

**Testimony of Robert Baugh**  
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**Before the U.S.-China Economic and Security Review Commission**  
**Currency Manipulation and Labor Violations as Illegal Industrial Subsidies**  
**April 4, 2006**

Members of the Commission, I want to thank you for the opportunity to testify today.

The AFL-CIO Industrial Union Council is a founding member of the China Currency Coalition. The testimony by Mr. Hartquist, representing the CCC, laid out a strong case on the urgency of our government taking action to address the Chinese government's manipulation of its currency. Currency manipulation is part of a broader pattern of illegitimate subsidies by the Chinese government affecting America's manufacturing industries. I will focus on these and most specifically — and most specifically on the continuing workers' rights abuses in China and their impact on American workers.

The litany of China's failures to meet its trade obligations is extensive—loans from state banks to industry that are never repaid, extensive currency manipulation, illegal dumping, rampant intellectual property violations, environmental degradation, and massive human rights, religious, and workers' rights abuses. Compounding these problems is a complete lack of transparency within China. It remains difficult and dangerous to obtain information on workers' or human rights problems, and the banking and financial systems are closed to outsiders. Additionally, the government of China implements stringent regulations making it a criminal act to reveal information deemed to be a "state secret." Unfortunately, "state secret" seems to apply to almost anything, including reporting on labor disruptions.

This hearing is particularly important, as Chinese President Hu plans a visit to Washington, D.C., later this month. While currency manipulation appears to be on the agenda for discussion at that meeting, we urge policymakers and the Administration not to neglect the ongoing humanitarian and economic issues raised by the Chinese government's repressive policies toward its own workers.

Our country is on a dangerous and unsustainable path, one that encourages and rewards irresponsible corporate policies, while leaving American workers, family farmers, domestic producers, and communities devastated. Growing debt in both the private and public sectors is powering American consumption, which in turn is driving global growth. This debt-driven growth masks underlying weaknesses and cannot be a sustainable solution.

The current situation serves the short-term interests of the multinational corporate elite around the globe, but is already failing working families here and abroad.

Falling real wages, negative savings, and growing inequality in the United States are clear signs that working families are paying the price today for these failed policies. We are mortgaging our children's future to pay for unsustainable debt and consumption today. And if we do not take dramatic steps soon to reverse this unsustainable trend, then the resulting collapse could be devastating to global economic prosperity and stability.

## **Trade Deficit and Job Loss**

The U.S. bilateral trade deficit with China hit \$201 billion last year. This is the largest bilateral trade deficit between any two countries in history. The Economic Policy Institute estimates this trade deficit has cost us 410,000 jobs and job opportunities in the past two years alone.

It is a sad but true fact that empty cargo containers are our largest export to China.. Our imports from China continue to outstrip our exports by more than five to one, making this by far our most imbalanced trade relationship with any major trading partner. Meanwhile, the United States has lost almost three million manufacturing jobs since 2001.

While many factors contributed to this devastating job loss, it is clear that the Chinese government's manipulation of its currency, violation of international trade rules, and egregious repression of its citizens' fundamental democratic and human rights are key contributors to an unfair competitive advantage. The Chinese government is flouting its international obligations, and no one is holding them accountable.

Unfortunately, to date, the U.S. government has failed to act effectively to stem the job losses resulting from the burgeoning U.S. trade deficit with China. The Bush Administration has refused concrete action to ensure that the Chinese government lives up to its international obligations on trade, currency manipulation and human rights. President Bush has denied American businesses and workers the import relief they are entitled to under the law, and he has taken positions at the World Trade Organization (WTO) that will only worsen our trade relationship with China.

Over the past five years, China has repeatedly and consistently failed to comply with WTO rules. The Bush Administration, rather than take advantage of the WTO's formal dispute settlement mechanism to address these violations, has preferred to rely on prolonged discussions and informal consultations in its failed attempts to guarantee China's compliance. Nothing has been accomplished.

## **Illegal Subsidies and Transparency**

Currency manipulation may be the most visible violations of trade law by the Chinese government but there are many other forms of illegal subsidies. The violations of workers' rights are the most egregious and costly of all.

### **Failure to Act on Currency Manipulation**

Since last summer the Chinese yuan is no longer technically pegged to the dollar. However, China's currency has barely moved from the rate established in 1994, and it is estimated to be undervalued by as much as 40 percent. This gives China an enormous competitive advantage in the U.S. market and creates an inherently unstable and unsustainable situation.

