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Good afternoon. Thank you all for that warm welcome. And thank you, John **[Frisbie, President of the Council]** for that kind introduction. I appreciate the opportunity to be with you today and to participate in the Forecast 2006 event. It's good to see some familiar faces and to have the chance to meet new friends.

As John mentioned, I'm a relatively new addition to USTR, having joined Ambassador Portman's team at the end of last year. But, in true USTR style, they had me using my passport just hours after being sworn in, accompanying the Ambassador on a trip to China, India and Korea, and then participating in the WTO Ministerial in Hong Kong shortly thereafter.

Although new to USTR, I feel like a bit of a veteran in the Bush Administration. I joined in 2001, working under Secretary Evans at the Department of Commerce for two years, and then moving to the Department of Transportation to work for Secretary Mineta in 2003. Over the course of my four-and-a-half years at these two agencies, I have been privileged to view and participate in U.S. international trade policy – and U.S. trade policy with respect to China in particular – through some interesting windows.

First, through the window of U.S. export control policy, where many of our most challenging issues pertained to the export of dual-use goods and technologies to China. The decisions whether to license a particular export – or to change policy governing exports of a particular category of controlled item – required careful consideration, not only of U.S. commercial interests, but also of China's economic position, its trade practices, its rapidly changing technological capabilities, and the national security and foreign policy dimensions of our relationship.

And then, over the past two years, I was privileged to view our relationship with China through the prism of U.S. transportation policy. The degree to which our transportation policy is affected by China surprises many, and yet it is profound – ranging from the pressure placed on U.S. ports and rail by burgeoning U.S. trade with China … to our efforts to expand the access of U.S. airlines to the Chinese market … to the impact that Chinese demand for oil and steel has had on the construction of U.S. automobiles, bridges and roads.

So suffice it to say that for a number of years, I have been thinking a good deal about China – traveling there a good bit, meeting with Chinese counterparts even more frequently, and negotiating over issues that varied from in-country inspections of U.S. high technology exports to airline and maritime service rights. And I have also been privileged to meet and speak with many on this side of the Pacific concerned with our trade relationship with China – including

U.S. companies seeking to enhance exports to China, members of Congress concerned about issues of security and religious freedom and American competitiveness, and employees concerned that competition from Chinese producers will cost them their jobs.

I come away from this experience with a number of thoughts about our trade relationship with China and how it is best managed, some of which I will circle back to in a moment. But as an overarching statement, I think that one can say several things about the relationship that are unquestionably true.

First, the U.S.-China trade relationship is enormously important and, accordingly, merits careful thought and attention. As some of you may know, at Ambassador Portman's direction, USTR's China office is leading an inter-agency "top-to-bottom" review of U.S. trade policy with China. In upcoming weeks, we will lay out our findings and recommendations. This has been a valuable effort and one that bears repeating from time to time to make sure that our trade policy with respect to China remains on course.

Second, as China's economy and our bilateral trade grow, our trade relationship has become enormously complex. Features of this relationship – the size of China's consumer base and labor force, for example, or the increasing sophistication of Chinese production – can be both encouraging and concerning at the same time. In short, the relationship lends itself neither to simplistic characterizations nor simple policy prescriptions. Instead, I believe, it calls for actions that are tailored to particular challenges or aspects of our relationship and that are informed by an understanding of the relevant Chinese forces and actors.

Third, this relationship is undergoing a process of rapid change.

In my remarks this afternoon, it is precisely this process of change that I want to talk about. Specifically, I would like to talk first about where our trade relationship currently stands, and second, about where we see the relationship going.

When attempting to take stock of where the U.S.-China trade relationship currently stands, it is instructive to look at where our relationship was 25 years ago, which in the grand scheme of things really isn't that long ago – except, of course, when you are talking about China.

In 1981, China had just begun to emerge from the Cultural Revolution, and to abandon the failed autarkic development model that it had pursued. U.S. trade with China amounted to $5.7 billion that year. U.S. exports were in the neighborhood of $3.6 billion, more than half of which were agricultural products, while Chinese exports to the U.S. amounted to $2.1 billion, over half of which were simple manufactures. China constituted the United States' 15th largest export market, but only its 26th largest supplier of imports, ranking behind countries like Malaysia, Indonesia, Australia and South Africa. U.S. goods trade with China recorded a surplus of $2.1 billion in 1981. There was virtually no U.S. direct investment in China, nor any Chinese investment flows into the United States.

