

House Committee on Ways and Means

Statement of Kristin J. Forbes, Ph.D., Member, Council of Economic Advisers

Testimony Before the Full Committee of the House Committee on Ways and Means

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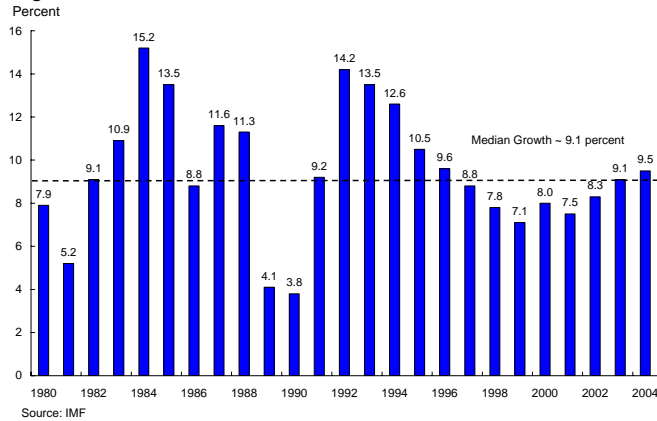
Mr. Chairman and Members of the Committee, thank you for inviting me to testify on the subject of China's economy and the impact of China's development on global trade and the U.S. economy. I will begin by discussing China's recent economic performance—highlighting not only its successes, but also its ongoing challenges. Then I will discuss how China's growth and development are affecting global trading patterns. Next I will provide a more specific evaluation of how China's development is impacting the U.S. economy, focusing on U.S. trade patterns, the U.S. trade deficit, and U.S. employment. Finally, I will close by describing steps the Administration has taken and will continue to take to help the United States adapt to and benefit from China's economic development.

A key theme throughout my comments is that China's rapid economic growth and its emergence as an important force in the global economy and global trading system presents a valuable opportunity for the United States. China (along with the United States) has recently been a key engine of global growth and China has been among the fastest growing market for U.S. exports. Adjusting to China's economic emergence, however, also presents challenges. The U.S. Administration is pursuing an active and multi-pronged agenda to ensure that the United States is able to benefit from these changes and to help facilitate the adjustment process. Although this process will be difficult at times, any steps taken to facilitate adjustment should also be aimed at supporting, if not improving, the competitiveness and dynamism of the U.S. economy.

China's Economic Performance

Although China's recent economic performance has been impressive and received substantial attention, the country still faces imposing challenges, such as resolving longer-term structural problems and addressing shorter-term risks related to overheating. In 2004, China's growth rate in real GDP was 9.5% (according to official Chinese government statistics).¹ This was among the fastest rates of economic growth anywhere in the world—although several countries rebounding from sharp recessions (such as Venezuela and Uruguay) experienced higher growth rates in 2004. Even more important than strong GDP growth in any given year, however, is a country's ability to maintain strong growth over an extended period of time. According to this criterion, China's economic performance is even more remarkable. Since 1980 China's annual rate of real GDP growth averaged over 9%—among the most rapid, sustained periods of growth observed anywhere in the world at any time. [Figure 1.]

Figure 1 - China's Real GDP Growth



This sustained rate of strong GDP growth has raised China's total annual output from about \$300 billion in 1980 to more than \$1.6 trillion today. At the end of 2004 China was the world's seventh largest economy when total output is measured using current exchange rates, ranking just behind Italy and ahead of Canada. Using purchasing-power parity exchange rates (which adjust for price differences for the same goods across countries), China was the world's second largest economy—ranked only behind the United States.

China's rapid economic growth has generated a dramatic improvement in the lives of Chinese citizens. Faster economic growth is the only way to substantially and permanently raise peoples' standards of living and provide resources to reduce poverty. In 1980, China's per capita income was approximately \$220—less than that of countries such as Chad, India, Ghana, and Nigeria. Today China's per capita income has increased nearly five-fold to more than \$1,000—so that the average citizen in China is more than three times as wealthy as the average person in Chad, Ghana and Nigeria, and closer to average income level in countries such as the Philippines.

China's social indicators have also improved significantly. Since the 1970's, average life expectancy in China has risen from 65 to 72 and adult illiteracy has fallen by half. From 1980 to 2000, infant mortality fell by nearly 20%. But perhaps the most noteworthy, and most uplifting, has been how China's growth has reduced global poverty. The World Bank reports that China's economic growth has been the single most important factor in countering global poverty since the 1980's. Since 1980, over 220 million Chinese citizens have been lifted above the global poverty line. Nearly 75% of the reduction in poverty throughout the developing world has taken place in China. During the same period, China's rate of rural poverty declined by 89%. During just the 1990's, the number of people consuming the equivalent of less than \$1 per day declined from 368 million to 265 million.²

