.

Mr. COURSEY. I really couldn't even speculate.

Cochair MULLOY. Because it was mentioned yesterday that the Section 421, which, as you note, is now made inoperable——

Mr. COURSEY. A dead letter.

Cochair MULLOY. There was testimony yesterday that they do hire American law firms and lobbying firms to lobby the interagency committee that was working on making the recommendation to the President.

Mr. COURSEY. Well, for example, right now, the Commerce Department is accepting public comments on a pretty obscure aspect of the dumping law. It's called the Separate Rate aspect of——

Cochair MULLOY. Yes.

Mr. COURSEY. —nonmarket economy dumping cases. And several segments of the Chinese government: MOFCOM, several others have hired a New York, Washington firm and filed comments with the Commerce Department on this. It's one of the first times I've seen that sort of representation not be done on the letterhead of the Chinese government itself. There are different ways to do this. You never know when you see something from a government on its letterhead whether they hired a lawyer on the side or an economist or somebody more intelligent, but here, you have, yes, they are hiring, the government agencies are hiring law firms, U.S. law firms now who are coming in under their letterhead saying we're appearing on behalf of the government of China, and here's what we have to say.

Cochair MULLOY. Now, I want to get quickly a couple of points. Do you know whether there was lobbying to block that bill last year by these interests?

Mr. COURSEY. Oh, no, I do not know; I did hear that importers were unhappy with this.

Cochair MULLOY. Okay; that helps. I got the picture.

Now, Ms. Foster, on page 6 of your testimony, you talk about this differential on apples; we've got a WTO system now on which we have zero tariffs on Chinese apples coming here, and what do we have—we have a huge tariff on our apples going to China. Now, that was in the agreement. Didn't you guys catch that before? Why would you permit something like that to get—because now, legally,

the Chinese can keep their tariffs at that level under the WTO system, right?

Ms. FOSTER. Right, and actually, they've reduced their tariff down to this level in the past year.

Cochair MULLOY. Yes.

Ms. FOSTER. I'd like to ask my colleague, Jim Cranney, who's Vice President of U.S. Apple, to perhaps address that because that was——

Cochair MULLOY. Well, let me ask one more question before we do that.

Ms. FOSTER. Yes, sir.

Cochair MULLOY. Mr. Martin, on page 6 of your testimony, you talk about the subsidies that the Chinese—export subsidies, which are banned by the WTO agreement. Why aren't we bringing a WTO case on that?

Mr. MARTIN. My suggestion is later on in the testimony that it's ripe for a case.

Cochair MULLOY. Okay; it's ripe; okay.

Mr. MARTIN. Many times, though, negotiation has proven superior to litigation.

Cochair MULLOY. Yes, but then, sometimes you file, and then, you settle after you file.

Mr. MARTIN. I think what was pointed out at the end of the discussion on property rights is that the threat of a case is a major hammer on the Chinese approach to these issues.

Cochair MULLOY. Yes.

Mr. MARTIN. And you can make quite a bit of progress. So I agree you have to keep the WTO process out there in front, and that's one of the major tools, just the threat, just the analysis of the threat.

Cochair MULLOY. Yes.

Mr. MARTIN. We've got to watch closely particularly this use of VAT and other subsidies for exports, because they are prohibited, and they agreed to zero them out. Transparency is a problem. The nature of the government is a problem. All these things are serious problems that have been discussed before. But unless you keep that in front, the fact that you will take a WTO case, you don't make much progress.

Cochair MULLOY. Good.

Mr. MARTIN. But the progress that's made, though, is typically in negotiation prior to the WTO case. It's timelier; that's for sure.

Cochair MULLOY. Well, sometimes, you file, and then you talk. There's no—Madam?

Ms. FOSTER. Yes, sir.

Cochair MULLOY. You wanted to respond to that?

Ms. FOSTER. Yes; I'd like to just say that I don't know that we were individually consulted on that question, and I also believe that at that time that the industry did not recognize the huge role that China was going to be playing in the apple industry.

But looking forward at the WTO process, we would be very concerned if China was designated as a developing country eligible for special and differential treatment for products that it would select. We're very concerned that apples may fall into that kind of category, and that would clearly be a step backwards rather than this

transparency and fairer situation that we are trying to describe and recommend to you.

Cochair MULLOY. Madam Chair, can I just ask a followup question?

Cochair DREYER. Yes.

Cochair MULLOY. Are you watching whether the Commerce Department determines that China is a market economy? Because that would make a differential on the dumping laws, would it not? Are you following that process and hopefully lobbying?

Ms. FOSTER. Yes, we are, and with the able help of my colleague, Jim Cranney behind me, we are doing that.

Cochair MULLOY. Okay; thank you.

Cochair DREYER. Commissioner Becker.

Commissioner BECKER. Thank you very much.

I share all your frustrations. I don't get a good feeling. Let me ask you something. Let me start with Mr. Martin over there. Is a bad deal better than no deal? How do you feel about that? You've got a bad deal, right?

Mr. MARTIN. No, I'm only going to repeat. The WTO process, the fact that the Chinese reduced their tariffs, the evidence is in, in four years, four and a half years, more than tripling of U.S. agricultural exports. We've got access to that market. Not a bad deal; a better deal results when they get full implementation. The sooner they get to full implementation, and they're more than halfway through the implementation period that they agreed to, the sooner we get to it.

There are serious issues from our perspective with the Chinese approach. We wouldn't be where we're at today without the deal that we made. That's the point I'm trying to make: we just need to keep—continue the pressure, use all the devices that are out there to make sure the deal gets completed.

Commissioner BECKER. I guess I was just trying to understand the depth in your frustration.

Do you feel the same way, Ms. Foster?

Ms. FOSTER. Is a bad deal better than no deal I believe was your question.

Commissioner BECKER. I don't need to explain that, do I?

Ms. FOSTER. No, no, sir.

In the apple industry, if you're in agriculture, you like to think of yourself as an optimist, and you look for solutions. And that's what we're trying to do.

Commissioner BECKER. Sure.

Ms. FOSTER. We'd like to be able to export more to China. We'd like to get rid of the import duty. We'd like to have greater transparency. But I think that the key issue is very major for our industry; we're on the threshold of something really huge with the fresh apple imports and the increasing product imports.

So we will be working with our government in the WTO process to try and get the best deal we can, because not look back but trying to look forward.

Cochair MULLOY. Mr. Coursey.

Mr. COURSEY. In terms of your general question, depends on the context; if you're talking about WTO generally, the problem from my clients' point of view is that they don't have a problem with

market access for agriculture and the good things that have been accomplished. The concern is that those things may have been accomplished through a tradeoff of their interests with respect to their ability to exist and operate in this country.

The fear with what's going on in Doha is that the dumping law is going to be sold down the river for market access for whatever or whoever in foreign countries, and we would prefer no deal to a deal like that.

Commissioner BECKER. Yes; I just wanted to make sure I understood where you were coming from, because it is awfully easy to interpret what you're saying as completely negative, and I really didn't think that was the case. I share your feeling on Doha, on the discussions on dumping laws. I don't think it's that clear cut that it's going to go down the drain, but there are a lot of people watching it now and concerned about that, and the Commission shares your concern on that.

You wanted to say something, Ms. Foster.

Ms. FOSTER. If I might just add something, for apples and the horticultural sector, the market access provisions of WTO are critical. Not having domestic subsidies and export subsidies; and we are advising our government to caution them against tradeoffs in that area, and for apples and horticulture to support the new WTO round, there need to be stronger market access provisions. About 25 percent of our crop is exported, so exports are vital to the profitability of our industry.

Commissioner BECKER. And we understand that.

From what I've read, one of the big problems with China exporting into the United States is we've taught them how to grow. We've taught them how to use genetically engineered products. We've taught them how to use genetically engineered products. We've taught them how to increase their field yields, and we're going to have the live with that. I don't know how we're going to deal with that.

They're much more efficient now than what they were if you go back 10 or 15 years ago. I was just curious about that, because we've gone through a myriad of problems here. We had this morning a discussion on intellectual property, and that seems to be something that hasn't got off the ground floor. Every industry has a lot of problems, and I was just wondering how you felt about the WTO at all, whether we should work within the system. A lot of people have suggested, not before this Commission necessarily, but I've read this that we should take another look at the whole process and shoot for a better deal; I don't know.

Anyway, I just wanted to get that part cleared up in my own mind. Thank you.

Cochair DREYER. I suppose that if any of you were a professional academic, the answer to Commissioner Becker's question would be it depends on how bad a bad deal vice no deal at all.

Commissioner BECKER. I think I found out that the deal is not all that bad.

Cochair DREYER. Yes; I was interested in your pirating of the apple, the Washington State apple, and it does actually say very clearly in the Chinese there that it's a product of Western China, but they have still taken the logo. And you may be aware of the

case where Chery, C-H-E-R-Y, the automobile, Toyota got peeved because the Chery logo looked like their logo.

They did take the case to court, and they lost. The Chinese court said that the logo did not look like the Toyota logo, which people at Toyota are not very happy about. But I was listening to your comments that Ms. Foster also mentioned: waiting for significant harm to be done before you could file a dispute mechanism and several of the comments that all of you made, it sounds as if you are spending a huge amount of time fighting regulations that take a lot of time and energy and run up large legal bills for the United States industry involved with no real track record of victory, meaningful victory; you can win, but you can't win enough.

Mr. Martin, you urged the governments of the United States and China to work together to reduce unjustified barriers against agricultural products, and somehow implicit in that is the idea that you think the Chinese government wants to help remove these agricultural barriers. Can you all comment on how anxious you think the Chinese government is to be helpful on this?

My impression is not. I'm a sometime-student of Chinese history who's married to a real Chinese historian, and this sounds like typical Chinese negotiating behavior from time immemorial. I see Mr. Coursey nodding on that. The Chinese will sign an agreement and then start niggling about the provisions or pass things that undercut the provisions or just not obey it at all.

The British got so upset at one point in the Nineteenth Century that they invaded Beijing and finally got what they wanted, but we can't do that anymore. Is there any way around this? My impression is no, because . . . well, you guys tell me.

Mr. MARTIN. I'll comment. I don't know that I have all of the answers, but I just returned from Beijing less than two weeks ago, and there's no doubt in my mind that China has got a major food security concern. They also have a major population transition concern, rural to suburban and urban population concern, so they have got a lot to deal with. I'm not necessarily agreeing with their system of dealing with it, but I recognize they have a lot to deal with.

Imported product, in particular, can be a big part of food security solutions. I think they recognize that. They certainly recognize that with some major commodities from the United States. Other commodities imported, value gets added in China and exported. That's the textile story, the cotton story. They have a vested in this in this.

And China also sees itself through the recognition and utilization of comparative advantage, sees itself as a major agricultural exporter. So I think have to be pragmatic, take Chinese interests in mind, recognize some of the problems we all do with their system, their governance generally, and point out to them that they do have gains from improved food security, improved market access, and I think that you can make gains on agricultural trade in particular with China. I think we are in a good position relative to some of the other problems with agriculture.

Cochair DREYER. Ms. Foster, would you agree with that?

Ms. FOSTER. Yes; great question. And what we have seen is that the Chinese, again, it's hard to pinpoint, because it's not a transparent system, but we have been told that when negotiations do

occur, the Chinese often go for a political solution rather than wanting to follow the science-based pattern requirement that is in WTO.

And we would say it's extremely important that commodities not be traded off against each other or that market access be granted because of some larger geopolitical interest. So I know that is an undercurrent during all our discussions here and when we talk about market access. But you say how do we get the Chinese to have the desire to do that? Yes, we have to look at their self interests, but we also have to look at what's good——

Cochair DREYER. Ours.

Ms. FOSTER. —for U.S. industries.

Cochair DREYER. Thank you.

Mr. Coursey?

Mr. COURSEY. I'll try to answer from a little difficult tack and try not to wander too much above my pay grade, because this is—as a dumping lawyer, I have a tendency to do that.

Putting it to a trade remedy case, clients, yes, they complain about costs, about regulations, about the intricacies, but at the end of the day, they're sort of at ease with that. It's a cost of living in an open and free society, that you live under rules, and rules get complicated, and you follow procedures.

What is the danger is when your partner you're playing with doesn't play by the same rules or doesn't appreciate the rules in the same manner, and I'll give you just one example from the dumping area. If you want to bring a subsidy case or a dumping case against market economy countries, India, France, you get your client; they tell you what they think is going on in the foreign country; then, you get on the Internet, and you figure out who out of the hundreds of consultants over there will help you figure out what's going on in the market.

When you try to do that in China, you get nowhere, notwithstanding the fact that there's all of these people supposedly selling you services, because trying to find out what's going on in production or in an industry in China for potential use in a trade remedy case is considered industrial espionage.

So it is a totally different game that you're playing or totally different rules that you're going by. And that sort of attitude is brought over and injected, unfortunately, into procedures in our system, so I think there's a great danger that we don't appreciate the differences in consideration of things like rule of law.

Cochair DREYER. Thank you; final question. Commissioner D'Amato had a final question.

Commissioner WESSEL. I have a quick followup on that.

Cochair DREYER. Yes, go ahead.

Commissioner WESSEL. I have a quick followup on an earlier point regarding just the lobbying, because I assume when the government of China intercedes, there are certain prohibitions, for example, on PAC contributions, et cetera, they simply can't make them, that now that you've seen an expansion of the industry supporting their efforts, shall we say, here in town that we're seeing political influence being more liberally shared.

We'd be interested, as you proceed over the coming months on behalf of your clients, we've heard some testimony that there's an

imbalance in terms of access to our own government leaders as it relates to these cases, something we take very seriously, a number of the Commissioners raised that, if you see that, any of you, as you try and advance the interests of your domestic industries and clients, please let us know, because we would like to make sure that our industry has equal if not better access.

Chairman D'AMATO. Thank you, Madam Chairman.

I want to reinforce what Commissioner Wessel just said. This is not just a one-day hearing. We're going to be pursuing these issues that we have taken up throughout the rest of this year to see what progress we can make. And I just want to point out that it is very important that you all stand up for yourselves.

You can't be bullied. The Chinese like to bully. They bully everybody. And if we succumb to that, we're lost. And I would say that what we would like to see is the possibility of filing as many WTO cases against them as we can come up with. And if you say transparency is the bar to filing a WTO case, that's the reason to file it. And then, we can get into China and find out exactly what's going on.

Now, as I understand it, in the apple industry, for example, Chinese are focusing on the horticultural apple. They cannot grow the grains to feed their society, but they can grow the horticultural stuff to export, and they are subsidizing that industry. That's illegal. That's WTO illegal, I believe, isn't it, subsidizing your industry?

Cochair MULLOY. Export subsidies.

Chairman D'AMATO. Export subsidies. That's what they're doing.

Cochair DREYER. Implementing the subsidies.