The Chinese government must allow the yuan to reflect underlying economic and market forces. It must revalue the its currency to reflect it true value, then adopt flexibility for the yuan and

cease its accumulation of U.S. dollar reserves. While the Chinese government's reluctance to take this action is perhaps understandable, the Bush Administration's failure to act more forcefully in this regard is not.

We believe Congress should take action by passing HR 1498, the Hunter-Ryan bill, and use its mechanisms to send a clear message to the Chinese government that the current situation is unacceptable and will not be tolerated. It is now clear that simple diplomacy and lackluster negotiations have failed.

### **China Misrepresents Actual Trade Surplus Figures**

The China Currency Coalition in a 2005 study found that China's global surplus is more than 325 percent higher than China's trade statistics claim, according to its partner trading data.

China is "hiding the ball" by deliberately reporting incorrect trade statistics. The China Currency Coalition maintains the figure reported by import partners more accurately reflects China's net income from trade. The problem of incorrect trade statistics underscores a much larger transparency problem across government agencies.

### **Free Money: China's Non-Performing Loan Practice**

The deliberate extension of billions of dollars in non-performing loans by China's central banks has given China another unfair advantage. Simply put, state banks make loans to industry with little expectation those loans will be repaid. Most of these free loans have been transferred to four government-owned asset management corporations (AMCs), so the government budget, rather than the banking system, will bear the costs.

According to IMF reports, bad loan ratios for the major commercial banks in China have fallen from about 24% of loans in 2002 to about 13% in September 2005. This apparent decline results from questionable accounting practices—they only report the bank share of the debt, and not the government-owned share.

Due to the lack of transparency in the Chinese banking and financial system, it is difficult to calculate the total amount of these illegal non-performing loans. However, IMF economists reported in 2005 that these bad loans may have amounted to as much as 30 percent of China's GDP in 2003.

It is further estimated that 40% of all loans in 2002 were non-performing, and that previous non-performing loans (some now in the form of government debt) might total \$400 billion.<sup>1</sup> Other estimates place the figure higher, at a whopping \$650 billion.<sup>2</sup>

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<sup>1</sup> Brad Setser. The Chinese Conundrum: External financial strength, Domestic financial Weakness, at page 16. October 31, 2005. RGEmonitor website at [<http://www.rgemonitor.com/redirect.php?sid=1&tgid=10000&cid=108028>].

<sup>2</sup> *Id*

Either way, it is clear that over the past decades, the Chinese have illegally subsidized business development through non-performing loans—unfairly subsidizing industry to the tune of hundreds of billions of dollars.

### **Direct and Indirect Subsidies: Free Land, Labor and Facilities**

Non-performing bank loans are just the tip of the iceberg when it comes to illegal subsidies by the Chinese government. Here too transparency is an issue because it is difficult to obtain accurate and complete data about these practices but it is clear from the information available these practices are widespread.

The U.S. government is aware of these violations, and our trade delegation in Geneva has actively used the WTO Transitional Review Mechanism (TRM) to scrutinize China's ongoing compliance with its WTO commitments and obligations. Last fall the U.S. used the TRM to question the Chinese government's failure to provide a comprehensive accounting of its subsidy program. The Chinese government continues to administer programs that are thought to be illegal. The U.S. government also questioned the Chinese government's Northeast Revitalization Industrial Policies, an industrial policy designed to help companies located in the north-eastern region of the country compete in global markets. Among other things, the policy provides export credits and carries out strategic restructuring of key enterprises in the oil, petrochemical, iron and steel, automotive, shipbuilding, and aircraft products manufacturing sectors.

The concerns over China's industrial policy and illegal subsidies are well placed. Senator Joseph Lieberman in an article, "The U.S. Must Act Quickly to Maintain Vital Defense Technology," outlined how illegal subsidies and industrial policy come together to capture manufacturing and technology in one critical industry:

"The migration of research and design capabilities to China is of particular concern. Chinese policy has resulted in a sharp upsurge in construction of fabrication facilities in that country, with plans for a great many more. To ensure that they develop the ability to build the next-generation fabrication facilities, the Chinese central government, in cooperation with regional and local authorities, has undertaken a large array of direct and indirect subsidies to support their domestic semiconductor industry ...