Despite these important and impressive accomplishments, China continues to face significant economic challenges. The banking system is still dominated by the government, causing an inefficient allocation of credit and impeding the growth of domestic capital markets. The banking system is believed to be insolvent if assessed according to western accounting standards, and the value of bank loans that are likely to never be fully repaid may be as large as 40% of GDP. China's rapid growth and heavy reliance on coal to satisfy its energy requirements have caused severe environmental damage. China's population is aging rapidly, with the ratio of

working-age people to retirees falling from about six today to two in 2040. This will impose significant fiscal costs on the government, especially as many citizens have no formal pension or health care coverage. State-owned enterprises consume a large share of public resources, contribute to banks' non-performing loans, and constrain the credit available to fund private-sector development. At the same time that the Chinese government is attempting to restructure its inefficient state-owned enterprises—often resulting in substantial layoffs—the government is concerned about creating jobs rapidly enough to absorb over 200 million new labor market entrants over the next decade.

In addition to each of these longer-term structural challenges, China also faces a number of immediate challenges related to its rapid growth and overheating economy. After experiencing real GDP growth of 9.3% in 2003, the Chinese government took a number of steps to attempt to rein in growth. Most of these steps were in the form of administrative controls and central government directives. For example, the government expanded price controls, placed restrictions on investment in certain sectors, and rationed bank credit for certain projects. The central bank of China raised interest rates (albeit only by 27 basis points) in October of 2004 and relaxed controls on certain interest rates so that banks could charge more for loans. Despite these attempts to slow growth, real GDP growth accelerated to 9.5% in 2004—well above the government target of about 7%.

This potentially unsustainable rate of growth presents a number of risks. Bottlenecks and shortages have already occurred in a number of sectors—including energy and transportation. Inflation could also pick up quickly. Although inflation fell slightly to 2.8% (y/y) in 2004 from 3.2% (y/y) in 2003, this was a sharp pickup from deflation in 2002. Moreover, recent data suggest that inflation increased again in 2005—reaching 3.9% (y/y) in February. One price increase of particular concern is the sharp rise in housing prices in major cities, which some analysts have interpreted as evidence that Chinese cities are experiencing a housing bubble. Average residential housing prices in the city center of Shanghai jumped 28% in 2004.³ Although the government has recently taken steps to rein in housing prices—such as raising down-payment requirements, increasing mortgage costs, and raising the tax rate on short-term capital gains for real estate in Shanghai—it is unclear if these steps will be effective.

Moreover, by relying mainly on administrative controls instead of more market-oriented mechanisms to try to slow growth throughout the economy, China is creating additional economic distortions that will lower productivity and growth in the future. These concerns are supported by recent data on fixed investment. Investment in fixed assets (such as factories, equipment, property and infrastructure) has been increasing rapidly—growing by almost 26% in 2004—so that fixed investment in 2004 reached 51 percent of GDP according to official Chinese statistics. This is very high and well above rates observed elsewhere. For example, the investment-to-GDP level in India and the United States averaged about 23% and 18%, respectively, over the decade through 2002. The average ratio for lower-middle income countries (which includes China) was 26%. The level and growth of fixed investment in China suggest that resources are not being used efficiently and therefore it will be increasingly difficult to sustain high growth rates.

If the Chinese economy is overheating and “bubbles” have formed in some sectors, such as housing, any adjustment could be sharp and severe. In the past twenty-five years, China experienced three episodes of overheating—in 1982, 1987, and 1992. In the first two of these episodes, a sharp increase in inflation was immediately followed by a rapid slowdown in growth. Although a slowdown in China could reduce global commodity prices, thereby benefiting net commodity importers, a sharp fall in Chinese growth could have serious repercussions for countries that have relied heavily on exports to China to support growth. This risk is greatest for many Asian economies and countries that are commodity exporters.

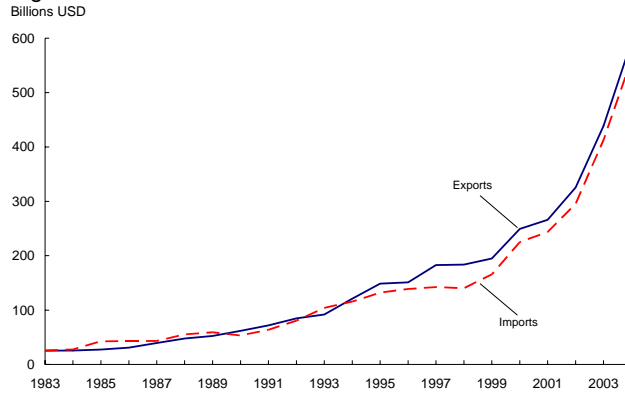
Therefore, as we discuss U.S. economic engagement with China, it is important to keep in mind the substantial challenges China currently faces in maintaining its high rate of economic growth and how China’s strong economic growth has benefited the global economy. Although China has had remarkable success in raising its per capita income level, it is still a relatively poor country (especially when compared to many of its Asian neighbors). Although China’s rapid growth has lifted hundreds of millions of people out of poverty, there are still hundreds of millions of people in China living in abject poverty. The World Bank estimates that over 200 million Chinese (about 15% of the population) remain below the international poverty threshold of \$1 per day. Moreover, since the United States and China are expected to be key drivers of global economic growth in 2005, any policies that cause a sharp economic slowdown in China could undermine global economic growth. It is in the interest of the United States and entire global economy that China reduces its risk of overheating, avoids a sharp economic slowdown, addresses its significant structural challenges, and continues to be a robust engine of global growth.