Chairman D'AMATO. Yes; so, in other words, they are targeting our market in apples; absolutely no doubt about it. And they're subsidizing that targeting. That's a WTO case, as far as I'm concerned.

This is the organization that we have succumbed our sovereignty to in this area. We ought to use it for our interests or get out of it so we can't get out of it yet, so we ought to use it for our interests. And it's true in the garlic area, too. I think the same issues prevail: no transparency, subsidization can't be a bar to bringing a case, it seems to us; it seems to me, anyway.

You've got your logo there; that's another case. If you can do it easily, certainly, you'd want to file that one, because clearly, it's a violation of your intellectual property rights.

Ms. FOSTER. The Washington Apple Commission is involved in numerous legal fights on that overseas, and it's a real unfortunate use of grower funds where those funds could be used really for other very valid reasons that benefit growers directly instead of just defending their legitimate rights.

Chairman D'AMATO. Yes, yes. Well, I just want to say that we appreciate your coming and to emphasize that these are issues that we are exploring for the purpose of bringing recommendations to our only client base, which is the people that inhabit these buildings, our client base, and we want to bring to them the opportunities to help you. So we'd like to continue to work with you on those issues.

Cochair DREYER. Thank you very, very much for coming. This has been fascinating. We hope we can continue our relationship with you, and any suggestions you have, as Chairman D'Amato has said that would be useful for Congress, we would very much appreciate hearing them.

Thanks again.

[Whereupon, at 12:59 p.m., the hearing was concluded.]

Statement of Larry E. Craig
A U.S. Senator from the State of Idaho

Mr. Chairman, I want to express my thanks to you for bringing together several panels today to discuss the issues related to the Continued Dumping and Subsidy Offset Act ("CDSOA") on U.S.-China issues. Let me be blunt, it is absolutely essential that we preserve this provision. As you know, this provision helps companies that have been harmed by foreign competitors who continue to dump or receive subsidies despite the imposition of trade measures taken in the United States.

We must stand firm on this. I have reviewed the WTO panel decision against the CDSOA provision, and I believe it is the worst decision to come out of the WTO since its inception. The problem with this decision is it purports to prohibit a practice—that of distributing antidumping or countervailing duties to affected companies and workers—that was never agreed to by the United States during WTO trade negotiations. The WTO must stop creating new obligations for the U.S. that we never agreed to. Additionally, this loss of sovereignty is very real and most disturbing to me.

The only way we can effectively deal with this problem is to negotiate a solution during the current round of trade negotiations. In both the 2004 and 2005 omnibus appropriation bills, Congress directed the Administration to clarify the fact that all nations retain their existing right to distribute duties collected on unfair imports to affected companies and workers. Moreover, I and 69 of my Senate colleagues sent a letter to the President telling him that it would be a mistake simply to revoke this provision instead of negotiating a solution to keep it in place. The Administration did put forward a proposal last April to do just that. However, we need to make certain that the Administration understands they must push hard to get this accomplished during the negotiations—in the meantime the CDSOA must stay in place.

When foreign companies continue to dump or get subsidies, the rightful benefits from the imposition of offsetting duties is negated. The CDSOA seeks to rebalance that problem, and has done a good job of doing so over the years it has been in place. As you know, this provision has been very helpful to several important Idaho companies that have been continually hurt by unfair foreign trade, including Micron Technology, Bennett Lumber, Clearwater Forest Industries, Regulus Stud Mills, and Hamilton Honey. In all, 10 Idaho companies received duties in FY2004 amounting to over $12 million.

As the Untied States continues to see increased imports from China, the remedial effects of the CDSOA provision will be even more critical. Micron Technology, a large and important semiconductor manufacturer in my state, has long had problems with foreign government subsidized support to build up Micron's competitors in Asia. This started in Japan, Korea, and Taiwan. As we witness today, China is the next battleground.

I cannot underscore enough the importance that we must have the Administration actively defending and supporting the CDSOA, and I add my voice to the majority of the Senate in urging the Administration to keep this law on the books.

Statement of Mike DeWine
A U.S. Senator from the State of Ohio

Commissioners, thank you for this opportunity to submit testimony. I have been very interested in your work investigating both the opportunities and challenges of trade with China. I am particularly appreciative that you held a field hearing in Akron, Ohio, last year on the Impact of U.S. Trade and Investment on Key Manufacturing and Industrial Sectors. I hope that you will consider doing more hearings in Ohio, and I look forward to continuing to work with you on your findings and recommendations.

Today I am here to testify on a matter that is of vital importance to my state and the country. I am talking about international trade. The economic future of our Nation will be determined by how we adapt to the expanding global economy. We can no longer afford to imagine a divide between large firms who trade globally and small companies with a purely domestic market. The information age means that every American business with an Internet connection can have a global reach, which has global implications for Congress.

Congress has answered the call of U.S. businesses large and small by opening new markets around the world through Free Trade Agreements and multilateral forums, such as the World Trade Organization. Yet, we in Congress have an obligation to embrace free trade responsibly. The full economic benefits of free trade can be real-

ized only if the trade between nations is fair. Free trade should never be given more priority than fair trade because they are two sides of the same coin, and it is the job of Congress to protect our Nation's long-term economic security by ensuring the United States has the tools it needs in its arsenal to promote free trade on the one hand, while unrelentingly combating unfair trade practices on the other.

One tool we can use is the Continued Dumping and Subsidy Offset Act (CDSOA), a program I introduced in Congress in 1999, and Senator Byrd incorporated into law in 2000. The CDSOA program builds upon the Tariff Act of 1930, which gives the President the authority to impose duties and fines on imports that are being dumped in the United States or unfairly subsidized by foreign governments. The revenues raised through the duties and fines traditionally went into the U.S. Treasury. With the CDSOA program, those duties and fines are transferred to the injured U.S. companies to be reinvested in their plants and workers.

When I first introduced the CDSOA program it was for the workers in the Ohio River Valley and the other hard working steel laborers who were losing their jobs not because they were uncompetitive, but because foreign steel producers were trying to drive them out of the market using unfair trade tactics. Once implemented, however, the CDSOA disbursement reports demonstrated the full extent of the dumping and unfair trade problem our country faces.

To put it into perspective, no less than 458 companies received funds through the CDSOA program in 2004, alone. Almost every state has companies benefiting from the CDSOA program, which means that every state has industries being targeted by unfair trade. This is why we enjoy broad bipartisan support for the program.

Detractors of the program often refer to the program as a subsidy, and portray CDSOA recipients as the fortunate recipients of a government handout. Nothing could be farther from the truth. The companies who receive CDSOA funds are engaged in a monumental struggle with foreign companies who cannot compete with them fairly, and therefore artificially lower their prices to drive American companies out of business. Once the U.S. competitors are gone, the foreign company is free to raise its prices because it no longer faces any competition. This means that even the short-term benefit consumers gain by anticompetitive behaviors, like dumping, soon dry up, leaving everyone paying more for products that could have been produced at a fair and competitive price here in the United States.

Countervailing and antidumping duties were the intended remedies for unfair trade, and once imposed, were supposed to level the playing field by offsetting the artificially low prices of foreign imports flooding the U.S. market. Duties are how the World Trade Organization wants countries to deal with unfair trade, even though it is quite obvious that companies engaging in unfair trade are not deterred by the penalties. These foreign producers have done the math. They have made a calculated decision that the cost of the duties is a price they are willing to pay in return for the long-term market share they will control if they drive competing U.S. firms out of business.

To add insult to injury, the World Trade Organization found the CDSOA program WTO-inconsistent. Instead of working to find a remedy to the unfair trading practices that seem to be unchecked by our current international system of trade rules, the World Trade Organization decided to make a ruling based upon obligations the United States never agreed to in signing the WTO accession agreements, and never intended to assume. Congress should not allow an activist international organization to re-define our international trade obligations without our consent.

That is why I have joined forces with other concerned Senators in instructing the Administration to bring the United States into WTO compliance by clearly negotiating our right to a CDSOA program in the upcoming Doha Round trade talks. Through negotiations we can bring the program into WTO compliance and clarify our trade rights—all without a single mention of repealing the program.

Ultimately, however, the fate of the CDSOA program is in the hands of the very trading partners who brought the case to the WTO. If foreign countries and their companies stop engaging in unfair trade practices, there would not be a need for the CDSOA program. So, if they want the program to stop, they need to stop.

Unfair trade is not just an Ohio issue—it is an American issue, and one that we cannot afford to ignore. That is why I will continue to work to ensure that instead of repealing programs that help U.S. firms, we work harder to end the unfair and injurious trade targeting U.S. businesses.

Thank you for giving me this opportunity to testify, and I look forward to working with you on addressing the challenges and opportunities of international trade during the 109th Congress.

Statement of Daniel K. Inouye
A U.S. Senator from the State of Hawaii

I appreciate the opportunity to join with my colleagues in support of the Continued Dumping and Subsidy Offset Act (CDSOA) by submitting written testimony today. The CDSOA, written by Senator Byrd and enacted in October 2002, provides targeted relief to United States businesses adversely affected by the continued dumping or subsidization of imported products after the issuance of antidumping orders or findings, or countervailing duty orders. Under the Byrd Amendment, the duties collected are distributed to affected domestic producers who supported the trade investigation.

Since the law's enactment, more than $750 million has been disbursed to companies adversely affected by foreign dumping and subsidization. These funds are used to upgrade manufacturing facilities and equipments, to improve personnel training and benefits, or for the acquisition of inputs and technology, thereby allowing our domestic producers to invest in their companies to improve production of items covered by the scope of the order or finding of dumping or subsidization.

While this provision benefits American companies, several other countries have been pushing for the elimination of this law. The Administration argued before the World Trade Organization (WTO) Appellate Body that there was nothing in the WTO Agreements that prevents the distribution of antidumping and countervailing duties to companies by governments. However, the WTO Appellate Body found that the CDSOA violated U.S. obligations under the WTO. I am concerned about this line of WTO cases that exceed the authority of the WTO dispute settlement process.

In the Fiscal Year 2004 and 2005 Omnibus Appropriations bills, the Congress directed the Bush Administration to clarify existing WTO obligations with respect to the distribution of antidumping and countervailing duties during the Doha Rounds of WTO negotiations. To that end, the Administration made a proposal in April 2004 to the WTO, but those negotiations must be expedited. A specific agreement allowing for the disbursement of duties, would bring CDSOA into compliance with WTO Agreements.

The CDSOA has benefited both companies and their workers in a broad range of manufacturing and agricultural industries in nearly every state of the nation. We need the support of the Administration to preserve and defend the CDSOA and other U.S. trade laws, to prevent them from being weakened by our trading partners and the series of questionable decisions coming from the WTO. I join Senator Byrd and the majority of the Senate in expressing my support for this law and for keeping it on the books.

Statement of Kevin M. Burke
President and Chief Executive Officer
American Apparel & Footwear Association

Thank you for providing us this opportunity to submit a statement for the record in connection with this hearing.

The American Apparel & Footwear Association (AAFA) is the national trade association representing apparel and footwear companies, and their suppliers. AAFA members produce, market, distribute and sell clothing and shoes in virtually every country in the world, including China and the United States.

Our comments are structured to offer commentary on the role of China in the post textile and apparel quota world as well as the role of China as a potential consumer market for U.S. footwear and apparel companies. We will then make recommendations on U.S./China trade policy, particularly with respect to China's compliance of its World Trade Organization (WTO) obligations.

Role of China in the Post Quota World

On January 1, 2005, the United States and other WTO member countries discontinued the use of quotas to restrain imports of textile and apparel products from WTO and many non-WTO countries. The end of quotas has generated considerable anxiety among textile and apparel interests worldwide as the prevailing view, reinforced by a number of academic studies and some industry assessments, is that China will become a dominant player in the industry in the coming years. While many developing countries have traditionally viewed quotas as a policy tool to limit their exports to the United States, they have only recently begun to view them as a mechanism that prevented one country from gaining a single dominant share in the marketplace.

We have made no official assessment of how China will perform in the post quota world. While statistics on some products freed from quotas in the past few years and other anecdotal evidence derived from other industries backs up the view that China will gain an enormous share of the U.S. import market, equally compelling facts show that China will have difficulty assuming this role. Many companies are reluctant to commit additional orders to China because they want to achieve diversity in their sourcing. Companies cite many reasons for retaining business in other countries, including proximity to markets, uncertainties in China, preferential trade arrangements, and pre-existing partnerships with factories.

Much attention has focused recently on the role that China safeguards—negotiated as part of China's accession package to the WTO—can play in the coming four years. The United States has already invoked the safeguard on four occasions and, pending a legal dispute, may consider an additional dozen or so cases. With all the hype surrounding these cases, it is important to understand several issues relating to the safeguard tool.

First, although many in the textile industry support their aggressive use, safeguards on imports of textile articles from China are not likely to promote textile and apparel manufacturing in the United States. Imports already supply 96 percent of the U.S. apparel market, so quotas on imports from China will merely divert some Chinese made apparel imports to other countries, primarily those in Asia. Moreover, safeguards only restrict the cutting and sewing of Chinese made apparel, and not whether that apparel contains Chinese fabrics. The safeguards may succeed in shifting some apparel operations from China to other countries but those diverted garments may still contain Chinese textiles. At a minimum, safeguards on Chinese apparel do not promote the use of U.S. inputs.

This is a critical point to understand as there is considerable expectation that quotas on China will result in increased business in the United States. Up until the beginning of last month, the United States maintained quotas on hundreds of textile and apparel articles from dozens of countries. Many of these quotas were in place for several decades. During that time, apparel import penetration grew to high levels while U.S. textile and apparel employment fell steadily. If quotas on dozens of countries for 30 years did not help protect the U.S. textile and apparel industry, it is unlikely that quotas on a single country for only four years will now accomplish that goal.

Second, the safeguard tool is intended to be used when there is market disruption in the United States that has occurred because of Chinese imports. In other words, it is intended to stop market disruption when the source of that disruption can be traced directly back to China. It is not intended, as some argue, to address real or perceived concerns with the Chinese economy or to encourage Chinese adherence to its WTO obligations. In fact, use of the safeguards as an enforcement tool, without data to show an explicit Chinese role in U.S. market disruption, may cause the WTO to find that the U.S. is violating its own WTO obligations with respect to China.

Third, there is an unintended side effect of quota restraints on China that should be more fully understood by the Commission. Efforts to restrain imports from China, or encourage the Chinese government to impose additional taxes on their textile and apparel exports to the United States, do indeed result in an additional cost. That cost is either borne by the U.S. apparel company or passed on to the U.S. consumer. In either case, that cost represents a transfer of funds from U.S. citizens to the Chinese government. We fail to understand why a policy promoting such a financial transfer is in the best interest of the United States, especially when the quota restraints achieved do not promote U.S. jobs.