The immediate and most powerful incentives for a highly leveraged industry are the direct and indirect subsidies, including the infrastructure needed for state-of-the-art fabrication plants, offered by the government. For example, the Chinese central government has undertaken indirect subsidies in the form of a substantial rebate on the value-added tax (VAT) charged on Chinese-made chips. While many believe this is an illegal subsidy under the General Agreement on Tariffs and Trade (GATT) rules, the impact of the subsidy on the growth of the industry may well be irreversible before—and if—any trade action has taken place. China also systematically undervalues its currency, often by as much as 40 percent, which gives its goods a major price advantage. This practice also may violate trade rules.

The development of special government-funded industrial parks, the low costs of building construction in China as compared with the United States, and China's apparent disinterest in the expensive pollution controls required of fabrication facilities in the United States all represent further hidden subsidies. ... These actions reflect a strategic

decision by the Chinese government to capture the benefits of this enabling, high-technology industry and become a monopoly supplier, and thus control pricing and supply levels.”

The cost of construction is also underwritten by continuing violations of labor standards. The April 4, 2006 report by the International Confederation of Free Trade Unions for the WTO General Council Review of the Trade Policies of the Peoples Republic of China found that “over 94 million private sector migrant workers are owed more than \$100 billion yuan in back wages ... the problem is most severe in the construction industry, which accounts for 70 percent of the total amount owed.”

### **Lack of Environmental Regulation Lowers Cost of Production**

Another unfair competitive advantage for manufacturers in China comes from lax environmental regulations and failure to enforce existing laws. Because China does not effectively regulate pollution, dumping, and emissions, corporations often fail to effectively employ even basic environmental protections. Cheaper goods, ruined communities, and sick workers are the result.

According to the Environmental Sustainability Index, an initiative by the Yale Center for Environmental Law and Policy (YCELP) and the Center for International Earth Science Information Network (CIESIN) of Columbia University, in collaboration with the World Economic Forum and the Joint Research Centre of the European Commission, China ranks a lowly 133 out of 146 nations. Its environmental sustainability rating, at 38.6 percent, is just below Iran, and just above Tajikistan.

A recently published study from the *Environment, Science, and Technology Journal* entitled, *Modeling Study of Air Pollution Due to the Manufacture of Export Goods in China's Pearl River Delta*, found that exported goods from China are cheaper to produce due to low or non-existent emission controls.

According to David Sheets, a policy analyst at Argonne National Laboratory and lead author of the report, "We in the West take advantage of cheap goods manufactured in China and other developing countries, and one reason they're cheap is because there aren't a lot of environmental controls. So we get the benefits of the cheap goods, and they absorb the air pollution; there's something not quite right about that."

### **Violations of Workers' and Human Rights**

In addition to the unfair competitive advantage gained through currency manipulation and illegal subsidies, the Chinese government's systematic repression of fundamental workers' rights is a key contributor to the undue advantage Chinese exports enjoy in the U.S. market. Chinese workers' most basic rights are routinely repressed, and they do not enjoy the political freedom to criticize, let alone change, their government.

Enforcement of wages, hours, and health and safety rules is lax or non-existent in many areas of the country. These abuses allow producers in China to operate in an environment free of independent unions, to pay illegally low wages, and to profit from the widespread violation of

workers' basic human rights. For example, Chinese mineworkers face conditions that rival or surpass some of the worst labor abuses in American history. Research indicates that more than 10,000 people die in Chinese mines each year. Coal mines in China may be the most dangerous places in the world to work. But unlike American mineworkers, Chinese mineworkers are denied the right to organize and bargain collectively.

Rates of illness and injury have never been higher in China's manufacturing sector -- as officials of China's own Work Safety Administration conceded as recently as February, 2006.<sup>3</sup> Aggregate unpaid wages have risen to record levels, setting off thousands of illegal demonstrations, labor shortages, and increased child labor – as adult workers increasingly refuse to accept such injustice. Workers who merely petition for payment of their wages are increasingly met with violence by security police and other local officials.

There are as many as ten to twenty million child workers in China – from one-eighth to one-quarter the number of factory workers. The problem of child labor has increased in recent years. China's minimum working age standard is very widely violated, and the Chinese government does little to enforce the standard. As the U.S. State Department stated in its 2005 Report on China, "The government continued to maintain that the country did not have a widespread child labor problem."<sup>4</sup> As reported in CSR – Asia Weekly last November local officials rushing to compete for manufacturing investments local are reticent to enforce child labor regulations.