China and Global Trading Patterns

As China’s economy has grown and developed, China has played a more important role in global trade flows. My colleague from USTR will provide a more detailed discussion of China’s trading relationships, so I will only comment briefly on this topic. I will focus on the broader implications of China’s emergence as an important participant in global trade.

China’s emergence as a major participant in world trade is fairly recent. Total imports to and exports from China were modest throughout the 1980’s. [Figure 2.] Imports and exports grew more rapidly in the mid-1990’s, partially in anticipation of China’s entry into the WTO. China’s trade flows have increased even more dramatically since 2000. As a result, the level of Chinese goods’ imports and exports has more than tripled over the past five years.

Figure 2: China's Trade in Goods

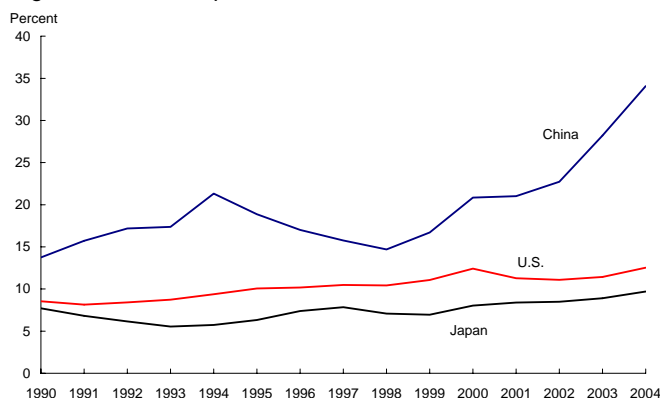


Source: Haver Analytics.

Focusing first on China's imports, China's increased demand for foreign manufactured goods and raw materials has been dramatic. In fact, China is now the world's largest importer of both iron and steel, and the world's third largest importer of manufactured goods. China now purchases about one-third of global soybean imports and one-quarter of global cotton imports. China's imports of both manufactured goods and raw materials have more than doubled over the past seven years. China's demand for imports is particularly striking when measured relative to GDP per capita. Data from the International Monetary Fund indicate that at the end of 2003 China imported \$363 worth of goods per dollar of per capita income—far higher than the comparable \$34 for the United States, \$20 for Germany, \$13 for the United Kingdom and \$11 for Japan. This increased Chinese demand for imports has boosted exports and growth in many economies, especially Asian neighbors and commodity exporters.

Some U.S. business owners are surprised to see this rapid growth in China's imports, since many companies have faced challenges penetrating the domestic Chinese market. It is true that there are hurdles to doing business in China—such as the weak protection of intellectual property rights and difficulty complying with Chinese regulations that are often not transparent. Even with these challenges, however, China has made progress opening up relatively quickly in a short period of time. [Figure 3.] According to the most common economic measure of openness (the share of imports in GDP), China's imports of goods are roughly 34% of GDP, well above the 13% share for the United States and 10% share for Japan.

Figure 3: Goods Imports as a Percent of GDP

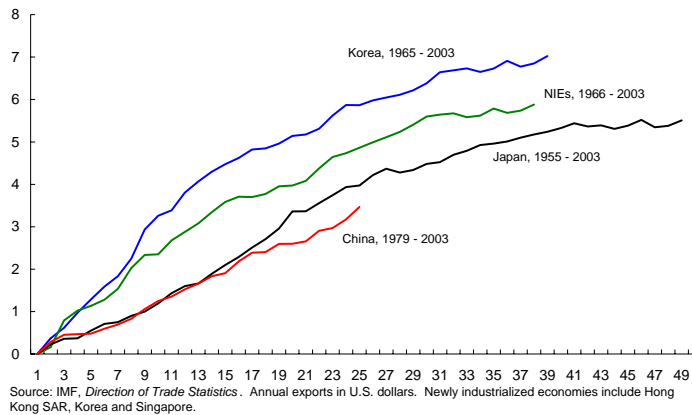


Source: Haver Analytics.

Turning next from China's imports to its exports, although China's exports have increased rapidly, this growth is not unprecedented. Several Asian economies actually experienced even more rapid export growth during their period of rapid economic development than China. For example, Japan, South Korea, and the newly-industrialized economies of Asia (Hong Kong, Singapore and Taiwan), had even faster export growth over an extended period of time than recently experienced by China. [Figure 4.]