Role of China as Consumer Market

With a middle class of over 200 million people and growing, China represents the next great market for U.S.-made and U.S.-branded products. Many of our members, including such well-known household names as Reebok and New Balance, have already blazed the trail for American brands by aggressively pursuing the Chinese consumer. Even so, multiple obstacles abound that restrict the access of U.S. footwear and apparel brands to this lucrative and growing market.

While we applaud the huge strides China has already made in meeting its WTO obligations, China has fallen short in two important areas that directly affect both our footwear and apparel members.

First, China continues to delay the issuing of regulations providing foreign firms distribution rights in the Chinese marketplace. In addition, the regulations issued to date allowing foreign firms trading rights in China are vague in many key aspects. As a result, our members must comply with a myriad of often conflicting regulations that can vary from region to region and forces them to enlist a Chinese

partner in order to sell their products in China. More importantly, without rules on distribution rights, our members are unable to sell their product in the Chinese market even if the product is made in China in Chinese factories. For example, with over 98 percent of the shoes sold in the United States being imported, U.S. footwear firms produce a significant percentage of shoes in China to serve not only the U.S. market but also many other countries around the world. Despite the fact China accounts for over half of the shoes produced worldwide, U.S. footwear firms currently cannot sell the shoes they make in China to the Chinese market. Under current rules, these firms are required to export the shoes out of China and then re-import them back into the country. Until China issues and then enforces a single, simple set of clear and transparent rules granting foreign firms distribution rights, U.S. footwear and apparel brands and the U.S. workers they employ in marketing, distribution, and research and development will continue to lose out on one of the biggest consumer markets in the world.

Second, the scourge of counterfeiting continues to run rampant in China, with knock-offs of well-known U.S. footwear and apparel brands sold in markets in virtually every Chinese city and town. Even if U.S. footwear and apparel firms are granted full distribution rights, they will have to compete against these inferior knock-offs that dramatically undercut U.S. brands. Not only are these products priced well below actual market value, but the low quality of the counterfeit products also tarnish the hard-earned reputation of U.S. brands.

Again, China has made significant progress in Intellectual Property Rights (IPR) enforcement. However, by all accounts, the most recent rules promulgated by China fall well short of what is needed to ensure that the intellectual property rights of U.S. footwear and apparel firms are protected. Among other problems, the new rules lack the criminal penalties needed to deter counterfeiting.

As you know, many of these same counterfeit products end up on the streets of U.S. cities, hurting U.S. footwear and apparel brands in their own home market. We believe concrete steps, such as those proposed in new bi-partisan legislation introduced in Congress last month, are needed to punish those in the United States that attempt to benefit from Chinese counterfeiting. The Stop Counterfeiting in Manufactured Goods Act, introduced by U.S. Representative Joe Knollenberg (R–MI), requires the mandatory destruction of equipment used to manufacture and package counterfeit goods. In addition, it addresses methods that counterfeiters have used to evade prosecution, such as the selling of patch sets or medallions that can later be attached to generic merchandise and given the appearance of a genuine product.

As the Commission moves forward with its deliberations, we would make several policy recommendations.

First, to the extent the Commission and the U.S. Government wish to discourage sourcing in China, there are several policy options that are far preferable than the imposition of additional quotas. Swift implementation of new trade agreements with Central America, such as the U.S.-Dominican Republic/Central America Free Trade Agreement (U.S.-D.R./CAFTA), would promote more imports from a region with a demonstrated capability and supply chain that favors U.S. textiles and yarns. This would promote more U.S. textile jobs. Similarly, enactment of programs, such as that proposed in the Tariff Relief Assistance Development Act of 2005 (S. 191), which would eliminate tariffs on countries like Bangladesh, Cambodia, and Sri Lanka, would promote sourcing in poor, developing countries that are highly dependent upon textiles and apparel for employment and foreign exchange revenues.

Second, we encourage the Commission to focus on those areas of China's WTO commitments where more progress can be made and where there are demonstrated U.S. commercial interests at stake. From our perspective, we believe greater attention to intellectual property rights (in particular preventing counterfeiting of trademarks or trademarked goods), distribution rights, and market access can promote greater use of U.S. exports or U.S. branded products in China while reducing revenue loss to U.S. intellectual property holders.

We also support resolution of the currency issue, primarily to induce more certainty into the relationship. Some of our apparel members and many of our footwear members are very dependent on China, both to import inputs that are used for U.S. assembly as well as finished products that are sold throughout the United States. Sudden shifts in the currency value would disrupt supply chains in a way that would ultimately harm U.S. interests. Likewise, imposition of additional taxes on imports from China, such as recent Congressional proposals, only raise emotions and uncertainty without making a positive contribution to the bilateral economic policy debate.

Third, we believe the China safeguards should only be invoked where the data shows a precise cause and effect between U.S. market disruption and imports from

China. We understand the EU is viewing these safeguards as a "last resort" and only when the "measures are fully justified." We would encourage a policy that is more in line with this thinking so that safeguard policy not act as a disruption to the broader commercial relationship. Above all, we believe safeguard policy should be part of a transparent process that leads to predictable, fact-based outcomes.

In conclusion, we are mindful that many in our industry, and many around the country, are concerned over the role that China will play in the coming years. At the same time, we know that many in our industry view China as an important strategic partner. While many disagree over whether China is more a challenge or an opportunity, most agree that the way forward involves a predictable and comprehensive approach that is based on rules and not political imperatives.

Thank you.

Statement of Randal Quarles
Assistant Secretary of Treasury for International Affairs

I would like to thank the U.S.-China Economic and Security Review Commission for its invitation to participate in its public hearing on February 4, 2005. It is with regret that I am unable to attend due to previous travel commitments. However, I would like to take this opportunity to submit a statement to the Commission for its consideration.

China's rapid economic growth and increasing integration into the world trading system and international financial system is a real opportunity for the United States and the world. China's growth has been an important source of support for global economic growth. Indeed, over the past 3 years, the United States and China together have accounted for half of world growth.

China's economy has changed tremendously since its decision 25 years ago to shift towards market-oriented economic reforms. At that time China was almost autarkic, with very little trade with the outside world and essentially no foreign investment. Since that shift in policies, China's economy has grown by an average of 9.5 percent per year. China's trade has grown much faster, and now represents over 70% of China's total GDP. China is now the third-largest trading economy, after the United States and Germany.

Opening up the Chinese economy to international trade and foreign investment was a critical factor in helping China achieve faster rates of growth. Chinese exports have grown rapidly, but so have their imports—both for investments in domestic infrastructure and to provide goods demanded by a population with rising incomes. Accession to the WTO was an important step for China's reformers, both to assure access to foreign markets, but also to assure continued market-oriented reforms domestically.

China's integration into the world trading system and membership in the WTO also carries responsibilities. China's WTO accession three years ago marked a commitment to liberalize trade and to abide by the rules of the international trading system. The Administration has been firm on its insistence that China live up to those commitments.

The Administration strongly believes that the world economy and international trading system work best with free trade, with the free flow of capital and with currency values set in open, competitive markets. The G7 group of major industrial nations have also consistently emphasized in their communiqués that flexibility in exchange rates is desirable for major countries to promote smooth and widespread adjustments in the international financial system.

China's fixed exchange rate regime may have been appropriate at an earlier stage of its development, and China's willingness to withstand large downward pressures during the Asian crisis in the late 1990's did help maintain international financial stability. But now that China has a much larger economy, its engagement in international trade has increased enormously, cross-border capital flows are increasing, and structural changes have greatly expanded the role of the market, a fixed exchange rate system is no longer appropriate and China should move towards a more flexible exchange regime now. Greater exchange rate flexibility would allow faster transmission of international price signals and better adjustment to global imbalances.

Treasury has emphasized that exchange rate flexibility is also firmly in China's interest. Flexibility avoids the buildup of imbalances and the emergence of one-way bets that have made fixed exchange rate systems problematic in so many countries. Greater exchange rate flexibility also greatly enhances the independence and effectiveness of monetary policy. Treasury has stressed that a market-based, flexible ex-

change rate would allow China greater scope to use monetary policy to reduce the risks of repeating economic cycles of booms and busts; to enjoy the benefits, while mitigating the risks, of a more open capital account; and to improve the allocation of resources and the quality of financial intermediation in the Chinese economy. The U.S. has argued that it is better to undertake an orderly exit from the peg as soon as possible rather than face a disorderly abandonment of the peg (in either direction), which could have potentially disruptive consequences for both China's real economy and the international economy.

China's leadership has clearly stated that they intend to move to a flexible market-based exchange rate. Following the U.S.-China Joint Economic Committee (JEC) meetings hosted by Treasury in September 2004, China "reaffirmed its commitment to further advance reform and to push ahead firmly and steadily to a market-based flexible exchange rate." Chinese Premier Wen has stated publicly that China will gradually make the exchange rate more flexible. China's central bank governor stated that China will quicken the development of its foreign exchange market, and push ahead with reform of the exchange rate regime. Chinese central bank governor Zhou also said recently that "rigid exchange rates amid imbalances in international revenues and expenditures present huge risks."

To bring about a flexible exchange rate regime in China, the Bush Administration adopted a financial diplomacy strategy that features candid senior-level discussions, multilateral support from other countries, and technical engagement to identify and overcome Chinese obstacles to a flexible currency.

Dialogue at the most senior levels has entailed frequent and substantive representations and consultations on exchange rate and financial markets issues. The JEC, held in Washington last September, in which Secretary Snow, Chairman Greenspan, and the Chinese finance minister and central bank governor participated, covered a broad range of economic policy, financial sector and capital markets issues with exchange rates as the central focus. Following several meetings late last year during the G–20 and G–7 forums, Secretary Snow will discuss China's economy and exchange rate with Finance Minister Jin and Governor Zhou this week when the G–7 Ministers meet in London. These are only a small part of the discussions that have taken place between senior officials of our two countries. These discussions are an extremely effective channel for identifying ways Treasury can help China's financial and monetary leaders on the path to a flexible currency regime.

The United States is actively assisting China to address the impediments to greater exchange rate flexibility that China perceives. In collaboration with China's central bank governor, Secretary Snow launched a technical cooperation program that led to three constructive sessions in 2004 that focused on the mechanics of a flexible currency regime. In February, sessions in Beijing dealt with assessing and supervising currency risk in banking systems and developing financial instruments to manage that risk. In June, Treasury provided extensive training in Beijing on banking supervision, credit analysis, international accounting standards, and resolution of non-performing loans. In September, Chinese officials came to Washington to discuss foreign reserve management and supervision and regulation of a currency futures market. The technical cooperation program will continue this year with focus on more practical aspects of exchange rate flexibility.

Treasury has also mobilized our trading partners in a multilateral effort to encourage China to move to a flexible exchange rate. This effort includes the G–7 and the G–20, as well as the Asia-Pacific Economic Cooperation (APEC) forum. These multilateral meetings have achieved a broad consensus on calling for flexible exchange rate regimes in large economies like China's.

The Chinese authorities are taking steps to bring about a move towards a flexible exchange rate. China has reduced barriers to capital flows to deepen markets involving foreign currency transactions. China is committed to bank reform and is working to strengthen domestic banks, bank supervision and regulatory structures, and to prepare these institutions for exchange rate flexibility. Late last year, China's central bank eliminated a ceiling on bank lending rates, which will give greater scope to pricing credit risks. In addition, China's banking regulator will focus this year on banks' capital adequacy ratios, the accuracy of non-performing loan classifications, and whether banks have sufficient provision coverage. China is also making progress in developing financial products and systems to support foreign exchange trading and hedging of currency risk. In this effort, twenty-four foreign banks and financial institutions have received approval to conduct foreign exchange derivatives business. China is also working to provide domestic and foreign banks with an on-shore foreign exchange trading platform for non-renminbi currency pairs. These systems and financial products will allow China's domestic banks and regulators to gain more experience with international foreign exchange trading, risk management techniques, and oversight of these markets and instruments.

The Administration will continue to pursue diligently the financial diplomacy strategy outlined above. Treasury will continue to engage with China on exchange rate policy, banking sector reform, capital market development, and further opening of financial services in China. We firmly believe that this approach, working in cooperation with the Chinese to bring about exchange rate flexibility as soon as possible, is the most effective way to achieve our common goal.

International AntiCounterfeiting Coalition, Inc.
Washington, D.C. 20006
February 11, 2005

Ms. Sybia Harrison
Special Assistant to Section 301 Committee
Office of the United States Trade Representative
600 17th Street, NW
Washington, D.C. 20508

Re: Request for Public Comment on the Out-of-Cycle Review of the People's Republic of China Pursuant to Section 182 of the Trade Act of 1974, 69 Fed. Reg. 74561 (December 14, 2004)

Dear Ms. Harrison:

On behalf of the International AntiCounterfeiting Coalition, Inc. (IACC), I respectfully submit the following comments in response to the United States Trade Representative's request for comments referenced above concerning the out-of-cycle review for the People's Republic of China and whether the acts, policies and practices of the People's Republic of China are producing substantial progress towards a significant reduction in IPR infringement levels.

The IACC is the largest multinational organization representing exclusively the interests of companies concerned with IP enforcement, i.e., product piracy and counterfeiting. Our members consist of approximately 150 corporations, trade associations, and professional firms and represent total revenues of over $650 billion. The intellectual property owners represent a cross-section of industries, consisting of many of the world's best known companies for the various products that they develop, manufacture and distribute in the entertainment, automotive, pharmaceutical, motion picture, consumer goods, personal care, apparel and other product sectors.

Because the IACC's membership represents a broad array of industries, there is no consensus on the part of our members regarding what specific actions to take against China in order to obtain immediate improvements and results in China's efforts against counterfeiting and piracy. In view of the recent judicial interpretations, some members believe time is needed to assess China's commitment to improved enforcement through effective implementation of the new interpretations.

We look forward to working with the USTR to address the issues raised in our comments and to assist in its efforts to promote intellectual property protection and enforcement in the People's Republic of China.

Respectfully submitted,

Timothy P. Trainer
President

People's Republic of China

Introduction

Based on available statistics and reports from our members, China has no equal either as a source of counterfeit and pirated goods to the world or as a market in which fakes are produced and sold locally. While acknowledging China's special position in the world as the single largest producer of counterfeit goods, the trademark community has not reached any consensus as to what actions might be taken to prod China to take more aggressive steps in the short term in order to reduce the levels of counterfeiting that exist.

The IACC has previously stated that Articles 41 through 61 of the TRIPS Agreement obligate China to implement ***effective*** enforcement procedures and provide remedies that have a ***deterrent*** effect. Despite right holders' abilities to prompt administrative raids and recent changes in the law, China's enforcement system still fails to afford intellectual property owners with effective enforcement which has a truly deterrent impact. This is due mainly to insufficient criminal enforcement and weak administrative sanctions. Current trends suggest China will remain the

world's worst violator of intellectual property rights unless decisive action is taken to fix the problem.