Given those numbers, it is not surprising that trade was not exactly the defining issue in our relationship with China in 1981. Of far greater concern, of course, were China's strategic intentions, its role as a potential ally against Soviet aggression, and its repression of domestic dissent.

Fast forward twenty-four years. The tally for U.S. trade with China in 2005 – once the numbers are totaled up – will likely amount to about $286 billion – more than 50 times the amount of bilateral trade in 1981. U.S. exports to China for 2005 – again, once the data is all in – are likely to reach about $42 billion. Our exports today are substantially more diverse: agriculture last year accounted for about one-eighth of our goods exports, with the rest of our goods exports led by machinery, aircraft, and optical, photographic and medical equipment. Chinese exports to the United States will be in the neighborhood of $245 billion -- generating a trade imbalance of approximately $200 billion … more on that later. China's exports to the United States today are dominated by a broad range of manufactures, representing China's strengths as a final point of assembly for companies in Asia and elsewhere, as well as by traditional, simple manufactures such as apparel, footwear, and toys.

China has grown on a country basis from our 15th to our 4th largest goods export market – trailing only Canada, Mexico, and Japan – and has become our second largest supplier of imports, behind only Canada. And in the area of direct investment, U.S. investment in China in 2004 – the most recent year for which data is available – reached an impressive $15.4 billion.

Today, our economic relationship is one of the principal issues – if not <u>the</u> principal issue – in our bilateral government-to-government relationship, and, according to one recent poll that I have seen, it is the first issue that comes to mind when the average American is asked about China.

What is noteworthy about the relationship is that, unlike many others, the bilateral trade relationship with China is critically important not only to China and the United States, but also to rest of the world. Let me address each in turn.

Thanks in large part to an export-led growth strategy – targeted in no small measure at the U.S. market – China's economic growth rate has exceeded an extraordinary nine percent for more than 20 years. But trade has permitted China to undergo more than just rapid economic growth. It has facilitated a political, social and technological transformation as well. Trade in items ranging from aircraft to telecommunications services to computer software has permitted the Chinese people to connect with each other, with people abroad, and with <u>ideas,</u> to an extent previously unknown.

Which is not to say that the impact of China's growth strategies has been unlimited. For one thing, economic growth has not touched everyone. Notwithstanding the migration of an astonishing 100 million people from the countryside to cities, hundreds of millions still live a hardscrabble rural existence far from the changes and growth that characterize many Chinese cities. Moreover, there have been clear limits on the extent to which economic reforms have generated political reform. While trade, economic growth and technological innovation have forced Chinese officials to accept some free flows of information, the suppression of civil liberties and religious freedom persist, posing a disturbing impediment to China's long-term quest for economic growth and political stability.

In the relatively brief period of the past 25 years, the U.S.-China trade relationship has had an important impact on the United States as well.

To start, U.S. exports to China have increased, especially in the past five years, since China entered the WTO. In fact, they have risen five times faster to China than to the rest of the world. U.S. consumers have clearly benefited from the trade relationship, having access to a wider variety of less costly goods. U.S. manufacturers – and the millions of Americans who invest in them – have also benefited by being able to source parts and equipment from low-cost suppliers in China. This has helped them stay competitive and led to greater efficiency and creation of more, higher paying jobs here at home.

On a macro-economic level, these low-cost consumer and industrial goods have assisted the United States in holding the line on inflation for a long time. This in turn has helped the Federal Reserve to maintain historically-low short-term interest rates for a sustained period, thus spurring U.S. economic growth – growth that in the past year was double the average growth rate of the other G7 countries.

The benefits to the United States of China's export-led growth strategy and economic transformation, moreover, extend beyond economics. There are clear political and strategic benefits that derive from a China whose economic health is tied into international commercial flows.

But challenges remain. Many in the United States are profoundly uneasy over the current state of our trade relationship, and there is growing frustration that China is not "playing by the rules." Exhibit #1, of course, is the trade deficit. That deficit exceeded $200 billion in 2005 – the largest bilateral trade imbalance in the history of the world. Simply stated: an imbalance of this magnitude is not sustainable, either economically or politically, over the long term. One need only ask whether – if the tables were turned – China would tolerate a bilateral trade imbalance of that size with the United States?