Figure 4: Exports of Selected Economies

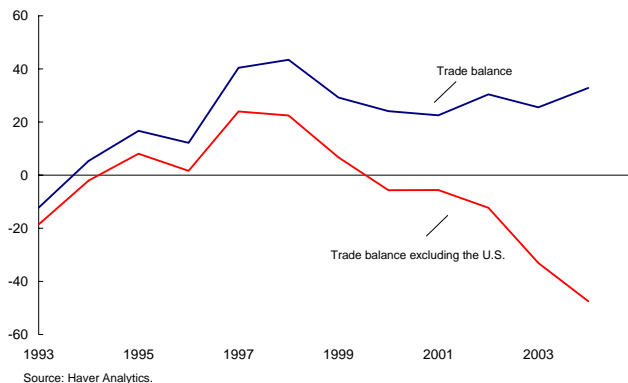
(Index, beginning of period = 1, log scale)



This combination of rapid growth in both Chinese imports and exports has generated a moderate trade surplus for China over most of the last 15 years. The trade balance has recently increased slightly, from 1.8% of GDP in 2003 to 2.0% of GDP in 2004. (China's current account surplus increased from 3.2% to 4.2% of GDP over the same period.) Much of this trade surplus, however, results from trade with the United States (discussed in more detail below). China has actually had trade deficits or very modest surpluses with many other economies and regions of the world. For instance, in 2004 China had a trade deficit equivalent to 1.4% of GDP with Japan, 2.3% of GDP with Korea, and 3.5% of GDP with Taiwan. China's trade deficits with most countries are so large that China has sustained a trade deficit with the world excluding the United States for several years, and in 2004 China's trade deficit with the world excluding the United States was 2.9% of GDP. [Figure 5.]

Figure 5: China's Trade Balance in Goods

Billions US\$



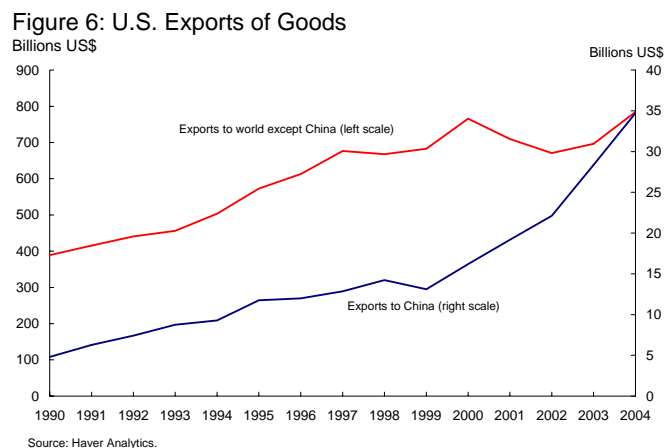
Another important aspect of China’s growing trade integration with the global economy is the role of foreign direct investment. Although China still maintains controls on many types of capital flows, China is fairly open to most types of foreign direct investment (FDI). Net FDI in China totaled \$64 billion in 2004, making China the world’s second largest FDI recipient in that year (after the United States). On a cumulative basis, the United States is the second largest foreign investor in China after Hong Kong, with \$48 billion invested through 2004.

High levels of foreign investment in China are closely related to China’s trade flows because many of “China’s exports” to other countries are actually goods produced by multinational companies in China or Chinese companies that are partially owned by foreigners. In fact, a large fraction of the recent surge in Chinese exports has come from Chinese subsidiaries of global multinational corporations. The share of Chinese exports produced by foreign firms rose from 1% in 1985 to 55% in 2003.⁴

Trade between China and the United States

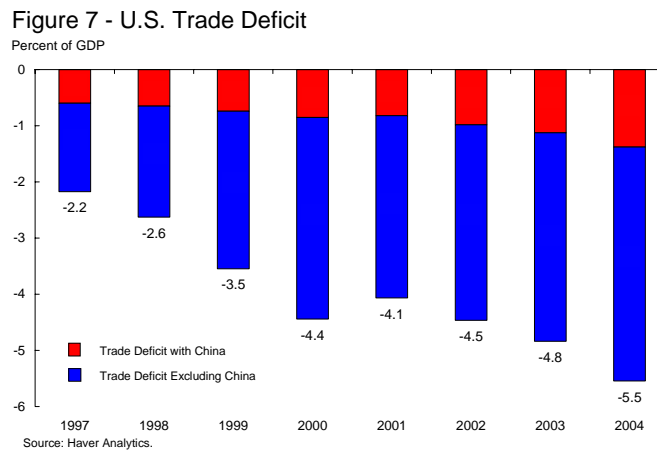
China’s rapid growth in its trade flows, foreign investment and overall economy has been apparent not only in the global economy, but also in the world’s largest economy—the United States. U.S. purchases of Chinese goods have nearly doubled since 2000, so that the United States is currently China’s most important export market. In 2002, China was the 2nd largest source of U.S. imports (behind only Canada).