IACC members report that little has fundamentally changed in the market since the IACC's most recent submission in September 2004 concerning China's compliance with WTO commitments. China continues to pose the greatest threat to IACC members' intellectual property (IP) assets as compared to other countries in the world. Despite significant improvements in China's IP legal regime over the last few years, which the IACC has noted in previous filings, the enforcement system continues to be fraught with weaknesses and inefficiencies that facilitate massive counterfeiting and piracy.

The exports of counterfeit and pirated products continue to flow from China causing lost sales and damage to brand image. China sourced counterfeits range from medicines and auto parts to home electrical products, to apparel and footwear. In addition to the impact on IACC member companies, China's counterfeiting industry has a direct impact on foreign governments. For FY 2004, the U.S. Department of Homeland Security's Bureau of Customs and Border Protection (CBP) reported the seizure of 2,826 shipments from China containing counterfeit and pirated product, having a domestic value of over $87 million dollars.[1] Based on these statistics, China accounted for 63% of the total monetary value of intellectual property seizures in FY 2004. The types of products coming from China seized by CBP included, but were not limited to, wearing apparel, cigarettes, consumer electronics, toys, batteries, watches, sunglasses, and automotive components. Similarly, the European Union has also found that China is the leading source of counterfeit and pirated products to its borders.[2] Anecdotal accounts of particular counterfeiting cases reveal the staggering scope of China's counterfeiting capabilities.

- On June 3, 2004, agents from the Department of Homeland Security's Bureau of Immigration and Customs Enforcement arrested at least 12 people and seized six shipping containers as part of an undercover operation that targeted an organization involved in large scale smuggling of counterfeit merchandise into the United States from China. The six seized containers were valued at about $24 million. The organization is believed to have smuggled at least $400 million in counterfeit goods into the United States in one year. Of the six containers seized, five held counterfeit handbags, luggage and wallets and the sixth contained counterfeit cigarettes. Agents also seized $174,000 in cash and 11 bank accounts (two in Los Angeles and nine in New York). Officials said the suspects probably imported about two containers per week with each container having a profit margin of $2 million to $4 million.[3]
- In another case that evidenced the wide range of criminal activity increasingly associated with sophisticated and highly organized domestic Chinese counterfeiting operations, Federal officials from the offices of the United States Attorney for the Southern District of New York announced the unsealing of indictments against members of two Chinese organized crime groups operating in New York City. The three indictments unsealed in November 2004 charged ***fifty-one*** defendants with a wide range of various crimes, including trafficking in counterfeit goods. As part of the investigation, Federal investigators seized $150,000 in cash and $4 million worth of counterfeit merchandise falsely bearing the trademarks of Chanel, Gucci and Coach from warehouses in New York City. Other assets confiscated included a $900,000 home belonging to one of the defendants, four vehicles and a restaurant in Florida. Other crimes detailed in the indictment included racketeering (RICO) offenses, numerous conspiracies, attempted murder, extortion, extortionate debt collection, alien smuggling, money laundering and the operation of large scale illegal gambling businesses.[4]

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[1] Both of these statistical measures were increases over FY 2003 when CBP seized 2,056 shipments with a domestic value of over $62 million.

[2] *See http://europa.eu.int/comm/taxation_customs/resources/documents/counterf_comm_2003_en.pdf* (accounting for 60% of articles seized by EU members).

[3] *See NY ICE Breaks $400M IP Smuggling Group*, Inside ICE (Volume 1, Issue 4); *ICE Breaks $400 Million Intellectual Property Crime Smuggling Case*, The Cornerstone Report (July 2004); Madison J. Gray, *Feds Bust Fake-Handbags Operation, Arrest 14*, The Associated Press State & Local Wire (June 3, 2004); *Statement of the Honorable Michael J. Garcia, Asst. Secretary for U.S. Immigration and Customs Enforcement, U.S. Department of Homeland Security*, Testimony Before the Subcommittee on Trade of the House Committee on Ways and Means (June 15, 2004).

[4] *See U.S. Indicts 51 Chinese Organized Crime Figures and Associates in Massive Coordinated Sweep*, United States Attorney Office for the Southern District of New York Press Release (November 12, 2004), *available at http://www.usdoj.gov/usao/nys/Press%20Releases/NOVEMBER04/Chinese%20OC%20Indictment.pdf*; *New York City Police Commissioner Raymond W. Kelly, et al. Announce 28 Arrests in the Takedown of an Organized Crime Operation*, New York City Police

- Other cases in 2004 illustrate the continuing threat posed by Chinese counterfeit goods to consumer health and safety. In July 2004, a Federal jury in Houston, Texas, convicted Zheng Xiao Yi, a Chinese national, of six counts of trafficking in counterfeit merchandise. The counterfeit merchandise was imported from China and contained counterfeit versions of trademarks registered to companies such as The Gillette Company, Underwriters Laboratories (UL), Marvel Enterprises and Nike. The counterfeit goods imported from China by Zheng included Spiderman toys, Nike slippers, Duracell batteries and electrical extension and power cords that bore counterfeit UL certification marks. The most alarming part of the seizure was that none of the electrical cords seized from Zheng passed the Underwriters Laboratories tests required to earn the UL certification mark. The counterfeit cords actually burst into flames when tested under normal household conditions.[5]
- An enforcement action conducted by Cartier in 2004 uncovered a two-room office in Manhattan that contained more than 550,000 fake watches. The watch parts were originally made in China, flown to New York via Hong Kong, assembled in workshops in Chinatown and then sold through hundreds of Web sites. The watch parts were valued at approximately five dollars and the counterfeit watches sold for $150 to $200.[6]

As with all illegal and criminal activity, IACC members have had difficulties in accurately measuring their losses resulting from counterfeiting in China. Indeed, many American companies and IACC members are victims of counterfeiting in China even though they have never maintained any type of formal presence in China. Counterfeit Chinese products are shipped not only to the United States, but to countries all over the globe.[7] Countries where IACC members report finding counterfeit goods of Chinese origin include: Belgium, Bulgaria, Congo, Gambia, Germany, Greece, Indonesia, Israel, Italy, Japan, Jordan, Malaysia, Malta, Netherlands, Singapore, Spain, Russia, United Arab Emirates, United States and numerous other countries in the Middle East, Europe and Southeast Asia.

Multiple IACC members have also reported individual seizures of counterfeit Chinese goods where the counterfeit items discovered have been measured in the hundreds of thousands. An informal compilation of data from IACC members providing enforcement related data shows that approximately 3 million infringing items were seized within China's borders alone in 2004. One IACC member reported uncovering an underground factory that employed over 100 persons, while another reported actions against one particular infringer who operated literally dozens of stores—all dedicated to selling infringing merchandise. An auto industry member has indicated that 50–60% of counterfeit product found globally is produced in China. Finally, one member confirmed that even Chinese military personnel were engaged in infringing operations. Other companies have reported that the military has often been found providing rented storage facilities to counterfeiters—a strategy which has proven successful in most cases in preventing IP owners from amassing seizures of fakes.

Adding to the complicated enforcement landscape in China is the Internet. In order to thrive, the business of counterfeiting needs suppliers, distributors, and retail outlets. And, just like legitimate businesses, counterfeiters are turning to the Internet to help establish these trading connections. Many of them find their niche at a "B2B" Web site, alibaba.com, whose operational base is in Hangzhou. This is the place to go to find suppliers and wholesale sources of counterfeit computer software, knock-off luxury goods and apparel, or clones of patented pharmaceuticals. Many alibaba-listed suppliers are high-volume dealers. For example, some suppliers of counterfeit anti-virus software will not accept orders for fewer than 300 pieces.[8]

Department Press Release (November 12, 2004), *available at http://www.nyc.gov/html/nypd/html/dcpi/pr–2004–121.html*; Julia Preston, *U.S. Charges 51 with Chinatown Smuggling*, New York Times, November 13, 2004, at B2; Larry Neumeister, *Dozens of Alleged Members of Violent Chinese Gangs Face Federal Charges*, The Associated Press, November 12, 2004 (*available in* LEXIS, News and Business Library, News Group File).

[5] *See Harwin Drive Importer Convicted of Trafficking in Counterfeit Merchandise*, U.S. Department of Justice U.S. Attorney's Office Southern District of Texas News Release (July 20, 2004); Jennifer C. Kerr, *Feds Warn About Counterfeit Holiday Goods*, Associated Press (December 11, 2003).

[6] *See* Peter S. Goodman, *In China, A Growing Taste for Chic*, Washington Post, July 12, 2004, at A1.

[7] *See*, *e.g.*, *Italy GDF Seizes 34 Mln Chinese Goods*, ANSA English Corporate Service, December 2, 2004 (referring to a seizure by Italian police of 34 million units of Chinese goods valued at $133.6 million, including toys and holiday decorations that failed to meet European safety regulations).

[8] *See http://www.alibaba.com/manufacturer/12569432/Sell__Norton__Software.html*.

A manufacturer of counterfeit cigarettes, claimed to be "98% close to original," lets buyers start small by taking "trial orders" of "one 40 foot container."[9] Counterfeiters from all over the world converge on the alibaba.com site. Alibaba.com touts itself as "The World's Largest Base of Suppliers," and, as a result, is serving the counterfeiting world. In view of the activities of alibaba.com, Chinese authorities should shut down this site and prosecute anyone involved with manufacture, distribution, offering for sale and sale of counterfeit goods.

In view of the counterfeiting activities both on the Internet and the old brick and mortar environments, gathering specific data detailing the scope of counterfeiting and enforcement related problems is especially difficult for small- and medium-size companies. Such information and data are difficult and expensive to obtain. Companies significantly affected by counterfeiters generally see a decrease in revenues. The decrease in revenues naturally leads to pressure to severely curtail costs; thus, making it even more difficult to budget the funds necessary to gather information addressing the problem (not to mention the funds necessary to do actual enforcement).

Local protectionism issues in China and the close ties between government and industry also make many legitimate companies hesitant to shine a spotlight on their counterfeiting problems in China. In many provinces, local government entities and agencies invest millions of dollars in the economic and physical infrastructure in the markets that sell infringing goods. These same bodies or their subsidiary agencies are also in charge of intellectual property enforcement. IACC members fear the economic reprisals that may result from complaining too loudly or too specifically.

IACC members certainly understand the need for industry to provide as much specific data as possible, but would also like to see the tables turned and place more of the onus on the Chinese to provide data proving that they are actually reducing the currently obscene levels of counterfeiting occurring within China and to improve transparency regarding the penalties imposed and whether counterfeiters and pirates are, in fact, paying fines and serving jail sentences.

On a positive note, the IACC applauds the long overdue decision by the Chinese authorities to permanently close the large counterfeit and pirate market known as Silk Alley in early 2005. Silk Alley, by itself, was responsible for hundreds of thousands of dollars in counterfeit sales every day. The IACC also applauds the support given by various local government departments in supporting brand owner efforts to partner with the government-owned companies that leased premises in the Silk Alley and other markets in Beijing, based on threats of civil and administrative enforcement against the landlords themselves.

Silk Alley is set to be replaced by a new indoor mall being built next door from the former Silk Alley. Many counterfeit vendors have complained that the rent is too high in the new building and that they will not conduct business there. Recent press reports, however, indicate that the developer of the new building is offering preferential policies to attract former Silk Alley vendors, including exemption from the property management fees and fifty percent rent discounts.[10] Even more disappointing, were reports that the government relaxed IP enforcement during the final days of Silk Alley so as to allow counterfeiters the opportunity to sell their excess inventories of counterfeit items.[11] There are also apparently no specific plans for enforcement at the new mall so as to prevent it from becoming an indoor version of "Silk Alley."[12] As of this writing, the affected brand owners have requested the Beijing government and the landlord to adopt stricter lease provisions to deter future tenants from dealing in fakes, but there appears to be resistance to acceptance of these provisions.

The IACC also applauds recent policies put into place in retail and wholesale markets in Beijing and Shanghai that ban the sale of any items bearing certain trademarks such as Louis Vuitton, Burberry, Chanel and some twenty other famous foreign brands. The Beijing AIC has recently requested brand owners to issue written declarations confirming that legitimate versions of their goods are not sold in Beijing markets, thereby facilitating future enforcement work. As nearly all items sold in such markets are counterfeit, it is only practical to have such a rule in place.[13] The IACC lauds this development which should lead to more trademarks

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[9] *See http://www.alibaba.com/manufacturer/12571959/Sell__Marlboro__555__Cigarette.html*.

[10] *See* Lu Haoting, *For Market, It's End of Silk Road*, China Business Weekly, January 7, 2005.

[11] Craig Simons, *Faking It*, South China Morning Post, January 10, 2005.

[12] *See* David J. Lynch, *China Closes Market for Pirated Goods*, USA Today, January 11, 2005, at 4B.

[13] *See* Betsy Lowther, *Copycat Central: China's Silk Alley*, WWD, October 11, 2004, at 21 (noting that a 2004 industry investigation found that 90% of all products in Silk Alley were counterfeit).

being added to the list of protected brands, but the IACC expresses the hope that these experiments in Beijing will lead to the introduction of a similar arrangement in all other major Chinese cities, and with all brands being offered the opportunity to benefit.

The actions mentioned above provide merely a glimpse into the effects that China's counterfeiting machine has on industry, governments and consumers all over the world. The remainder of the IACC's comments will focus on two of the most pressing areas in terms of China's intellectual property enforcement mechanisms: (1) the need for continued attention to thresholds for criminal liability and prosecution of counterfeiting cases and greater resources being dedicated to criminal enforcement; and (2) the need for strengthening of Chinese Customs procedures and regulations in order to improve border enforcement.

I. Criminal Prosecution Thresholds for the Crime of Trademark Counterfeiting

There is relatively little criminal prosecution in China when compared to the staggering amount of intellectual property crime occurring in the country. Although arrest, prosecution, and conviction rates have increased gradually for IP crimes, the actual number of criminal cases pursued in China is still a drop in the bucket when compared to the need. Accordingly, there is a consensus that China's current system of IP protection relies too heavily on enforcement by administrative authorities—generally accomplished by officials from the Administration for Industry and Commerce (AIC) and the Technical Supervision Bureau (TSB).[14]

Administrative officials lack the authority to arrest and their powers are generally limited to seizure of counterfeit products and the imposition of fines. The seizures conducted and fines imposed by administrative authorities are generally viewed by most counterfeiters as a mere cost of doing business. Although administrative enforcement can be efficient and useful in many ways, it has proven, on the whole, to have little or no deterrent impact against counterfeiters.

China's failure to make greater use of criminal prosecution for willful counterfeiting arguably violates China's obligations under Articles 41 and 61 of the TRIPS Agreement which requires access to criminal enforcement for counterfeiting and piracy conducted on a "commercial scale" and for overall "remedies which constitute a deterrent to further infringement." The Chinese government's use of administrative sanctions cannot replace the enforcement of criminal law, and the obvious strategy for making progress in the future is to dramatically increase criminal prosecutions and at the same time strengthen administrative penalties.