Americans are rightly proud of our ability to compete, but cannot do so when China is offering generous subsidies to favored industries, creating barriers to American products, and following currency policies that inflate the price of U.S. imports while making Chinese imports to the United States artificially cheap.

Nor do Americans believe that China is competing fairly when rampant piracy, counterfeiting, and copyright infringement cost American businesses billions of dollars each year. It is theft pure and simple, and American businesses are right to insist that it stop. Camcorders have no place in movie theaters, and factories turning out rip-offs of everything from handbags to autos need to be shut down. Even companies that have substantial operations in China want to see improvement – especially in the IPR area. A 2005 White Paper issued jointly by the American Chamber of Commerce in China and the American Chamber of Commerce in Shanghai reported that 80 percent of 331 American companies surveyed described China's IP protection as "ineffective" or "totally ineffective."

The upshot of these difficulties, not surprisingly, is that support for the bilateral trading relationship is being challenged as never before. Perhaps most troublingly, small and medium-sized manufacturers, in particular, have begun to wonder whether a growing trade relationship is in their best interests. And, absent progress, some in Congress have indicated that they may well act.

The U.S.-China trade relationship – and many of the changes it has wrought – has also had a profound effect on the global economy. China has played a growing role as a final assembler for companies located elsewhere in Asia. It has emerged as a tough competitor for third countries that traditionally have been major suppliers to the U.S. Moreover, China is competing with these countries not only for U.S. market share, but also for foreign direct investment. Indeed, China has become a "battleground" for today's multinationals, which have been willing to invest billions to capture shares of the rapidly growing China market and to capitalize on China's competitiveness as a production base. But at the same time, China's rapid growth has also generated growth abroad – particularly in the Asia Pacific region, where major trade partners Korea, Malaysia, Indonesia, Singapore, Philippines and Taiwan averaged real economic growth rates of just over 5% a year over the past ten years. For developing countries in Asia other than China, China is the largest single goods export market and the largest single supplier of imports. In addition, China has sought to expand its economic reach, seeking to foster trade and investment relationships with many lesser developed countries in Latin America and Africa.

While China's rise as a trading power has had important effects, trade-savvy commentators have, in recent years, been increasingly disturbed about China's failure to participate in the <u>strengthening</u> of the global trading system. They point, for example, to China's reluctance to open its markets beyond the specific requirements of its accession agreements, or to play a more active and positive role in the Doha Round negotiations. These criticisms are not without merit – China has <u>not</u> played a role in strengthening the international trading system commensurate with its commercial heft and with the benefit it has obtained from that system.

In many ways, the United States and China have entered the third phase of our economic relationship in the modern era. The first began in 1986 when the United States formally acknowledged China's goals to modernize and integrate itself into the global marketplace by commencing negotiations for China to become a party to the General Agreement on Tariffs and Trade (GATT), or as it was subsequently renamed, the World Trade Organization.

That phase lasted for 15 years and was focused on identifying and negotiating the kinds of commitments China needed to make in order to gain admission to the WTO. Great strides were made during that first phase in modernizing and strengthening our bilateral trade relationship. By the end of this period, China had made enough progress in its own program for reform and opening that it was able to agree to lower trade barriers in virtually every sector, protect intellectual property rights, and adopt special rules to address subsidies and other forms of state ownership and control of economic resources.

The second phase began in December 2001, when China joined the WTO and began to implement the commitments it made as a condition of membership. During this time, we essentially focused on a checklist of China's obligations, and our view of China's performance as a trading partner was largely based on how well it implemented the items on the checklist. That checklist addressed issues such as scheduled reductions in tariff rates, expansions in market access for services, and elimination of non-tariff barriers. Input from many businesses represented here today has played an important role in helping us evaluate China's performance.

China made progress with respect to many of the items on that checklist. For example, China lowered its tariffs on the goods of greatest value to the U.S. economy from an average of 25 percent to an average of seven percent; most import license requirements were eliminated; companies were granted trading rights and allowed to engage in distribution; and new opportunities were created for many companies in the service sector.