U.S. exports to China have also increased dramatically so that China is currently the 5th largest export market for the United States. Between 2003 and 2004, U.S. exports to China increased by 22%. This was among the largest increases in U.S. exports to any country in the world. Even more impressive, U.S. exports to China have increased by nearly 115% since 2000. The United States has not increased exports by a comparable amount to any other country in the world over this period. This increase in exports to China is particularly noteworthy considering that U.S. exports to the rest of the world were fairly stable between 2000 and 2004. [Figure 6.] Moreover, even if growth in China moderates, China’s large population of over 1.3 billion individuals combined with its expected growth rate higher than in most other large economies suggest that China will continue to be an important driver of U.S. export growth in the coming years.



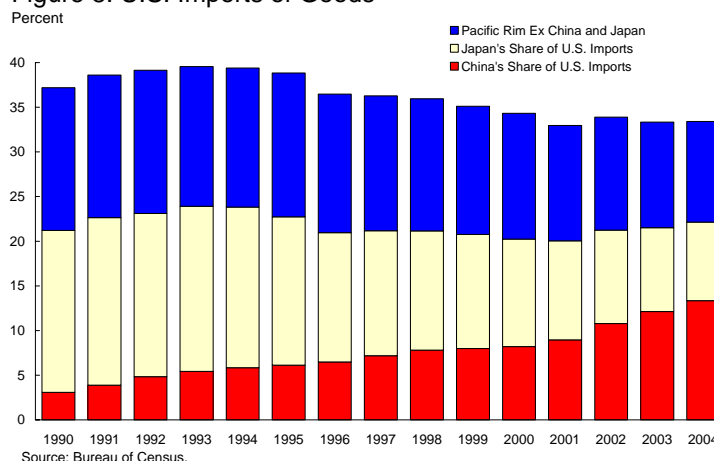
Although U.S. imports from and exports to China have both been increasing rapidly, trade between the U.S. and China is imbalanced. In 2004 the United States reported a trade deficit with China in goods of \$162 billion, which is equal to 1.4% of U.S. GDP. This is about 25% of the total U.S. trade deficit of 5.5% of GDP in 2004. Since the U.S. trade deficit with China has increased over the same period that the overall U.S. trade deficit has increased, trade with China is often blamed for the recent increase in the U.S. trade deficit. This is not entirely accurate, however, for three reasons.

First, the U.S. trade deficit excluding China has also risen sharply. In fact, even if the U.S. trade deficit with China was not included, the U.S. trade deficit would still have increased sharply from 1.6% of GDP in 1997 to 4.2% at the end of 2004. [Figure 7.] Trade with China accounted for roughly 24% of the increase in the U.S. trade deficit since 1997—only slightly more than the contributions from U.S. trade with the Euro area (20%) and NAFTA (18%). In fact, China’s current contribution to the overall U.S. trade deficit is slightly less than its contribution in 1997, when the U.S. trade deficit with China was 1.5% of GDP.



Second, increased imports from China largely reflect decreased imports of the same goods from other countries, instead of a net increase in the U.S. trade deficit. In other words, many of the products that the United States currently imports from China were previously imported from other countries, not produced domestically in the United States. For example, although the share of U.S. goods’ imports coming from China has increased since 1990, the share of imports coming from other countries in the Pacific Rim has fallen by even more—so that the total share of U.S. imports coming from the Pacific Rim (including China) has actually fallen. [Figure 8.] In fact, much of China’s recent increase in U.S. import share has come largely at the expense of Japan. Japan’s share of U.S. goods imports fell from 12.0% in 2000 to 8.8% in 2004. Over the same time period, China’s share of U.S. goods imports increased from 8.2% to 13.3%. Therefore, the share of U.S. imports coming from both China and Japan has only increased slightly, from 20.2% in 2000 to 22.1% in 2004.

Figure 8: U.S. Imports of Goods



This pattern of increased U.S. imports from China largely replacing imports from other Asian countries is apparent not only in bilateral trade patterns, but also in many of the individual sectors in which U.S. imports from China have recently surged. For example, the share of U.S. footwear imports from China increased from 9% in 1989 to 69% in 2003, while the share of U.S. footwear imports from other Asian countries (Japan, Hong Kong, Taiwan, and South Korea) fell from 51% to 1% over the same period. South Korea's share of the U.S. footwear import market fell from 27% in 1990 to 0.3% by 2004, while Taiwan's share fell from 16% to 0.4%.

Third and finally, although China is competitive with some low-end U.S. manufacturing products, U.S. trade with China is largely complementary. U.S. imports from China are over 60% consumer goods and 27% capital goods. U.S. exports to China are largely capital goods (46%), industrial supplies (35%), and food (11%). U.S. consumers and U.S. companies that purchase Chinese goods benefit from less expensive Chinese products. Many U.S. retailers that specialize in consumer goods have been able to open more stores and hire more workers due to their ability to sell lower priced goods imported from China. These trends have been particularly beneficial for many low- and middle-income Americans that spend a higher share of their incomes on consumer goods that are more likely to be imported from China.