Given the historical circumstances and the fact that a large number of administrative enforcement officials exist to deal with cases, the Chinese government has consciously limited criminal enforcement to only those cases that are deemed "serious" under Articles 213 and 215 of the Criminal Code. As there is no definition of "serious" in the Code itself, the job of creating one had been left to judicial authorities.

Until recently, criteria for criminalization of IP crimes was governed by prosecution guidelines issued on April 18, 2001, jointly issued by the Supreme People's Procuratorate and the Ministry of Public Security. Unfortunately, the previous standards for determining whether cases fulfill the standards necessary for criminal investigation and prosecution were hopelessly ambiguous, illogical and provided little practical guidance. Moreover, the numerical thresholds set out therein were in any case too high to be practical and useful. This is evidenced in part by the fact that criminal transfers of counterfeiting cases from the AICs to the PSBs actually decreased from 2001 to 2004.

The original guidelines from 2001 were officially replaced in December 2004 with a new Judicial Interpretation issued jointly by the Supreme People's Procuratorate and the Supreme People's Court.[15]

Unfortunately, the new judicial interpretations do not appear to be much of an improvement on the prior guidelines. Indeed, in some areas they appear to be a step backward. The following comments detail those provisions we feel need some clarification in terms of what they mean and in terms of how they will be consistently applied by enforcement officials.

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[14] Local AIC officials are authorized under the PRC Trademark Law. Local TSB officials are authorized under the PRC Product Quality Law.

[15] The Judicial Interpretations were released on December 22, 2004, with the title, "Interpretation of the Supreme People's Court and the Supreme People's Procuratorate on Several Issues in the Concrete Application of the Law in Handling Criminal Cases of Intellectual Property Infringement."

At the outset and before delving into comments relating to specific provisions of the new judicial interpretations, the IACC notes its objection, in principle, to the use of any thresholds for criminal liability, and, in particular, for any numerical standards. The IACC hopes that China will, consistent with international practice and the minimum requirements of Article 61 of the TRIPS Agreement, allow for criminal prosecution of all cases of willful counterfeiting, regardless of the scale of the operation.

China is virtually alone among nations in imposing such thresholds. The relevant United States Federal criminal statute against trafficking in counterfeit goods (18 U.S.C. §2320) does not have any threshold value that must be met. To the IACC's knowledge, Vietnam is the only other country to impose numerical requirements for pursuing prosecutions against counterfeiters. The IACC recognizes that government resources are always limited and that decisions to investigate and prosecute will always be subject to practical, financial and manpower limitations. Imposing numerical standards, however, particularly for liability determinations, simply creates loopholes that provide safe harbors for counterfeiters.

Ultimately, the IACC supports having no numerical thresholds whatsoever. Each case of counterfeiting, regardless of size or scope, should be eligible to be prosecuted. The threshold concept/system, however, is based on the presumption that administrative penalties in China are appropriate and have the required deterrent impact. This has, in practice, proven to be an unreliable assumption. The ultimate result is that Chinese counterfeiters believe that trafficking in small amounts of counterfeit goods is acceptable or will generally be overlooked. The IACC naturally does not agree with this position.

As noted above, TRIPS rejects the use of numerical standards for allowing access to criminal enforcement. Article 61 of TRIPS requires that any counterfeiting or piracy on a commercial scale shall be eligible for criminal penalties. Under the new interpretations, counterfeiters must still be caught with approximately $6,000 worth of counterfeit goods to be eligible for criminal penalties. This begs the question as to why $5,999 worth of counterfeit goods does not qualify as "commercial scale" or "serious" infringement, but $6,000 does qualify. As a practical matter, such numerical thresholds actually impede enforcement efforts. Chinese police are often unwilling to commence investigations until the brand owner and/or administrative authorities have provided convincing evidence that the necessary numerical thresholds have been met. Producing such evidence is often a difficult, tedious and costly task, mainly because most counterfeiters are sufficiently clever to avoid being caught with the requisite amount of fakes or related transactional documentation. Police should instead be encouraged to investigate based on mere suspicion of "serious" infringements and then investigate to gather the necessary evidence. If they are already allowed to do this, then this should ideally have been made clear in the guidelines or separate guidelines issued in parallel to the new Judicial Interpretation.

Relevant Criminal Code Provisions and Criminal Threshold Guidelines

Criminal Code Provisions

Articles 213, 214 and 215 of the PRC Criminal Code detail three separate types of criminal trademark violations. The text of each Article follows:

Article 213

Crime of Counterfeiting Registered Trademarks ("Passing Off")

Whoever, without permission from the owner of a registered trademark, uses a trademark which is identical with the registered trademark on the same kind of commodities shall, if the circumstances are serious*, be sentenced to fixed-term imprisonment of not more than three years or criminal detention and shall also, or shall only, be fined; if the* circumstances are especially/extremely serious*, he shall be sentenced to fixed-term imprisonment of not less than three years but not more than seven years and shall also be fined.*

Article 214

Crime of Selling Commodities Labeled With Counterfeit Trademarks

Whoever knowingly sells commodities bearing counterfeit registered trademarks shall, if the amount of sales is relatively large*, be sentenced to fixed-term imprisonment of not more than three years or criminal detention and shall also, or shall only, be fined; if the* amount of sales is huge*, he shall be sentenced to fixed-term imprisonment of not less than three years but not more than seven years and shall also be fined.*

Article 215

Crime of Producing Trademarks Against the Law and Selling Trademarks Produced Against the Law

Whoever forges or without authorization of another makes representations of the person's registered trademarks or sells such representations shall, if the circumstances are serious*, be sentenced to fixed-term imprisonment of not more than three years, criminal detention or public surveillance and shall also, or shall only, be fined; if the* circumstances are especially/extremely serious*, he shall be sentenced to fixed-term imprisonment of not less than three years but not more than seven years and shall also be fined.*

The Criminal Code Articles themselves fail to define the phrases "serious," "especially/extremely serious," "relatively large," or "huge." The new Judicial Interpretation attempts to clarify the definitions of these terms, although it remains very uncertain as of this writing whether the new definition will provide sufficient support for increased criminal enforcement. The text of relevant portions/articles of the new interpretations and the IACC's comments concerning them follow.

Judicial Interpretations [16]

Article 1

Using an identical trademark on the same merchandise without permission of the registered owner in any of the following circumstances falls under the definition of "the circumstances are serious" stipulated in Article 213 of the Criminal Code and shall be sentenced to fixed-term imprisonment of not more than three years or criminal detention and shall also, or shall only, be fined for committing the crime of forging registered trademarks:

(1) the amount of illegal business amount being more than RMB 50,000 or the illegal gains being more than RMB 30,000;
(2) forging more than two registered trademarks, the amount of illegal business amount being more than RMB 30,000 or that of illegal gains being more than RMB 20,000;
(3) other circumstances of a serious nature.

Whoever conducts any of the following acts that falls under the definition of "the circumstances are especially serious" stipulated in Article 213 of the Criminal Code shall be sentenced to fixed-term imprisonment of not less than three years but not more than seven years and shall also be fined for committing the crime of forging registered trademarks:

(1) the illegal business amount being more than RMB 250,000 or the illegal gains being more than RMB 150,000;
(2) forging more than two registered trademarks, the illegal business amount being more than RMB 150,000 or the illegal gains being more than RMB 100,000;
(3) other circumstances of an especially serious nature.

Article 2

Whoever knowingly sells commodities bearing counterfeited registered trademarks, if the amount of sales is more than RMB 50,000, and thus falls under the definition of "the amount of sales is relatively large" stipulated in Article 214 of the Criminal Code, shall be sentenced to fixed-term imprisonment of not more than three years or criminal detention and shall also, or shall only, be fined for committing the crime of selling commodities bearing counterfeited registered trademarks.

Whoever sells such commodities valued over RMB 250,000 falls under the definition of "the amount of sales is huge" stipulated in Article 214 of the Criminal Code and shall be sentenced to fixed-term imprisonment of not less than three years but not more than seven years and shall also be fined for the crime of selling commodities bearing counterfeited registered trademarks.

Article 3

Whoever forges or makes representations of another person's registered trademarks without authorization or sells such representations in any of the following circumstances and thus falls under the definition of "the circumstances are serious" stipulated in Article 215 of the Criminal Code shall be sentenced to fixed-term imprisonment of not more than three years, criminal detention or public surveillance

[16] The analysis of the new judicial interpretations provided herein is based on an unofficial English translation provided by industry sources.

and shall also, or shall only, be fined for committing the crime of illegally making registered trademarks and selling illegally-made registered trademarks:

(1) the amount of the representations of other person's registered trademarks forged or made without authorization or that of the sold representations of other person's registered trademarks forged or made without authorization being more than 20,000 copies, or the amount of illegal business amount being more than RMB 50,000, or the amount of illegal gains being more than RMB 30,000;
(2) the amount of the representations of other person's registered trademarks forged or made without authorization or that of the sold representations of more than two of other person's registered trademarks forged or made without authorization being more than 10,000 copies, or the amount of illegal business amount being more than RMB 30,000, or the amount of illegal gains being more than RMB 20,000;
(3) other circumstances of a serious nature.

Whoever conducts any of the following acts that falls under the definition of "circumstances of an especially serious nature" stipulated in Article 215 of the Criminal Code shall be sentenced to fixed-term imprisonment of not less than three years but not more than seven years and shall also be fined for committing the crime of illegally making registered trademarks and selling illegally-made registered trademarks:

(1) the amount of the representations of another person's registered trademarks forged or made without authorization or that of the sold representations of another person's registered trademarks forged or made without authorization being more than 100,000 copies, or the illegal business amount being more than RMB 250,000, or the amount of illegal gains being more than RMB 150,000;
(2) the amount of the representations of other person's registered trademarks forged or made without authorization or that of the sold representations of more than two of other person's registered trademarks forged or made without authorization being more than 50,000 copies, or the amount of illegal business amount being more than RMB 150,000, or the amount of illegal gains being more than RMB 100,000;
(3) other circumstances of an especially serious nature.

IACC Comments Regarding Articles 1–3

Articles one through three of the new interpretations attempt to define and clarify what specific circumstances will qualify as "serious" under Articles 213 and 215 of the Criminal Code and what illegal sales amounts will qualify as "relatively large" under Article 214 of the Criminal Code.

As detailed above, the IACC reiterates its objection to the criminal thresholds or numerical standards established in the Criminal Code and the new interpretations. The IACC supports having no thresholds whatsoever. Each case of counterfeiting should be eligible to be prosecuted. The threshold concept/system supports the notion that certain amounts of counterfeiting are acceptable or will generally be overlooked. That position is unacceptable and counterproductive.

With respect to the language in the interpretations, the IACC notes that the vague phrases "other circumstances of a serious nature" and "other circumstances of an especially serious nature" used in Articles one and three are left wholly undefined. What types of counterfeiting activity are these phrases meant to include? Do the phrases include counterfeiting a famous or "well-known" mark? Do they include the counterfeiting of goods that present severe health/safety risks such as car parts or pharmaceuticals? The prior criminal prosecution guidelines from 2001 expressly contained such provisions, but they are absent in the new guidelines and no explanation for their removal has been given. (Article 61 of the previous guidelines referenced pharmaceutical products and Article 63 referenced well-known marks).

Articles one through three of the new interpretations take a significant step backwards with respect to violations committed by repeat offenders. Articles 61 and 63 of the 2001 guidelines, (implementing Articles 213 and 215 of the Criminal Code, respectively), provided that where an alleged infringer had received administrative punishment on two or more prior occasions, the accused was eligible for criminal investigation and penalties regardless of the value of the counterfeit products sold/manufactured/possessed. Although these older provisions left certain questions unanswered, they represented one of the stronger provisions of the guidelines.[17] The

[17] For instance, they failed to clarify whether all three violations had to involve the same trademark or whether two or all three of the offenses could have involved different trademarks.

repeat offender provisions were removed from the new interpretations in their entirety. In comments submitted to the United States and China months before the guidelines were issued, the IACC noted that it would be easier to build criminal cases based on the then existing repeat offender provisions if administrative enforcement actions were centrally recorded and the TSBs and AICs provided swift access to this enforcement information. The IACC was suggesting a solution to a problem. China chose to deal with this problem by eliminating the provisions entirely.

Article 9

The "amount of sales" as stipulated in Article 214 of the Criminal Code refers to all the illegal income gained or sought to be gained by selling commodities bearing counterfeited registered trademarks.

Any of the following circumstances shall be regarded as falling under the definition of "knowingly" stipulated in Article 214 of the Criminal Code:

(1) Knowing that the registered trademarks on the commodities that he/she sells have been altered, replaced or covered;
(2) Selling the same goods for which one has already been given administrative penalty or has borne civil responsibility for selling goods bearing counterfeited registered trademarks;
(3) Counterfeiting or altering the authorization documents of the registrant or knowing such documents have been counterfeited or altered;
(4) Other circumstances in which the fact that the registered trademarks on goods are counterfeited is known or ought to have been known.

IACC Comments Regarding Article 9

The language defining "knowledge" for vendors of fakes under Article 214 of the Criminal Code appears to be too restrictive in that it only provides three narrow examples of conditions in which this standard will be deemed satisfied. The "should have known" portion of the above standard only appears in a catch-all phrase and it should have been amplified to explicitly cover a "willful blindness" standard. "Willful blindness" can be said to exist where a person has good cause to suspect "wrongdoing and deliberately fails to investigate."[18]

Article 12

"Illegal business amount" as stipulated in the Interpretation refers to the value of the products produced, stored, transported and sold by the doer in the course of infringing intellectual property rights. The value of the products produced by infringing on intellectual property shall be computed according to the prices at which such products are actually sold. The value of the products produced by infringing on intellectual property produced, stored, transported, and those not sold shall be computed according to the indicated prices or the actual prices at which the goods are found to have been sold after investigation. The value of the products produced by infringing on intellectual property without indicated prices or whose actual prices are impossible to be ascertained shall be computed according to the median market prices of the infringed products.

The provisions also failed to explain what would happen when the required three administrative actions were brought by a combination of different administrative enforcement agencies (e.g., AICs and TSBs).