But it has now been four years since China joined the WTO. China has a track record now as a WTO member, and that track record is decidedly mixed. The commitments that were easiest to fulfill have largely been fulfilled, and those still outstanding will require a more serious level of bilateral and multilateral focus and attention.

As we enter the third phrase of our bilateral trading relationship with China, China's apprentice period must now come to a close, and China must act as a fully accountable participant and beneficiary in the international trading system. It must act in all aspects of its trading relationships – multilaterally, regionally, and bilaterally – as a mature partner and, to borrow a phrase, a "responsible stakeholder." Like any stakeholder, China must find a way to pursue its own self-interest while also adhering to, and helping to shape, the policies and institutions that undergird its own growing prosperity and the prosperity of its trading partners. The United States will work constructively – as we have over the past 25 years – to help China fulfill this role. But, given the nature of the challenge, much of the burden must fall on China itself.

Unfortunately, some within China continue to advocate a very guarded approach towards economic liberalization. Their approach favors careful selection of sectors and markets for at best partial opening, continued state control, government collaboration with and protection of local interests, non-transparent decision-making, and even subtle (or not so subtle) threats of intimidation against domestic or foreign companies that buck the system. This approach fosters inefficient allocations of resources, uneven applications of the law, and corruption. In short, advocates of this approach have not yet fully embraced the culture of free enterprise, transparency and the rule of law that is necessary for creativity and entrepreneurship to flourish and sustain long term economic growth. China must move more fully beyond this approach, recognize the systemic value of an open and free trading system, and on this basis engage as a leading partner in global trade.

Multilaterally, China must play a role commensurate with its global economic heft. China has gained a lot from its membership and participation in the international trading system. And it stands to lose much if that system is weakened or atrophies. As it takes its place as one of the larger WTO members, China should be expected to provide leadership in advancing the rules-based system and a global framework for fair and free trade in the context of the WTO. At the most basic level, that means advancing meaningful offers and requests in the WTO negotiations, especially in the areas of agriculture and services. It also means fully embracing and complying with the letter and spirit of the obligations it has already undertaken.

Much as we have seen China play a constructive role in regional efforts to address threats such as North Korea's nuclear weapons program, we need to encourage China to play a constructive role in ensuring that the conditions for safe, secure and efficient trade prevail in the region. As both a driver and beneficiary of economic growth in the Asia Pacific region, China has a great incentive in joining with other regional economies to open markets, promote trade security, and build the infrastructure needed to ensure that trade can flow smoothly. It also has powerful incentives to address proactively threats – such as disease and pollution – that do not recognize national borders, but that could have enormously damaging effects on trade – to say nothing of human welfare – if left unaddressed.

And, while China has recently made important contributions in APEC, the region would be benefited by greater Chinese leadership in APEC in helping to advance the Doha Round, improve intellectual property protection, and help ensure that FTAs in the region are comprehensive and ambitious.

More has been done by the United States to promote and facilitate China's integration into the international trading system than has been done by any other nation in the world. Through sustained and constructive engagement, the United States has contributed greatly to China's integration into the global economy and its current success as a rising economic power. In this same vein, the United States will continue to engage China as it continues its transformation.

Whether through high level fora or the more routine contacts that occur regularly – and most certainly will increase – between officials of our two governments, we will work steadily to broaden and deepen our relationship, and to make progress in addressing the discrete challenges that confront it. As we move into this new phase of our trading relationship, it is critical that China – as a responsible international trading partner – demonstrate the commitment to the rule of law needed to confront rampant intellectual property rights violations. It is equally critical that, as a responsible partner committed to a growing bilateral trade relationship, it address non-tariff barriers to trade and other restrictions that make it hard for our companies – especially small or mid-sized U.S. companies – to do business in China. And we will continue to press China to address policies that make it difficult and often impossible for our competitive domestic companies to compete against unfairly subsidized Chinese exports.