For all of these reasons, focusing just on the bilateral trade deficit with China is problematic. In fact, the bilateral trade balance between any two countries is generally not considered meaningful in an economic sense. Instead, it is more important to focus on multilateral trade balances, and the corresponding domestic factors causing any multilateral imbalances. A multilateral trade deficit reflects a shortage of national savings relative to national investment. Therefore, any reduction in the U.S. trade deficit would need to be balanced by a reduction in the difference between U.S. national savings and investment. If the U.S. trade deficit with China was suddenly reduced, it would need to occur with a corresponding adjustment in other variables—such as an increase in the U.S. trade deficit with other countries, an increase in U.S. national savings, or a decline in U.S. national investment. An increase in U.S. national savings or a decline in U.S. national investment would likely correspond to slower growth in the United States.

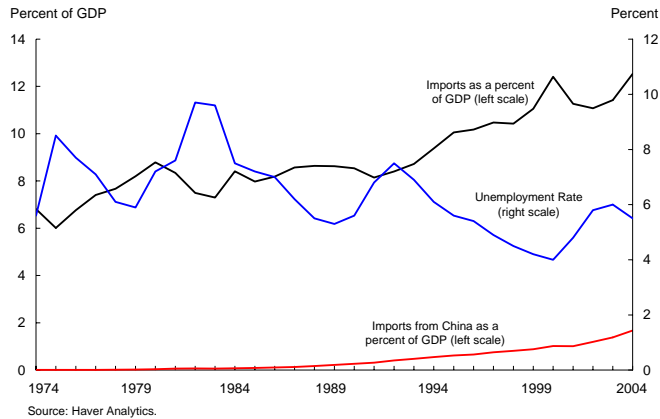
In addition to the relationship between trade with China and the U.S. trade deficit, a closely related issue that has received substantial attention is the impact of China's economic growth and increased trade flows on U.S. employment—especially manufacturing employment. Trade with any country does play a role in shifting U.S. employment towards industries in which the United States has a comparative advantage (mostly services and high-skilled, high-tech manufactured products). Increased trade with China, however, has not caused a large share of aggregate U.S. job losses, even in the manufacturing sector as a whole.

Increased trade with China is a relatively recent phenomenon, while manufacturing employment has been declining as a share of total U.S. employment for decades. This long-term downward trend in manufacturing employment primarily reflects relative gains in manufacturing productivity that have not been offset sufficiently by increased purchases of manufactured goods. In fact, although U.S. manufacturing employment has fallen roughly 20% since 1970, rapid productivity growth has allowed manufacturing production to more than double over the same period.

More recently, the most severe job losses in U.S. manufacturing were mainly concentrated in industries where imports from China are small. Five industries that have contributed significantly to manufacturing job losses since 1997 are: computer and electronic equipment (15.4% of all manufacturing job losses from 1997 to 2004), transportation equipment (8.5%), machinery (11.4%), fabricated metal products (6.4%), and apparel (13.4%). With the exception of apparel, these are export-intensive industries for the United States. Therefore, a more important factor driving job losses in these sectors (with the exception of apparel) was slower export growth to most of the world (excluding China) instead of increased competition from China.

Moreover, employment in the United States has recovered over the past two years, at the same time that imports from China have continued to increase. In fact, over a longer time period, there is no apparent relationship between imports from China, or even total imports, and U.S. unemployment. [Figure 9.] Even though imports as a percentage of GDP (from China as well as the world) have increased since the 1970's, this has not led to any significant increase in the U.S. unemployment rate. Over the past decade the U.S. economy has experienced historically low unemployment, even though imports grew significantly. Roughly 3 million jobs were created in the United States since May 2003, 33,000 jobs were added in manufacturing since February 2004, and the unemployment rate fell to 5.2% in March—below the average of the past three decades. All of these improvements in the U.S. labor market occurred as imports from China surged. Moreover, as trade between the United States and China continues to increase, analysts expect strong job growth to continue in the United States. Blue Chip consensus forecasts predict that approximately 2.2 million jobs will be added to the U.S. economy in 2005 and 2006.

Figure 9: Imports and the Unemployment Rate, 1974 - 2004



Administration Engagement to Ensure the United States Benefits from China's Economic Development

The Administration has been pursuing an active and multi-pronged agenda to ensure that the United States continues to benefit from China's economic growth and increased trade flows. It will be important to continue and strengthen these efforts. Even if trade with China has had a relatively small impact on aggregate U.S. employment and the recent increase in the U.S. trade deficit, individual sectors of the U.S. economy can be harmed by China's rapid economic growth and increased role in global trade. Although some companies and their corresponding workers benefit from increased exports to China, other companies and workers face greater competition from increased imports from China. Although many U.S. consumers benefit from cheaper sneakers, toys and sporting goods from China, other Americans could become unemployed due to this greater competition. These difficult adjustments affect not only individual companies and workers, but also their families and communities. Therefore, the Administration has taken a number of steps to help individuals adjust to these changes and to ensure that U.S. workers have adequate skills in order to succeed in new job opportunities. After discussing these specific steps, I will then describe a number of additional components of the Administration's strategy (including on exchange rate policy and maintaining U.S. competitiveness) to ensure that the United States continues to benefit from China's economic development.