[18] Secondary liability for trademark infringement exists in the United States under the "should have known" standard. At least two Federal appellate courts have recognized the liability of real world swap meet owners for providing a forum for and profiting from the sale of counterfeit merchandise on their premises. *See Fonovisa, Inc. v. Cherry Auction, Inc.*, 76 F.3d 259 (9th Cir. 1996); *Hard Rock Café Licensing Corp. v. Concession Services, Inc.*, 955 F.3d 1143 (7th Cir. 1992). Such liability is imposed based upon a "knowing or having reason to know" standard. Hence, willful blindness can be equated to actual knowledge. Willful blindness can be said to exist where a person suspects "wrongdoing and deliberately fails to investigate." *See Hard Rock*, 955 F.2d at 1149. *See also Fonovisa*, 76 F.3d at 265 ("[A] swap meet can not disregard its vendors' blatant trademark infringements with impunity."). In the *Polo Ralph Lauren Corp. v. Chinatown Gift Shop*, 38 USPQ 1509 (S.D.N.Y. 1996), a landlord who leased space to a retail tenant was accused of contributory infringement based on the tenant's sale of counterfeit goods. The court granted summary judgment of no contributory infringement because the landlord took the proper steps to avoid liability—i.e., upon notice from the trademark owner, the landlord first served notice to vacate and then refused to renew the lease.

Chinese law permits liability to attach to landlords (e.g., Article 50 of the Implementing Regulations of the PRC Trademark Law, Article 9 of the Judicial Interpretations Regarding the Manufacture and Sale of Counterfeit and Shoddy Goods). Such legal liability should be pursued aggressively by administrative and criminal authorities. The IACC urges China to aggressively pursue landlords who fail to take effective action to stop infringements and knowingly rent space to counterfeiters.

The illegal business amount, illegal gains and amount of sales shall be computed cumulatively in cases of repeat infringements of intellectual property where such acts have not yet been the subject of administrative penalties or have not previously been the subject of criminal procedures.

"Copies" as stipulated in Article 3 of the Interpretation refers to one piece of representation of the complete logo of the trademark.

IACC Comments Regarding Article 12

At first glance, Article 12 appears to do away with the earlier ambiguity as to whether it is necessary for the purpose of criminal prosecution to prove that an infringer actually sold product prior to the seizure of warehoused goods. The IACC welcomes this clarification. Article 12, however, is still somewhat confusing and ambiguous regarding exactly how the value of finished and unfinished products and sold and unsold products will be calculated. This confusion is likely to be shared by administrative authorities and the police, and, consequently, it is feared that delays in arrests and decisions to prosecute will ensue—thereby giving counterfeiters unnecessary opportunities to flee.

Article 12 appears to provide that, for purposes of valuing goods that were previously sold or seized incidental to legal action, product prices shall be calculated according to the actual sales price of the counterfeiter. This is not practical, much less fair, as the infringer's price is usually a mere fraction of the price of a genuine item. Problems also arise with respect to how the infringer's price will actually be determined—e.g., what types of evidence will be used or permitted to be used? Will mere declarations by the infringer be accepted? Will the infringer be required to corroborate sales prices set out in documents it produces? All of these questions are left unanswered.

Article 12 provides that the product values may otherwise be calculated according to the "indicated prices" of the goods. The term "indicated prices" is not defined in the interpretation, but it has been explained by Chinese authorities to refer to the price indicated on packaging or price tags displayed at retail outlets. The absence of written clarification in this regard is troublesome, but since fakes are not routinely sold with prices indicated on the packaging, the importance of this provision is perhaps not critical. Article 12 leaves some key questions unanswered: Does the term refer to the actual price appearing on the packaging or price tags attached to the goods? (Counterfeiters could obviously "indicate" an extremely low price on all the products they store in warehouses for future sales as a means to avoid criminal liability). What if the products contain no indicated price? Will they be valued at zero?

Article 12 goes on to state that if products have no "indicated price" or the actual sales price cannot be verified then the product value will be calculated according to the "median market prices of the infringed goods." Unfortunately, this term is also not defined. Does this term refer to the price of legitimate goods in the same market? Trademark owners have no idea how Article 12 will work in practice. If the answer is based upon the price of the infringing goods then there is no deterrent value to the provision. Clarification and answers to the questions posed herein are necessary.

Article 15

Where a unit commits any of the crimes stipulated in the Articles 213 through 219 of the Criminal Code, it shall be convicted and sentenced according to the criteria that are three times as high as those for convicting and sentencing individuals committing same crimes according to this Interpretation.

IACC Comments Regarding Article 15

Article 15 provides higher monetary criminal thresholds for enterprise operations, as opposed to individual natural persons. To qualify for criminal penalties, an enterprise operation must engage in counterfeit operations at least three times greater than the value/threshold required for individual persons. The IACC has long held that this distinction is arbitrary, makes little sense and hinders effective enforcement. The damage done to IP owners is the same regardless of who commits the crime. Enterprise standards should be lowered to meet the lower monetary thresholds used for individuals or eliminated entirely. The new interpretations in this regard stand in contrast to the judicial interpretations issued jointly by the Supreme People's Procuratorate and the Supreme People's Court on April 10, 2001, to clarify the scope of Articles 140–149 of the Criminal Code (provisions relating to product quality violations) which do not contain separate criminal liability standards for enterprise and individual violators.

Article 16

Whoever knowingly provides loans, funds, bank accounts, invoices, certificates, licenses, production and operation places, as well as facilities and assistance in producing, storing and import-export agency services shall be deemed an accomplice in the crime of infringing on intellectual property.

IACC Comments Regarding Article 16

The new interpretations do not state whether "accomplices" will be punished in the same manner as the main defendant. They also fail to state whether the operation the accomplices assist in must meet the threshold levels spelled out in Article 1, 2 or 3 of the new interpretations. Furthermore, the interpretation fails to clarify whether the knowledge requirement for accomplice liability may be satisfied in accordance with the knowledge provisions relating to direct vendors of counterfeits as contained in Article 9.

Article 16 refers to criminalization for import-export agencies as accessories. Brand owners were hopeful that the interpretation would go further by making clear that "export" is a type of "sale" under the Criminal Code (Art. 214). Chinese customs has been seeking clarification on this issue for many years and it is not clear why the Supreme People's Court and prosecutors did not deal with the issue in the interpretation.

Although not directly related to Article 16 alone, the IACC also notes that the new interpretation does not confirm whether it may be used to deal with crimes which took place before its effective date (December 22, 2004). IACC members report that this issue is likely to be resolved favorably through the handling of a number of pending test cases, but it remains to be seen exactly what will happen.

The Role of the New Judicial Interpretations

When making the determination whether a particular counterfeiter or counterfeiting operation should be subject to criminal penalties, due attention should also be given to the value of any equipment/machines used to produce the goods, the number of workers in the factory, the infringer's bad faith, oral admissions by the infringer, evidence of prior violations not subject to enforcement, warning letters received from the right holder, the infringer's willingness to cooperate with law enforcement and produce documentation,[19] whether the infringer operates an "underground" or unlicensed facility, and possession of semi-finished products or component parts. The new interpretations do not seem to direct enforcement officials to take these telling factors into consideration when deciding whether to pursue criminal sanctions.

Another significant gap in the interpretations is the absence of language addressing the problems caused by counterfeiters who operate underground factories/facilities without the necessary business/commercial licenses from the government. There should be no minimum monetary standard required for criminally pursuing counterfeiters who operate these types of underground facilities. Article 225 of the Criminal Code provides up to five years imprisonment for engaging in "illegal operations." It is the IACC's understanding, however, that Article 225 only applies to parties that deal in products specially regulated by the government (such as cigarettes, telecommunications and publishing).

The text of the new interpretations, while important, should not be the sole focus of our efforts. Whatever steps the Chinese take—new regulations/interpretations, increased training, more funding, IP units in the Public Security Bureau, etc.—such steps must result in more criminal prosecutions, heavier fines, more jail sentences and a reduction in the overall counterfeiting levels. The natural solution is for Chinese police to take a leading role in the investigation of counterfeiting cases. Additionally, the AICs, Customs, TSBs and other administrative enforcement bodies need to cooperate more closely with Chinese police and Public Security Bureaus (PSBs) and promptly transfer those cases that meet the standards for criminal investigation and prosecution. There is an urgent need for more money, manpower, training and action plans in specific priority regions where counterfeiting levels are particularly high such as: Shenzhen, Guangzhou, Zhongshan, Chaoyang, Chaozhou, Jieyang (all in Guangdong), Yiwu and Linyi (in Zhejiang), Beijing, and Shanghai.

Ultimately, two key questions must be addressed with respect to the new interpretations: (1) has the political will in China changed; and (2) how will the new interpretations be applied in practice? Ideally, we would like to receive data from the Chinese government regarding the number of criminal prosecutions for trademark crimes (if any) since December 22, 2004, when the new guidelines took effect. To

[19] It is important to note that Article 55 of China's Trademark Law provides that the suspected parties must render assistance and cooperate with administrative enforcement officials.

the IACC, nothing in the new interpretations indicates the Chinese intend to be serious when it comes to criminally pursuing counterfeiters. Questions from brand owners regarding the ambiguities in the new judicial interpretations produced largely inadequate responses from Chinese government officials at the recent U.S. Ambassador's Roundtable on IP in China. The failure to clarify these ambiguities has only fueled industry concerns that China is not serious about complying with its obligations under TRIPS and fulfilling the promises it made at the April 2004 JCCT.

"Fixing" the criminal threshold regulations was a necessary step. Upon analyzing the regulations, however, they appear to be insufficient. The real measure of the new regulations' adequacy or inadequacy will be whether there will be a suitably large increase in the number of criminal trademark related prosecutions that result in criminal fines paid and time served. China promised significant decreases in counterfeiting levels at the April 2004 JCCT and this simply has not come to pass.

Based on the reasoning and analysis detailed above, the IACC urges the Chinese government to:

(a) provide clarifications to the question presented herein regarding ambiguities in the new judicial interpretations;
(b) eliminate or significantly reduce all numerical based thresholds;
(c) allow PSB's to conduct investigations themselves based on proper suspicion (as opposed to the current system where brand owners are often required to gather the evidence necessary to prove counterfeiting levels worthy of criminal enforcement);
(d) apply the retail value of the legitimate item as the basis for valuation of the counterfeit goods;
(e) provide for the automatic transfer of cases for counterfeiters who operate underground factories/facilities without the necessary commercial licenses;
(f) lower the thresholds for enterprises to meet the lower monetary thresholds used for individual persons (or eliminate them entirely);
(g) record all administrative actions and make such data quickly and easily accessible to brand owners;
(h) provide that repeat offenders will always be eligible for criminal prosecution regardless of the value of counterfeit goods they possessed;
(i) increase the transparency of both the administrative and criminal enforcement processes;
(j) impose more severe penalties; and
(k) provide explanations, upon appropriate requests, and in writing, to brand owners regarding the reasons why a particular case was not transferred to criminal enforcement authorities.

II. Customs Enforcement

China's new Customs regulations entered into effect on March 1, 2004 ("Regulations of the People's Republic of China on Custom's Protection of Intellectual Property Rights"), and replace earlier regulations from 1995 on the protection of IP rights by local customs offices. Additionally, China's General Administration of Customs (GAC) recently issued new implementing rules/measures on the protection of IP rights by Customs. The new implementing rules took effect July 1, 2004. It is too early to fully and fairly evaluate how the new rules will be implemented in practice. While we commend the effort to issue new regulations and note some positive developments, several issues remain problematic and need further clarification.

Bond Requirements

The new implementing rules give customs the flexibility to fix bond amounts at somewhere between nothing and 100 percent of the value of the counterfeits (Article 22). The new rules regarding bonds are certainly an improvement over prior practices, but the IACC believes the situation could be improved further. Based on an English translation of the new rules acquired by the IACC, it appears this sliding scale for the bond amount applies *only* when the IP owner has filed the necessary paperwork for a seizure pursuant to Article 21 of the new rules. Article 21 deals with those situations where Customs has discovered counterfeit goods as a result of an *ex officio* investigation/inspection (i.e., without a specific request from the IP owner). Article 22 provides the following provision with respect to posting of bonds:

- if the goods seized are valued at less than RMB 20,000 (about $2,300), the bond should be equivalent to the value of the seized goods
- if the goods seized are valued between RMB 20,000 to RMB 200,000 ($2,300 to $23,000), the bond will be equivalent to 50% of the value of the goods, but in no case less than RMB 20,000 (US$2,300)

- if the value of the seized goods is over RMB 200,000 (US$23,000) the bond should be RMB 100,000 ($12,000)

Article 22 also states that "subject to the consent of Customs, the IP holder may post a general bond with Customs." The amount of a general bond (in other words a bank guarantee or surety), must not be less than RMB 200,000 ($23,000). The GAC has apparently not yet determined how it will formally implement a policy of allowing for general guarantees. The IACC supports a policy whereby GAC would follow internationally established norms and liberally allow for the posting of general bonds in lieu of posting a separate bond for each seizure/case.[20]

For seizures made pursuant to Chapter Three of the new implementing rules (i.e., pursuant to a specific request/application from the IP owner), Article 15 states that the IP holder shall post "a bond equivalent to the value of the goods." Chapter Three of the new rules covers those situations where the right holder files an application for seizure on its own accord (and not in response to notice provided by Chinese Customs as a result of counterfeit goods discovered during an ex officio inspection as is the case with Articles 21 and 22 described above). The IACC would prefer that the bonding provisions provided for in Article 22 be made available across the board for all seizures and not just those based on ex officio discoveries of IP violations. Based on the current language in the rules, it is not clear if this is already the case.

The new regulations (issued March 1, 2004) also limit the scope of "counter-bond" payments to patent cases. Under the old system, suspected infringers were able to obtain the release of seized goods by simply paying a "counter-bond" equal to the value of the goods. The IACC was pleased to see this practice eliminated for trademark infringement.

Storage Costs/Disposition of Counterfeit Goods

Unfortunately, the new rules continue to require the right holder to cover the costs of storage and disposal of infringing goods (Articles 30–33). When Customs assists in the enforcement of an injunction or a property preservation ruling, the IP holder must cover the expenses related to warehousing, custody, disposal, etc., of the goods during the time period the goods are detained by Customs (Article 31). Right holders will also be required to cover the same costs when the goods are confiscated by Customs for a period of up to three months (measured from the date on which the decision to confiscate the infringing goods was served on the consignor or consignee). IACC members would like to see storage costs covered by the infringers.

One glaring deficiency is that the new rules continue to permit Customs to donate infringing goods to public welfare organizations. If the goods are not of the type that cannot be donated to a public welfare organization, the new rules permit the infringing goods to be auctioned after removal of the infringing features. Only when the goods cannot be disposed of by either charitable donation or public auction will the goods be destroyed.

The IACC believes these provisions are arguably inconsistent with TRIPS. The IACC further notes that counterfeit goods should always be destroyed and that donations to charity or public auctions should only happen with the prior consent of the right holder. We have three reasons for this position. First, nobody can or will vouch for the safety of a seized product. The dangers posed by counterfeit products like medicines, beauty care products, batteries or car parts are obviously significant. To avoid the problem of sending out dangerous products altogether, they should all be destroyed. Second, allowing counterfeit goods to re-enter the marketplace through charitable donations or auctions also hurts the right holder. Counterfeit goods are generally of lower quality than the legitimate product and allowing inferior products to re-enter the marketplace will only further injure the right holder's brand equity and valuable reputation among consumers. It is not uncommon for counterfeit goods donated to charity or sold at auction to re-enter the stream of commerce as they can easily be repurchased by the infringers and leave brand owners right back where they started. Finally, destroying the goods sends a message to counterfeiters and pirates that their illegal activities are never acceptable.