China oversees a system of forced labor, not prison labor. The precise number of forced prison laborers is unknown but estimates range from 1.75 million to 6 million and higher.<sup>5</sup> Independent researchers, the Congressional-Executive Commission on China, and the U.S. House of Representatives confirmed that goods produced in China by forced labor continued to be exported to the United States in 2005.<sup>6</sup> In its 2005 resolution condemning China's forced labor, the House of Representatives detailed the appalling working conditions, hours of work, and that the "Chinese Government has continuously encouraged the export of goods produced through the Laogai prison system and relies on forced labor as an integral part of its economy.

Chinese policies amount to a deliberate and artificial suppression of wages below what a freely bargained wage would be, and even below what would be efficient in the Chinese context. This exploitation impacts American workers and domestic producers, as well as those in other developing countries, and artificially lowers the price of Chinese exports in the U.S. market.

In China, the result has been "labor shortages," wildcat strikes, and massive protests. According to Time Magazine ("Inside the Pitchfork Rebellion," by Hannah Beech), "Violent local protests are convulsing the Chinese countryside with ever greater frequency-- and Beijing has proved unable to quell the unrest. By the central government's own count, there were 87,000 'public order disturbances' in 2005, up from 10,000 in 1994."

That is an average of 238 protests every day last year.

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<sup>3</sup> Reported in Cao Desheng, "Diseases at Work Haunt Migrant Workers," China Daily (February 17, 2006)

<sup>4</sup> U.S. Department of State, Bureau of Democracy, Human Rights, and Labor, Country Report on Human Rights 2005: China (March 8, 2006).

<sup>5</sup> Evan Osborne, "Some Economics of Chinese Prison Labor," Wright State University and Osaka University Institute of Social and Economic Research (undated); Philip Pan, "China's Prison Laborers Pay Price for Market Reforms," Washington Post (June 14, 2002)..

<sup>6</sup> Congressional-Executive Commission on China Roundtable on Forced Labor (June 22, 2005).

President Bush did not demand any specific improvements in human rights when he met with China's President Hu in the summer of 2003. Instead, the Bush Administration has only engaged in an ambiguous and ineffective "cooperative dialogue."

The Administration's failure to take concrete actions on human rights and workers' rights in China allows rampant violations to continue. Workers in China, the United States, and around the world pay the price for this inaction, while companies producing in China enjoy the profits.

### **Workers' Rights Section 301**

Over two years ago, the AFL-CIO filed an unprecedented petition with the United States Trade Representative under Section 301 of the Trade Act of 1974. The petition asked the Trade Representative to take action to end the Chinese government's repression of the human rights of its factory workers.

It marked the first time in the history of Section 301 that a petition invoked the violation of workers' rights as an unfair trade practice, although it is common for corporations or the government to use Section 301 to challenge commercial unfair trade practices, such as illegal subsidies or violations of intellectual property rights.

Section 301(d)(3)(B)(iii) of the Trade Act provides that acts, policies, or practices of a trading partner are unreasonable if they constitute "a persistent pattern of conduct" that –

- (I) denies workers the right of association,
- (II) denies workers the right to organize and bargain collectively,
- (III) permits any form of forced or compulsory labor,
- (IV) fails to provide a minimum age for the employment of children, or
- (V) fails to provide standards for minimum wages, hours of work, and occupational safety and health of workers.

The petition showed that the Chinese government was engaged in a "persistent pattern" of denying the fundamental rights of its factory workers. Second, it demonstrated that China's violation of workers' rights artificially reduces wages and production costs in China and, as a result, displaces hundreds of thousands of manufacturing jobs in the United States.

The petition also showed that workers in China are being forced to work for wages 47 to 86 percent below what they should be, often as bonded laborers, with few workplace health and safety protections and no right to join or form free trade unions. The cost-advantage of this worker repression is staggering. If the Chinese government enforced workers' rights and its own minimum wage and workplace standards, manufacturing costs there would rise between 12 and 77 percent, or an average of 44 percent.

This unfair cost advantage, continues to add to the stunning bilateral trade deficit with China,. Under the terms of Section 301, we argued that this clearly "burdens and restricts" U.S. commerce.

In the model of development embodied in section 301(d), the global integration of labor markets, capital markets, and markets in goods and services is not intrinsically a bad thing. If workers' rights are vigorously enforced, then the impoverished and underemployed – whether in China, India, Indonesia, Mexico, or the United States -- may improve their standard of living and

generate new domestic demand in a virtuous cycle of equitable development, while providing new markets for overseas investors and workers, including those in the United States.