The Administration has taken a number of important steps to ensure that U.S. workers have adequate skills in order to adapt to and benefit from increased trade with China (as well as trade with all other U.S. trading partners). Several programs focus on ensuring that workers receive training so that they can adopt new technologies to succeed in the global economy. For example, the Trade Adjustment Assistance (TAA) program was recently expanded to cover more workers and provide more income support, training, relocation and job search allowances. A health coverage tax credit was also added. The President's "Jobs for the 21st Century" initiative supports students and workers by improving high school education and strengthening post-secondary education and job training. This initiative includes funding to increase job training at community colleges. In addition, to help workers find better, higher-paying jobs, the President has proposed doubling the number of people trained through our principal job-training grant programs that are authorized under the Workforce Investment Act.

To further increase individual choice for workers, Innovation Training Accounts, as proposed by the President in his Job Training Reform proposal, build upon the success of Individual Training Accounts that are authorized under the Workforce Investment Act. Innovation Training Accounts allow individuals to access a broad range of public and private training resources through a single, self-managed account. They would also authorize longer-term training opportunities by acknowledging that many skills needed for today's jobs require more than just short-term attention and exposure.

Another important new step for helping Americans succeed is Personal Reemployment Accounts (PRAs). PRAs will provide certain individuals who lose their job with money that they can use in a manner they think will best help them obtain a new job—such as for training, transportation, child care, or relocation. Workers who find new jobs quickly and retain those jobs for six months will receive a reemployment bonus. The Department of Labor currently is administering a PRA demonstration that includes seven states.

Also, to help workers in poor communities and communities that have lost manufacturing, textile and other jobs, the President has proposed the creation of opportunity zones. These zones will include special tax relief and other incentives to attract new business and to improve housing, job training, and high-tech infrastructure in order to assist these communities. Although none of these proposals can fully remove the difficulty and suffering for workers and their families when they become unemployed, they should help ease the transition and help provide workers with new skills to find employment. As a strong signal of commitment to all of these programs, the President has proposed over \$21 billion for worker training and employment programs in the 2006 budget, including more than \$7 billion in Pell Grants to be used at two-year post-secondary schools, where many people train for work.

In addition to taking steps to help U.S. workers adjust to increased global trade flows, the Administration is also taking a number of steps to ensure that the U.S. continues to benefit from increased trade with China. The Administration is actively engaged in a number of dialogues and meetings to ensure that China continues to open its market to U.S. exports and fully implements its commitments made to the World Trade Organization. China must continue to open its markets to U.S. services, agriculture and industrial products, as well as to effectively enforce intellectual property laws. My colleague from the USTR will discuss the Administration's vigorous efforts in these areas in more detail.

The Administration is also actively engaged with China to reduce barriers to capital flows, develop more open and sophisticated capital markets, and adopt a more flexible exchange rate regime. The Administration has stated in private bilateral meetings as well as in multilateral forums (such as the G-7, IMF, and APEC), that the international trading system works best with free trade, the free flow of capital, and currency values set in open and competitive markets. In particular, the Administration believes that now is the appropriate time for China to adopt a more flexible exchange rate regime. It is in China's best interest to adopt a more flexible currency now while economic growth is strong. A more flexible currency would provide China with greater independence in monetary policy — a step that would help reduce the current risk of overheating.

The Chinese authorities, on a number of occasions, have clearly stated their intent to move to a more flexible exchange rate regime. Although they have not specified a date for this adjustment, China has recently taken a number of steps to build the necessary infrastructure and gain experience useful to successfully adopt more exchange rate flexibility. For example, China has recently taken important steps to develop foreign-exchange trading, including the development of hedging instruments and internal controls on foreign-exchange exposure. In March 2005 China announced that seven international banks would join two domestic ones as market makers for foreign-exchange trading. These banks will be able to trade and quote prices in eight currency-pairs—providing a platform that can then be used to trade a more flexible yuan. China is also making solid progress in restructuring its state-owned banks by reducing non-performing loans and improving lending standards and corporate governance.

The Administration, led by the U.S. Treasury Department, has also been actively assisting the Chinese authorities in resolving concerns in areas they see as obstacles to exchange rate flexibility. For example, the U.S. Treasury has established a Technical Cooperation Working Group that had three sessions with China in 2004 to focus on issues such as supervising banks' management of exchange rate risk and regulating foreign currency derivatives' markets. Additional sessions are already planned for 2005. In September 2004, Secretary Snow hosted a high-level meeting of the Joint Economic Committee (JEC), which included Federal Reserve Chairman Greenspan and 40 Chinese delegates. The JEC discussed a range of economic and financial issues and agreed to a joint public statement including China's commitment to exchange rate flexibility. The U.S. Treasury Department also designated a special representative, Ambassador Paul Speltz, to continue frequent dialogue with the Chinese government on these issues and encourage them to accelerate movement toward a flexible exchange rate regime.