The new regulations do provide the right holder with the opportunity to purchase the infringing goods, but the rules fail to detail the price that would need to be paid

[20] The new European Council Regulation 1383/2003, July 2003, took effect on July 1, 2004, and states that rather than a bond, IP owners are to submit a declaration accepting liability (Article 6). The World Customs Organization's new Model Legislation concerning Border Measures (February 2003) has in the notes accompanying Article 10 suggestions and recommendations that Customs authorities permit a continuous bond so that IP owners are not under constant obligations to post new bonds for each shipment that is stopped. The notes also adopt the new European Council approach of a declaration rather than a bond.

to purchase the counterfeit goods. This seems to be the only way a right holder can guarantee that the fake goods will be destroyed and, logically, the practice seems inherently wrong. Having expended resources to get enforcement at all, the IP owner is practically forced to buy back counterfeits to ensure that they do not enter the stream of commerce.

Procedures in line with TRIPS Article 59 should provide for the government to order destruction of counterfeits rather than place the burden on IP owners. Moreover, given the potential high cost of storage, procedures should be adopted that are clear as to administrative handling of cases within a specific, but reasonable, timeframe with the possibility that destruction could occur except for samples as evidence once a definitive decision on the goods has been made.[21]

Criminal Transfer

Article 26 of the new regulations (issued March 1, 2004) specify that if Customs identifies a case suspected of constituting a criminal violation, Customs is required to transfer the case to the criminal authorities for prosecution. Absent the possibility of transferring customs cases for possible criminal investigation and prosecution, there is no deterrence. The new implementing rules do not contain a section dealing with criminal transfers.

IACC members are reporting that such transfers are still not taking place. Indeed, the IACC is not aware of any case transferred from Customs to the PSBs. Practical measures must be introduced to ensure that such transfers actually take place. Absent the possibility of transferring customs cases for possible criminal investigation and prosecution, there is no deterrence.

In late January 2005, it was reported that representatives from Chinese Customs and the police had scheduled to meet to discuss how they can better cooperate to ensure that more counterfeiters and pirates face the prospect of criminal investigations/remedies and how to speed up the criminal transfer process. Li Qunying, a director in the Intellectual Property Division of the Customs Service, emphasized the importance of information exchange in this regard and noted that, currently, Chinese Customs simply does not know when or if an infringer has been prosecuted in another part of the country.[22] The IACC urges the Chinese government to take the steps necessary to facilitate information referrals from Customs to the PSBs to investigate counterfeit and pirate manufacturing facilities uncovered during Customs investigations and seizures.

Chinese customs claims they have recently had some successful cases where the PSB intervened in parallel to customs (but not through a formal transfer where customs processed the export-trading company), while the PSB investigated the factory which supplied the goods. This is somewhat encouraging news, as it responds to requests from industry for stop-gap action. But without the threat of criminal enforcement, import/export companies in China will no doubt continue to be unwilling to cooperate fully in revealing the source of fakes; they will likewise not take seriously their obligations to check the legitimacy of the intellectual property content of the goods they handle.

Information Disclosure

Access to information should be guaranteed to IP owners. The new rules contain provisions detailing information that will be provided to IP owners after seizure of the goods (Article 28). Chinese officials should be encouraged to provide for the disclosure of information regarding persons/companies involved in the export of counterfeit and pirated goods (e.g., identity of Chinese companies that are supplying infringing goods to the consignors). IP owners would benefit significantly for having access to information such as the identity of overseas purchasers or Chinese factories/trading companies involved in the counterfeit production chain. In China, it is generally left to the brand owner to pursue counterfeit manufacturers as Chinese Customs has limited its scope of enforcement to the parties that actually declare the goods to Customs (generally the trading companies). Given the information disclosure possibilities under the European Council Regulations and U.S. regulations, this would simply make China consistent with many other countries.

Fines

The new regulations and the new implementing rules do not mention whether customs will continue to have the power to impose administrative fines against vio-

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[21] A legal determination as to whether the goods are counterfeit or not should be separate from a decision regarding the sanctions to be imposed upon the persons involved.

[22] *See* Emma Barraclough, *Chinese Customs to Cooperate in Criminal Cases*, Managing Intellectual Property, January 30, 2005, *available at http://www.legalmediagroup.com/news/print.asp?SID=15043&CH=*.

lators and there is no indication that rules permitting such fines will be issued anytime soon. Under China's earlier regulations, customs was empowered to impose fines up to 100 percent of the value of the goods concerned. IACC members encourage Chinese customs to follow international practice and continue to empower local customs to impose fines in amounts consistent with the PRC Trademark Law and Copyright Law.

Based on the foregoing, the IACC urges the Chinese government to:

(a) clarify inconsistencies within the new implementing rules regarding the bond requirements and permit the new "sliding scale" procedure to apply to all seizures;
(b) permit donations to public welfare organizations and public auctions of infringing goods only with the consent of the right holder and/or only after the right holder has been given the option of destroying the goods themselves;
(c) require the infringers to pay the costs of storage and disposal;
(d) transfer customs cases routinely for possible criminal investigation and prosecution;
(e) provide the identity of Chinese companies that are supplying infringing goods to the consignors and/or the Customs declarant; and
(f) restore the power of Customs to impose administrative fines against violators.

United States Chamber of Commerce

Submission for USTR's Special 301 Out-of-Cycle Review on China's IPR Protection and Enforcement

As the world's largest business federation representing 3 million businesses of every size, sector, and region, the U.S. Chamber has a considerable interest and stake in China's intellectual property rights (IPR) protection and enforcement efforts. We appreciate this opportunity to share our views on this critical matter. The following submission draws on the experiences of our broad membership, and we thank the member companies and organizations that contributed to this report.

I. Introduction

Despite some recent progress in China's IPR enforcement efforts relating to recent changes to China's legal regime for criminal IPR enforcement and the launch of a yearlong enforcement campaign, the scope of copyright piracy and counterfeiting in China, including the manufacture, distribution, sale, and export of counterfeit goods, worsened for our member companies in 2004. The U.S. Chamber was heartened by the promises of Vice Premier Wu Yi at the April 2004 Joint Commission on Commerce and Trade (JCCT) meetings on the intention of the Chinese government to significantly reduce IPR violations. However, we remain concerned that limited legal reforms and enforcement campaigns alone, without bolder changes to key laws, additional police resources, and new enforcement policies and procedures will fail to deliver the results that our companies expect and that Madame Wu and others in China's government have promised.

Based on inadequate levels of IPR protection and enforcement in China and their adverse impact on U.S. economic interests, ***the U.S. Chamber recommends that the Office of the United States Trade Representative (USTR) should immediately request consultations with China in the World Trade Organization (WTO) and place China on the Priority Watch List in its upcoming 2005 Special 301 Report.*** **The Chamber also believes that the USTR should conduct a second Special 301 Out-of-Cycle Review for China later this year to assess China's implementation of the judicial interpretation and other enforcement efforts.** The Chamber and its members are seeking demonstrable evidence in 2005 from Chinese authorities that the IPR climate is improving, including far-reaching systemic reforms and substantial prosecutions, convictions, and incarcerations that foster a climate of deterrence. Short of that evidence emerging quickly, the U.S. Chamber would support U.S. Government efforts to address China's failure to comply with its IPR commitments through the WTO and other policy mechanisms.

II. Scope of the Problem

After three years as a member of the WTO, it is clear that the protection which China is according to companies of all sizes fails on the whole to meet the standards of "effectiveness" and "deterrence" set out in the Trade Related Aspects of Intellectual Property Rights (TRIPS) Agreement. IPR violations now severely affect vir-

tually all industries, from consumer and industrial goods, medicines, autos and auto parts, food and beverages, and cosmetics to copyright works, including entertainment and business software, movies, music, and books.

China is also exporting counterfeit and pirated products widely to world markets. The failure to control such exports is eroding our companies' profit margins, diminishing brand value, and, in some cases, endangering public safety. Increasingly, counterfeiting in China of products derived from U.S. intellectual property (IP) is harming small- and medium-size U.S. businesses as well, many of which do not even have operations on the Mainland and must confront a flood of Chinese knock-offs in the U.S. market or in third-country markets where they export. Customs seizure statistics clearly indicate that China is the world's largest single source of counterfeit and pirated goods. U.S. Customs statistics showed an increase of 47% in the value of counterfeit goods seized in the year ending October 31, 2004. Statistics compiled for 2004 by other governments are expected to reflect a similar trend. China remained the single largest source of counterfeit goods in 2004. This is illustrated by U.S. and European Customs statistics, which suggest that Chinese fakes account for about 67% of all items seized.

China's increasing levels of piracy and counterfeiting are highlighted in, but not limited to, the following examples:

Autos

Counterfeiting and piracy of automotive products, trademarks, and designs in China are serious and growing problems facing the auto industry, governments, consumers, drivers, passengers, and pedestrians.

> *Counterfeit:* Counterfeit and pirated automotive products—inferior products intentionally misrepresented as genuine—can take several forms, including goods that do not meet national or international safety specifications or standards, packaged as genuine parts. The most common counterfeit parts are aftermarket maintenance and high-volume items, such as disc brake pads and shoes, batteries, wipers, belts, fluids, auto glass, oil and oil filters, spark plugs, alternators, valves, fan belts, and gasoline filters. In many cases, counterfeit parts very closely resemble authentic components, right down to packaging and other materials.
>
> *Trademark:* Automakers spend billions annually to market and promote their brand name so that it is widely recognized and respected. In China, the outright theft of a trademark for counterfeit products has become common, especially on parts packaging, and is becoming more common at the whole vehicle level, where similar, but not identical trademarks are often used.
>
> *Design/Patent Violations:* IPR violations can also take the form of theft or unauthorized copying of unique and protected design elements, from individual parts up to the entire look and design of a motor vehicle. The growth, scope, and magnitude of this problem in the automotive sector are alarming and should be closely monitored, both for violations and for lack of enforcement.

Consumer Products and Luxury Goods

Counterfeit consumer products and luxury goods—ranging from handbags to shampoos to disposable razors—are widely available in China both for use in the domestic market and for export. The problems faced by brand owners in this area are much the same as those faced by the auto and pharmaceutical sectors.

Not only are there the obvious health and safety issues to the consuming public, but also hundreds of millions, perhaps billions, of dollars of profits are lost each year. Economic loss is measured in direct lost sales as well as in the tarnished reputation of companies that have spent billions of dollars over many decades to assure the consuming public that when they buy "X" brand, they are buying the highest quality. Years of effort to foster brand loyalty can be lost in an instant when an unsuspecting consumer buys an inferior knock-off and then infers that the brand is "no longer what it was." To most brand holders, their brand, and the promise of the quality that it holds, is the foundation of their corporate structure.

It is in the consumer and luxury goods areas where some of the highest profit margins on counterfeits are made. Yet it is in these areas where sanctions by the Chinese government are often no more than a "slap on the wrist." The Chinese government seems to have taken the position that counterfeiting in these areas is a "victimless crime," and the only people being hurt are foreign corporations. The level of consumer and luxury goods counterfeiting in China is borne out by the statistics:

much of the 47% increase in the value of counterfeit goods seized by U.S. Customs from China in the year ending October 31, 2004 (from US$94 million in 2003 to $138 million in 2004) was made up of electronics, apparel, cigarettes, and luxury goods.

Copyright

U.S. copyright companies had US$2.6 billion in losses to piracy in China in 2003. The problem worsened in 2004 as China failed to increase arrests of major counterfeiters. The estimated piracy rate of films reached nearly 100%, and annual losses to the American film industry due to audiovisual piracy in China are estimated to be US$280 million in 2004, more than a US$100 million increase over the estimated losses in 2003 and the highest annual losses since 1995. Pirated music, books, business software, and video games are also readily available on the market, and unauthorized use of software by business is rampant, hindering the ability of both indigenous and U.S. creators and rights holders to build successful businesses. For example, losses to American sound recording companies exceeded $200 million in 2004. Internet piracy, such as the illegal and unauthorized downloads of online journals and other materials, is increasingly prevalent. There are thousands of active Web sites offering thousands of infringing copyrighted materials—some for sale, some for free.

Pharmaceuticals

China's IP protection for pharmaceutical patents remains weak. China agreed to protect pharmaceutical patents in the 1992 U.S.-China IPR Agreement and to provide WTO-consistent data exclusivity in its WTO Accession Agreement. Recent decisions by the State Intellectual Property Office and the Chinese courts striking down key U.S. pharmaceutical patents underscore the weakness of China's patent regime. Inconsistent application of data exclusivity and patent linkage rules creates uncertainty in the market and undermines investor confidence. An additional problem facing the pharmaceutical industry in China is the unlicensed production and trading of a medication's active ingredient in bulk form. Chemical companies engaging in this practice should be subject to the same regulations governing production and trading of pharmaceuticals. Lastly, counterfeit pharmaceuticals represent a significant and increasing problem in China, especially over-the-counter products sold outside of hospitals. The fact that there is no such thing as a "safe" counterfeit medicine makes drug counterfeiting unique. The health risk associated with counterfeit medicine should, in and of itself, be enough to generate automatic criminal investigations.

In sum, the scope of counterfeiting and piracy in China remained the same, at best, and, in many instances, worsened in 2004 for our members.

III. Assessment of Key 2004 Developments

Noteworthy IPR-related developments in China during 2004 are as follows:

Judicial Interpretation

In a positive development, China's Supreme People's Court and Supreme People's Procuratorate issued a long-awaited judicial interpretation on December 21, 2004. While this interpretation includes a number of very important changes that can bolster IP criminal enforcement efforts, it also demonstrates a questionable commitment to success by leaving key enforcement questions unanswered.

In a positive sense, the *Judicial Interpretations on Several Issues Regarding Application of Law in Criminal Intellectual Property Rights Cases* aims to increase criminal prosecutions of IP offenses, and ultimately raise the level of deterrence to IP theft in the market. The U.S. Chamber is encouraged by the release of this new interpretation, which contains a number of potentially helpful changes to China's criminal IP enforcement regime, including the following:

- ➢ The interpretation reduces the numerical thresholds for prosecution and conviction in criminal IP offenses—to as low as US$3,700 in some cases. For copyrights cases, the interpretation reduces the numerical thresholds for pursuing criminal liability to US$6,000 for the value of an infringing product and to 1,000 for the number of units sold.
- ➢ The interpretation institutes minimum jail sentences for "extremely serious cases."
- ➢ If an offender has been raided on multiple occasions, the interpretation permits authorities to aggregate the value of products seized to generate the illegal business amount for criminal enforcement purposes.

