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Chairman Camp, Ranking Member Levin, distinguished members of the Committee, thank you for the opportunity to testify today on our economic relationship with China.

Challenges and Opportunities

Since the outset, President Obama has placed a high priority on pursuing a more balanced and fair economic relationship with China. This is central to our goal of doubling exports in five years and supporting several million U.S. jobs. And, indeed, since 2009, U.S. exports to China have grown by 61 percent, nearly twice as fast as our exports to the rest of the world. Despite this progress, the playing field is still uneven. To secure the future for our children, the Administration will continue working hard to get the economic relationship right.

China needs to take action at an accelerated rate, so that the potential of our relationship translates into real near-term benefits for our companies and workers. China's leaders understand that China must shift to domestic consumption-led growth, provide a secure environment for the protection and enforcement of intellectual property rights, level the playing field between state-owned and private enterprises—domestic and foreign, and liberalize the exchange rate and financial markets. China needs to take these actions to sustain its own growth, as well as to address the concerns of its trade partners. On these issues, we have actively pressed China to accelerate the pace of reform in order to achieve more balanced growth and create fairer competition, and there has been some progress, but there are strong interests within China that favor a go-slow approach.

In the wake of the financial crisis, with American households saving more and demand weak in Europe and Japan, our exports increasingly will be directed at the fast-growing emerging markets if we are to create the good jobs with good wages that we need to grow our economy. For the next decade, China is expected to be the biggest source of demand growth in the global economy. The International Monetary Fund (IMF) forecasts that China's growth will average 9.4 percent per year over the next five years, and the Organization of Economic Cooperation and Development (OECD) estimates that China's share of global imports will increase from six percent in 2008, to over nine percent in 2012. This is a market opportunity that we must seize.

Foreign investment also is playing an increasingly important role in supporting jobs in the United States, and we expect this trend to continue. In 2009, majority-owned U.S. affiliates of foreign companies were an important contributor to U.S. economic activity, employing approximately five percent of the U.S. private workforce and 17 percent in the U.S. manufacturing sector. In the decade ahead, China will be a fast-growing source of foreign direct investment among major economies. Indeed, the stock of Chinese foreign investment in the United States more than doubled last year alone. Protecting national security is always our first concern, but where Chinese investment does not affect national security, we should welcome it. To create jobs here

at home, it matters whether Chinese investment ultimately ends up in Anhui province, Argentina, or Alabama.

In order to derive a better balance of benefits from trade and investment opportunities with China, we need to see progress on three key challenges. First, in many sectors in which the United States is competitive globally, China must address a range of discriminatory policies, including those that favor domestic state-owned enterprises through barriers to foreign goods, services, and investment, as well as the provision of subsidies and preferential access to raw materials, land, credit, and government procurement. Second, rampant theft of intellectual property in China lowers the return to investments in research and development and innovation that represent a fundamental source of our country's national competitive edge. Third, China must shift to a pattern of growth that can be sustained, drawing on home-grown demand rather than excessive dependence on exports. This requires that China bring its exchange rate into alignment with market fundamentals.

China's Reforms

China's current headline growth rate may look enviable right now, but China will face daunting challenges in coming years. We have a tremendous stake in ensuring that China deals with those challenges in a way that fundamentally reorients its growth pattern through greater balance and fairer competition.

China has had remarkable success in lifting hundreds of millions of its citizens out of poverty. But it has come at some cost, including large-scale environmental degradation and an economy that spends much more on investment than goods and services for its people. Chinese leaders understand that, with per capita income of around one-tenth of that of the United States in 2011,[1] and per capita household spending less than one-twentieth of that in the United States, the way China grew in the last two decades will not get them to the next stage of development. Instead, China will face what economists call the "middle income trap."

China's excessive dependence on growth driven by exports to advanced economies and investment will need to change. During the 2008-2009 global crisis, China was able to sustain growth through a massive credit-fueled investment boom. This will leave a financial hangover for years. China risks repeating the experience of other fast growing Asian economies that experienced sharp falls in growth soon after their investment-to-gross domestic product (GDP) ratios peaked. With investment reaching an all-time high of almost 48 percent of GDP, however, China's peak is higher than other Asian economies.

China already is seeing rapidly slowing labor force growth, and the number of workers in China soon will be on the decline. While China maintains many advantages, a study by KPMG concluded that rising labor costs in China are shifting a rising market share of light manufactured goods to other producers in Asia.[2] A recent study by the Boston Consulting Group similarly concluded that China's cost advantage is rapidly eroding.[3]

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[1] September 2011 IMF World Economic Outlook Database, using market exchange rates.
[2] KPMG International, Product Sourcing in Asia Pacific 2011, pp. 7-9.
[3] Boston Consulting Group, Made in America, Again, August 2011, p. 5.

In the face of overinvestment and rising wages, China will need to move up the value chain. But China's weak protection and enforcement of intellectual property rights threaten to retard the development of Chinese innovation and Chinese brands.