We will carry forward this agenda in a smart, targeted, constructive, respectful, but firm way. Our experience in negotiating an expanded air services agreement with China offers a bit of guidance in that regard. This agreement was, I would submit, one of the more significant successes of the last 18 months in gaining new market access for U.S. companies to the Chinese market – an agreement by China to allow the United States to more than double the number of airlines permitted to operate to China, increase by five-fold the number of flights they could operate, and expand substantially the scope of their operating rights in China. I believe that several useful lessons can be learned from that experience:

- First, China will move when it believes that it is in its commercial interests to move. In the case of the air services agreement, we argued that constraints on air transportation ran the risk of choking China's own economic growth. We took the time to explain to senior Chinese policymakers – in a number of relevant agencies – why liberalization of this sector was in their best interests. We were given a fair hearing, and ultimately prevailed.

- Second, important progress can be made in incremental steps. In the air services context, China was not prepared to subject itself to the full force of an "Open Skies" agreement – a deregulated air services market. But it was prepared to accept substantial liberalization, and we – wisely, I believe – took that important incremental step forward.

- Third, it is important to take a longer-term view of China's development, especially where it offers win-win solutions. Case in point: one of the rights we sought and obtained was an "unlimited" right for U.S. airlines to operate services to certain "underdeveloped" parts of China (principally in its Western and Northeastern provinces.) While China was quite willing to grant the rights, no U.S. carrier thought the rights were worth much at the time, with most carriers interested only in the developed markets in Beijing, Shanghai and Guangzhou. However, less than a year after concluding the agreement, U.S. carriers have been approached about and are exploring the possibility of entering these markets. China is changing so quickly that it behooves us to take a longer-term view when defining our goals.

- Fourth, we must remember that China – and the Chinese Government – is itself in process of generational change, and we must seek to encourage that change. In the case of the air services agreement, progress was achieved quickly with the arrival on the scene of a young and quite forward-leaning minister for civil aviation.

While the air services agreement provides some useful lessons, I don't pretend that this relatively discrete negotiation offers all the solutions. These same approaches may not work to address other, more intractable bilateral problems. Indeed, some of those problems may not be amenable to negotiated settlements at all.

In that regard, I should make it clear that the United States will not hesitate, when appropriate, to use all tools at its disposal to ensure that China lives up to its commitments, including dispute settlement at the WTO or the use of trade remedies within our own legal system. Earlier this month, we were poised to bring a case against China for its treatment of our kraft linerboard exports, when at the eleventh hour China reversed course and rescinded its improper antidumping duties. We will continue to hold China accountable. That is our responsibility to the workers, farmers, and businesses here in the United States.

However, utilizing these tools should not be viewed as a failure in our bilateral relationship. If our two countries have a dispute and use legal channels to resolve it, it is not a sign of an adversarial relationship but rather a sign of a mature one. After all, disputes between the United States and Europe have not obscured the benefits of our billion-dollar-a-day trade relationship. And knowing that litigation is a real option tends to have the benefit of focusing minds on viable solutions.

Above all – as I said at the start – our trade policy with respect to China must be credible and muscular, but also flexible. We have a complicated task as we seek to achieve the dual objectives of solving specific, immediate problems, and encouraging the long term transformation of China into a rules-based, open economy. Solutions that work in one area may not work in others.

In all situations, however, we at USTR will continue to depend heavily on you, the business community. We are committed to working with you to develop strategies and resolve issues in ways that will not jeopardize the success that many of you are already enjoying in your China business ventures. However, we cannot do this alone. You know the problems you face on the ground in China better than we do. We need your unique insight and experience when it comes to working closely with China. We will need your assistance in providing information on the challenges and opportunities you face. We cannot be effective unless you provide comprehensive data and compelling facts to help us engage the Chinese in solving specific problems and embracing specific opportunities that will benefit you, both countries, and the global trading system. This is especially true now, as we turn from addressing the relatively easy problems, such as changing laws and regulation, to addressing the deeply embedded systemic problems that have proven to be more difficult.

I said at the very top that our trade relationship with China is quite complex. That is certainly true. But, as with many complex things, first principles often supply a ready compass by which to chart a course. That is why, when engaging with China, we are guided – as we are across our entire trade agenda – by the twin goals that have animated U.S. trade policy since World War II: promoting an open, rules-based international trading system that is consistent with U.S. security needs and that reflects American values of fairness and transparency; and capturing the economic benefits of open markets for the American people. Ultimately, these goals matter most to the workers, farmers, and businesses that make America's success in international trade a reality, and they will continue to guide us as we work to strengthen the US-China trading relationship.

Thank you.