- ➢ The interpretation allows authorities to hold criminally liable as an accomplice parties that knowingly provide funding, transportation, or other support for counterfeiting activities.

Regrettably, however, this interpretation remains untested, and it is unclear whether the political will now exists in China to allow China's criminal enforcement and judicial authorities to seize upon the lower thresholds in the interpretation to increase prosecutions, convictions, and imprisonment of IP offenders. We must see evidence of these actions in 2005.

Also regrettably, China failed to send a clear signal to IP owners and infringers that it would no longer tolerate counterfeiting and piracy. China must quickly address key enforcement questions if the interpretation is to translate into meaningful results.

- ➢ **Thresholds Offer Loopholes:** We are concerned that the interpretation continues to rely on thresholds that in certain instances remain too high and provide gaping loopholes that potential counterfeiters and pirates are likely to exploit. Continuing dependence on thresholds, that in the eyes of many experts contravene the TRIPS standard of "commercial sale," sends IP owners and infringers a mixed message about China's commitment to prosecute, convict, and jail IP offenders.
- ➢ **Individual Vs. Enterprise Designation:** The new interpretation also perpetuates a distinction between individuals and enterprises with respect to the thresholds that must be met before offenders can be subjected to criminal penalties. This artificial difference, which allows enterprises to counterfeit or pirate at three times the level of an individual before the relevant threshold is met, offers a loophole to counterfeiters that will spur abuse of China's corporate designation.
- ➢ **Valuation:** The Chamber is disappointed that the judicial interpretation failed to set forth clear procedures that would allow enforcement authorities to use the market price of the infringed goods, rather than the infringer's price, to calculate illegal business volumes. Given the wide disparity that often exists between the market and the infringer's price, it is essential that the authorities use market prices if the thresholds in the judicial interpretation are to be meaningful. The Chamber hopes that China will move quickly this year to clarify the new interpretation to make clear to IP owners and infringers that market prices will be used to calculate thresholds.
- ➢ **Knowledge Standard:** The interpretation also narrowly prescribes when authorities may presume that a vendor is knowingly selling infringing goods. This restrictive "knowledge" standard could create new loopholes and provide an excuse for local authorities to refuse to investigate or transfer cases from the administrative to the criminal enforcement track.
- ➢ **Repeat Offenders and Export Enforcement:** The lack of language targeting repeat offenders and language identifying the export of infringing products as a type of "sale" are glaring omissions in the interpretation.
- ➢ **Copyright Loopholes and End User Piracy:** In the copyright area, the interpretation continues to rely on relatively high numerical thresholds that could provide loopholes to pirates. The new interpretation also fails to specify a liability standard for end users of infringing software and reinforces a flawed provision in China's criminal code, which requires that copyright violators must be shown to have acted with a profit-making motive to be convicted of an IP crime. Criminal enforcement of copyright continues to be burdened by the fact that China's criminal code requires a demonstration that piracy is occurring for the purpose of making a profit, which is very difficult to prove, especially in the online environment.

Enforcement and Awareness Campaigns

The Chamber also recognizes that China has initiated new enforcement campaigns during 2004 and into 2005. These campaigns appear to be aimed at fostering increased coordination among and between authorities at the central and local levels responsible for IP protection and enforcement. Senior Chinese government officials and Public Security Bureau (PSB) officers have touted "Operation Mountain Hawk," a yearlong campaign directed at coordinating and increasing the IP enforcement efforts of local police, as a significant step forward in China's efforts to reduce IP infringement. To ensure the effectiveness of these campaigns, China needs to quickly release new guidelines that encourage IPR case acceptance and investigation by police authorities. We also remain concerned, however, over the lack of information being disclosed by the Chinese government regarding the exact level of new police resources that are being allocated to IP enforcement. China's oral commit-

ment to crack down must be accompanied by new resources that target, in particular, IP hot spots throughout China. Whether such resources and supplementary police action are forthcoming will determine, in part, whether China's enforcement results match its public statements.

Customs Regulations

New regulations issued by China's General Administration of Customs in 2004 focused on customs enforcement of IPR. In a positive step, the new regulations now allow customs to enforce an unrecorded right, increase transparency for the transfer of customs IPR enforcement cases to the Chinese police, and could substantially lower deposit amounts for detention of infringing products in some cases. The regulations, nevertheless, fail to improve the linkage between China's courts and customs authorities, and IP owners are likely to continue to experience difficulties in obtaining judicial action on cases in which customs has already acted in an administrative capacity. The new rules also increase the burden and risk on IP owners, who are now responsible for damages arising from Customs failure to confirm actual infringement in the case of a seizure of goods. The Chamber hopes that China will further clarify its IPR enforcement framework in 2005 in a manner that allows customs and criminal enforcement authorities to work in tandem to prosecute offenders and to curb exports of counterfeit products.

IV. U.S. Chamber Expectations for China's IPR Protection and Enforcement in 2005

The U.S. Chamber acknowledges China's increased efforts in recent months to arrest its deteriorating IP climate, including through the issuance of the judicial interpretation. We wish to underscore, however, that these steps, which have focused overwhelmingly to date on process-related improvements, are insufficient to halt China's worsening IP environment. They should quickly be buttressed by more comprehensive efforts and resources to protect and enforce IPR during the first half of 2005.

To ensure that the momentum generated under Vice Premier Wu's leadership during late 2004 is not lost, we call upon China to accelerate its IP enforcement efforts in the following areas during the first half of this year:

1. China should expeditiously resolve high-profile IPR cases, including the Pfizer patent case and General Motors trade secrets case, to send a clear signal to IP owners and infringers that China is indeed serious about combating IP theft.
2. Building on the issuance of the judicial interpretation in late 2004, China should during the first half of 2005 strengthen and supplement existing laws and regulations relating to criminal, administrative, and civil enforcement to achieve the following:
   - Clarify legal provisions, including standards for case acceptance and investigation by the police, to facilitate criminal investigations and prosecutions against parties in China involved in the production and trading of counterfeit and pirated products destined for export to other countries.
   - Strengthen administrative sanctions through the issuance of new regulations that will impose deterrent fines on IPR violators, clarify the conditions under which other sanctions may be imposed, and ensure that IPR violators are referred for criminal prosecution in appropriate cases based on clearly understood standards.
   - Increase the effectiveness of the seizure and destruction of infringing products and, where appropriate, significantly enhance the practice of confiscating and destroying equipment used in the production and/or packaging of counterfeit goods.
   - Clarify the standards for the issuance of preliminary injunctions in civil disputes involving IPR.
3. China should allocate substantially greater resources for police investigations into counterfeiting and piracy. It should consider the establishment of specialized IPR enforcement teams within police units in key areas.
4. China should enact legislation to provide full copyright protection and enforcement and accede to and implement the WIPO Internet treaties, namely the WPPT and the WCT, and bring its copyright law into compliance with the TRIPS Agreement, including eliminating the current requirement that the infringement occurred for the purpose of making a profit. In particular, China should provide enforcement procedures that permit effective action against any act of infringement, including expeditious remedies to prevent infringements and remedies that constitute a deterrent to further infringements.

5. China should accelerate efforts to promote public awareness of the dangers of IPR violations in collaboration with Chinese and foreign business leaders.
6. China should strengthen border enforcement to curtail the massive flow of counterfeit and pirated products into and out of the country. Enforcement measures should include prompt and thorough investigation of new cases and increased information sharing and cooperation with police and customs authorities in other countries.
7. In accordance with China's WTO obligations, China should freely circulate for comment to foreign governments and business communities draft regulations in the areas of standards for criminal case acceptance and investigation, criteria for the transfer of cases from customs to police authorities, and guidelines for calculating administrative fines and determining the conditions under which infringing goods and associated production equipment may be destroyed.

V. Recommendations to the U.S. Government

The U.S. Chamber strongly supports the ongoing work of the USTR and other departments to monitor and enforce China's IPR commitments, both in a bilateral and multilateral context. To ensure the continued effectiveness of U.S. Government efforts, the Chamber recommends the following:

1. The U.S. Government should establish and administer a new system to rank China's provinces for IPR protection and enforcement. The U.S. Government should release the results of this evaluation to the public in a semiannual report.
2. The U.S. Government should increase funding for monitoring and enforcing China's IPR commitments. The Chamber hopes that the U.S. Government will continue to work closely with the U.S. private sector to maximize synergies stemming from close public-private partnerships in the areas of policy, public awareness, and capacity building.
3. The U.S. Government should bolster its diplomatic efforts to foster multilateral approaches to combating IPR theft in China and elsewhere.

VI. Conclusion

As the U.S. Chamber stated in its fall 2004 report on China's WTO implementation record, enforcement of IPR will not be effective until civil, administrative, and criminal penalties are routinely applied to IPR infringers. While China's government modestly improved its regulatory environment for IPR protection and carried out raids and other enforcement actions at the central, local, and provincial levels in 2004, administrative penalties remain small or nonexistent. Despite some signs that new efforts are under way, the commitment to pursue criminal prosecutions with deterrent penalties remains weak, at best. Action plans are urgently needed that focus on specific regimes and direct greater attention to generating public awareness of the need for effective IP protection. The limited steps taken by China to date do not match the boldness required to arrest the worsening IP climate that both domestic and foreign companies face from the continuing surge of counterfeiting and piracy in China.

The U.S. Chamber is eager to do its part to ensure that the Chinese follow through on Vice Premier Wu Yi's April 2004 commitment to stronger enforcement efforts, including greater use of criminal prosecution and deterrent-level penalties. In this regard, we look forward to advancing capacity-building efforts in China during the first half of 2005 and to assisting the government to carry out a coordinated IPR educational and public awareness campaign. To achieve these goals, we will embark on a program that furthers coordination of enforcement initiatives among central and local government bodies through on-the-ground Chamber efforts. We will also work closely with our AmChams in China and other key stakeholders in the United States, Europe, and Japan.

The Chamber looks forward as well to working closely with the U.S. and foreign governments, our corporate members, and counterpart associations, including with our AmCham network in China, to benchmark China's progress in implementing the new judicial interpretation through monitoring the number of judicial prosecutions, convictions, and jail sentences for IP crimes in 2005. In addition to monitoring the criminal track of enforcement, we will collaborate with these partners to track enforcement by administrative agencies, including administrative penalties, export enforcement, and the number and types of cases that are referred from the administrative enforcement channel to the criminal track.

A reduction in China's piracy and counterfeiting levels in 2005, however, will ultimately hinge on Chinese authorities' political will to use all available tools in key hot spots to prosecute, convict, and jail offenders, while simultaneously employing and enhancing administrative measures and linkages to the criminal prosecution

process. Prosecuting, sending and keeping major criminals in jail are vital to bringing this form of large-scale, criminal activity under control. The sincerity of China's pronouncements that it is serious about protecting and enforcing IP rights will further be tested by its willingness to eliminate loopholes for infringers in existing and new regulations and to resolve high-profile cases that impact domestic and foreign IP owners.

Full protection under PRC law and enforcement of IPR in China as set forth in China's TRIPS obligations are critical to the interests of foreign and PRC companies in China, as well as to China's public health and safety, the integrity and attractiveness of China's investment regime, and its broader economic development goals. We hope that the PRC government will accelerate IP enforcement in 2005 by further enhancing national leadership and dedicating additional capital and resources. Only through the exercise of even more aggressive measures will China's IPR protection enforcement regime be effective and respected.

In light of our ongoing concerns regarding China's protection and enforcement of IPR, the U.S. Chamber is fully justified in asking the USTR to immediately request consultations with China in the WTO and place China on the Priority Watch List in its upcoming 2005 Special 301 Report. We remain hopeful that China will dramatically improve its IPR record in 2005, but we remain insistent on seeing tangible evidence of that improvement this year.

STATUTORY MANDATE OF THE U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

Pursuant to Public Law 108–7, Division P, enacted February 20, 2003

RESPONSIBILITIES OF THE COMMISSION.—The United States-China Commission shall focus, in lieu of any other areas of work or study, on the following:

PROLIFERATION PRACTICES.—The Commission shall analyze and assess the Chinese role in the proliferation of weapons of mass destruction and other weapons (including dual use technologies) to terrorist-sponsoring states, and suggest possible steps which the United States might take, including economic sanctions, to encourage the Chinese to stop such practices.

ECONOMIC REFORMS AND UNITED STATES ECONOMIC TRANSFERS.—The Commission shall analyze and assess the qualitative and quantitative nature of the shift of United States production activities to China, including the relocation of high-technology, manufacturing, and R&D facilities; the impact of these transfers on United States national security, including political influence by the Chinese Government over American firms, dependence of the United States national security industrial base on Chinese imports, the adequacy of United States export control laws, and the effect of these transfers on United States economic security, employment, and the standard of living of the American people; analyze China's national budget and assess China's fiscal strength to address internal instability problems and assess the likelihood of externalization of such problems.

ENERGY.—The Commission shall evaluate and assess how China's large and growing economy will impact upon world energy supplies and the role the United States can play, including joint R&D efforts and technological assistance, in influencing China's energy policy.

UNITED STATES CAPITAL MARKETS.—The Commission shall evaluate the extent of Chinese access to, and use of United States capital markets, and whether the existing disclosure and transparency rules are adequate to identify Chinese companies which are active in United States markets and are also engaged in proliferation activities or other activities harmful to United States security interests.

CORPORATE REPORTING.—The Commission shall assess United States trade and investment relationship with China, including the need for corporate reporting on United States investments in China and incentives that China may be offering to United States corporations to relocate production and R&D to China.

REGIONAL ECONOMIC AND SECURITY IMPACTS.—The Commission shall assess the extent of China's "hollowing-out" of Asian manufacturing economies, and the impact on United States economic and security interests in the region; review the triangular economic and security relationship among the United States, Taipei and Beijing, including Beijing's military modernization and force deployments aimed at Taipei, and the adequacy of United States executive branch coordination and consultation with Congress on United States arms sales and defense relationship with Taipei.

UNITED STATES-CHINA BILATERAL PROGRAMS.—The Commission shall assess science and technology programs to evaluate if the United States is developing an adequate coordinating mechanism with appropriate review by the intelligence community with Congress; assess the degree of non-compliance by China and [with] United States-China agreements on prison labor imports and intellectual property rights; evaluate United States enforcement policies; and recommend what new measures the United States Government might take to strengthen our laws and enforcement activities and to encourage compliance by the Chinese.

WORLD TRADE ORGANIZATION COMPLIANCE.—The Commission shall review China's record of compliance to date with its accession agreement to the WTO, and explore what incentives and policy initiatives should be pursued to promote further compliance by China.

MEDIA CONTROL.—The Commission shall evaluate Chinese government efforts to influence and control perceptions of the United States and its policies through the internet, the Chinese print and electronic media, and Chinese internal propaganda.

LIST OF WITNESSES, COMMUNICATIONS, AND PREPARED STATEMENTS