And the adjustment process – whether to greater consumption-led growth, higher value services, or innovation-intensive activities – is hampered by China's continued excessive reliance on administrative controls, such as credit quotas to maintain price stability and intervention to temper exchange rate adjustment, that are subject to political determinations and thus leave policy making behind the curve. These controls are reflected in a financial system that fails to offer Chinese households financial assets that keeps up with inflation, let alone economic growth, and starves China's most innovative firms and sectors of capital, despite massive domestic savings, while also depriving foreign competitors of the opportunity to offer a full range of products and services. Relying more on market-based prices, such as exchange and interest rates that facilitate adjustment to changing conditions, would make China's growth more resilient, and avoid an excessive build-up of foreign exchange reserves.

For sustained growth, China wants greater access to U.S. technologies and high-tech dual use exports, to make progress on bilateral investment, and wants their exports to be accorded the same terms of access as exports from other market economies. We are willing to make progress on these issues, but our ability to move will depend in part on how much progress we see from China on issues that are important to us.

U.S. Engagement and Enforcement

We have worked tirelessly across the Administration to pursue a tight set of priorities with China – using the Strategic and Economic Dialogue (S&ED), as well as the Joint Commission on Commerce and Trade (JCCT). And since many other countries share our concerns, we also pursue these issues through multilateral channels, such as the G-20, the IMF, and the World Trade Organization (WTO), which are critical complements to our bilateral engagement. To advance our goals, whether it is faster appreciation of the exchange rate or reduced barriers to U.S. exports, we need to work smartly with our partners around the world and with China. And when engagement proves insufficient, this Administration will continue to be more aggressive than any of its predecessors in using all appropriate tools to address the particular problem, such as going after China's unfair trade practices by taking China to the WTO and vigorously applying U.S. trade remedy laws.

While we face substantial challenges, and our job is far from finished, we have made important progress towards leveling the playing field and making the bilateral relationship more beneficial for American companies and workers. China's trade surplus has declined from 7.7 percent of GDP in 2008, to 3.9 percent in 2010, and has declined further in the first half of this year compared to the same period last year, though an important part of the decline was due to slower growth in China's export markets. In both its latest Five-Year Plan and the recent S&ED, China committed to targets to promote consumption-led growth, including raising household incomes, increasing minimum wages, and increasing services relative to GDP.

On the exchange rate, since China resumed exchange rate adjustment in June 2010, the renminbi has appreciated about seven percent against the U.S. dollar and about ten percent taking into

account China's higher rate of inflation relative to inflation in the United States. China's currency has appreciated nearly forty percent against the dollar over the past five years in real terms. But the continued rapid pace of foreign reserve accumulation and the ongoing decline in the share of Chinese consumption in GDP indicate that the real exchange rate of the renminbi remains misaligned despite recent movement, and a faster pace of appreciation is needed.

Renminbi appreciation on its own will not erase our trade deficit. But allowing the exchange rate to adjust fully to reflect market forces is the most powerful near-term tool available to the Chinese government to achieve two of its top economic goals: combating inflation and shifting the composition of demand towards domestic consumption. By contrast, persistent misalignment holds back the rebalancing in demand needed to sustain the global recovery both in China and the world, and gives rise to substantial international concerns and ultimately to trade frictions. Further, emerging markets that compete with China resist appreciation of their own currencies to maintain their competitiveness vis-à-vis China.

At the G-20 earlier this month, surplus emerging markets such as China committed to accelerate the rebalancing of demand towards domestic consumption, and to move toward more market-determined exchange rates through greater exchange rate flexibility.

We also are making progress on our bilateral trade and investment priorities, in close collaboration with the Office of the U.S. Trade Representative and the Department of Commerce. At the most recent S&ED, after commitments made during the January state visit of President Hu and the prior December JCCT, China pledged to rescind all of its government procurement indigenous innovation catalogues, including by provincial and municipal governments. So far, the Central government has repealed four key measures that underpinned the indigenous innovation product accreditation system, and a number of local governments have taken positive steps. China also pledged to increase inspections of government computers to ensure that agencies use legitimate software, and to improve its high-level government coordination and leadership mechanisms to enhance long-term protection and enforcement of intellectual property rights. And last year, China met its S&ED pledge to raise the threshold for central government review of foreign investments from $100 to $300 million, leaving more foreign investment approvals to the mayors and governors who better understand the benefits of foreign direct investment.

Reforming and opening up China's financial sector also remains a key priority. This not only would provide Chinese households with savings and insurance products to meet their financial goals without having to save so much of their income, but also would level the playing field with China's state-owned enterprises for access to credit. We will continue pushing hard to address market access barriers in China's financial sector, and we are seeing modest signs of progress. China now allows foreign banks to underwrite corporate bonds and is creating more opportunities for our financial services firms to manage investments in China as well as manage Chinese investments abroad. At the most recent S&ED, China committed to allow foreign firms to sell mutual funds, provide custody services, and sell mandatory auto liability insurance.

In short, while we will stand up to unfair and discriminatory practices and demand change, we will continue to engage with and encourage China as it pursues its reforms. And to meet this generational challenge, we must continue to work to strengthen the multilateral system that

governs trade and finance, and not turn away from it. I believe this is the best way to promote American interests.

Thank you.