The U.S. Administration has also recently built on these bilateral engagements by continuing to work through multilateral channels to encourage China to move to more exchange rate flexibility. In February of 2005, G-7 Finance Ministers and Central Bank Governors met again with their Chinese counterparts. They reaffirmed their support for flexible exchange rates and emphasized that more flexibility "is desirable for major countries that lack such flexibility to promote smooth and widespread adjustments in the international financial system." In the last two months key Ministers in Japan, Korea, and Britain have spoken publicly on the need for a flexible currency regime in China. The International Monetary Fund has repeatedly called for China to adopt a more flexible exchange rate regime, including most recently in its World Economic Outlook just released as part of the Bank-Fund Spring meetings. President Haruhiko Kuroda, in his first press conference as the new head of the Asian Development Bank, also urged China to adopt more exchange rate flexibility.

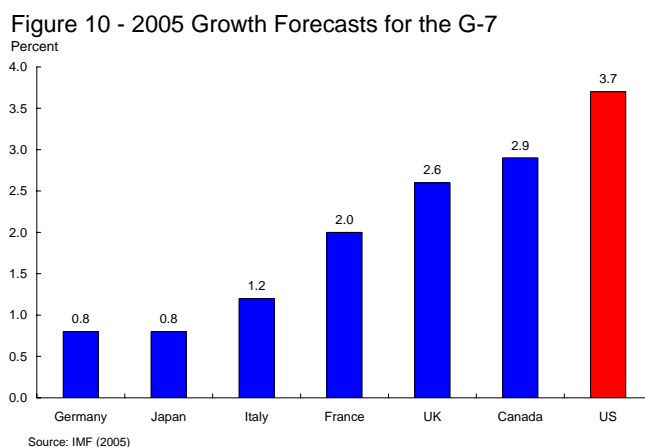
A final key pillar of the Administration's strategy to ensure that the United States benefits from China's rapid economic growth and increased trade flows is to strengthen the U.S. economy and make certain that the United States is an attractive and competitive location for companies to do business. In an effort to attain these goals, the Administration will continue to restrain spending and strengthen institutions such as social security for future generations. The Administration will continue to enforce our trade agreements and lower barriers to trade through multilateral and bilateral trade agreements, in order to ensure that U.S. companies can successfully compete in

foreign markets. The Administration will also continue to support pro-growth policies, such as: making tax relief permanent; reducing the burden of lawsuits by supporting additional tort reform; passing a comprehensive national energy policy in order to increase energy efficiency and ensure an affordable and predictable energy supply; making health care costs more affordable through proposals such as Association Health Plans, tax-free Health Savings Accounts and health information technology; and streamlining regulations to ensure that they are reasonable and affordable.

Final Thoughts

China's rapid economic growth and development has lifted hundreds of millions of people out of poverty and helped spur global exports and global growth. China's emergence as a significant participant in the global economy and global trade, however, also presents challenges as countries, including the United States, adjust to these developments. The U.S. Administration is pursuing an active and multi-pronged agenda to ensure that the United States is able to benefit from these changes. Since China is one of the fastest growing export markets in the world, part of this agenda will continue to be to ensure that U.S. companies have access to this large market and the opportunity to compete. Although adjusting to China's increased economic role will not be easy, it is important to remember that any steps taken to smooth this adjustment should also be aimed at ensuring the United States continues to be a competitive and dynamic economy.

Average GDP growth in the United States in 2003 and 2004 was higher than in any other member of the G-7 group of developed economies. This trend is expected to continue in 2005—with the IMF forecast predicting that growth in the U.S. will be 3.7% in 2005—not only stronger than in every other member of the G-7—but more than double the expected growth rates in Germany, Italy, and Japan. [Figure 10.]



Therefore, as we discuss different proposals to shape the future, we must be careful not to threaten this success with short-term fixes that could damage our long-term competitiveness. Instead, it is important to focus on ways to help strengthen the U.S. economy as the global economy evolves, and ensure that we continue to improve the competitiveness of companies operating in the United States. The Administration is committed to continuing and building on these efforts.

¹Chinese government statistics are imprecise and subject to error. Private sector estimates indicate that real GDP growth in China was likely higher than the official government estimates in 2004.

²World Bank Country Assistance Strategy for China. February 2003. Speech by World Bank Vice President for Asia and the Pacific. October 17, 2004.

³ Source: *Economist*, “Property in China”, March 23, 2005.

⁴ Source: Nicholas Lardy, “China: The Great New Economic Challenge,” in C. Fred Bergsten (2004) *The United States and the World Economy: Foreign Economic Policy for the Next Decade*.