If, however, the workers' rights of one-quarter of the world's workforce are radically suppressed – as they in fact are, in China -- then labor conditions for the world's unskilled and semiskilled workers are worsened; domestic and global demand is depressed; excess productive capacity is created; and a path of inequitable, unsustainable development is promoted.<sup>7</sup>

Failure to address the systematic, egregious, and institutionalized repression of workers' rights in China costs hundreds of thousands of good jobs here, creates conditions of desperation and exploitation in China, and fundamentally alters the nature of global labor competition in the rest of the world.

The AFL-CIO's 301 petition sought to ensure that our government would give this issue the priority it deserves in its economic dialogue with the Chinese government.

### **China Denies Workers' Rights**

The overwhelming evidence that the Chinese government denies the workers' rights covered by the Section 301 petition in 2004 has only become stronger in the two years since the case was filed. The petition amassed evidence from the U.S. State Department, the International Labor Organization (ILO), labor unions, academics, newspaper accounts, and human rights groups. The AFL-CIO and other organizations continue to track the Chinese government's violations. Rather than showing signs of improvement, all reports indicated conditions are worsening.

- *China denies freedom of association and the right to bargain collectively.* The Chinese government relentlessly represses attempts to organize unions that are independent of the government-controlled All-China Federation of Trade Unions (ACFTU). The ACFTU is officially and legally subservient to the Communist Party and to local officials who profit from export enterprises. Workers who attempt to strike or organize unions independent of the ACFTU have been arrested, imprisoned, beaten, and tortured. Even workers who have spoken out against corrupt managers, who have had the temerity to demand that wage arrears be paid, or who have attempted to publicize workplace problems have been subject to severe reprisals and arrest.
- *Conditions of forced labor are widespread.* Many of the workers in China's export sector are temporary migrants from the countryside, who work under a repressive system of internal controls. Factory workers arriving from the countryside must pay substantial fees to local government officials and to employers to obtain the residence and work permits required by the "hukou" system, often leaving them heavily indebted. They lose their deposit if they quit without the employer's consent. In addition, employers frequently withhold one month to several months' pay, which workers lose if they quit or assert their rights. They are thereby essentially turned into bonded laborers who cannot leave their employment without incurring large and disproportionate penalties. The wages, conditions of work, and hours often turn out to be quite inferior to what is

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<sup>7</sup> See, e.g., Minqi Li, "Aggregate Demand, Productivity, and 'Disguised Unemployment' in the Chinese Industrial Sector," *World Development* vol. 32, no. 3 (March 2004) at pp. 409-425.



promised upon arrival, meaning that workers have clearly not entered into a free labor market, with fairly enforced rules.

- *China does not enforce its own laws with respect to minimum wages, maximum hours, and workplace safety and health.* Many manufacturers in China, including multinational corporations, pay their workers much less than the minimum wage standards set by the central and provincial governments. It is apparently common for companies to keep double and triple sets of books, to hide this practice. Workplace safety and health practices are atrocious, and China has the highest rate of industrial deaths and accidents in the world. Government officials simply do not enforce their own laws on wages, hours, and safety and health.

The AFL-CIO's petition did not challenge China's right to compete in the global economy on the basis of low wages. It is natural for a developing country with an excess supply of poorly educated rural workers to have low wages. We fully understand that even if China fully enforced its workers' rights, the wage gap between Chinese and American workers would not disappear. But it would surely narrow. The AFL-CIO challenge was specifically targeted to the *incremental* cost advantage that comes from the brutal and undemocratic repression of workers' human rights. That increment was then and remains today illegitimate advantage under universal norms of human rights. And it is illegitimate under U.S. trade law as well.

### **Workers and Currency: No Action Then, No Action Now**

Between China's brutal repression of workers' rights and its continuing currency manipulation, the Chinese government has a one-two punch that is destroying American manufacturing jobs and critically endangering our national security.

While the Bush Administration conceded there were serious concerns with regard to China's workers' rights abuses, it nonetheless denied the AFL-CIO's petition. Seven months after the President rejected the AFL-CIO's first petition, the Chinese government abruptly cancelled an international conference on the monitoring of workplace conditions.

In its 2005 Annual Report, the Congressional-Executive Commission on China (CECC) concluded "the Chinese government has avoided discussions with the international labor community on Chinese workers' rights." The CECC also found in 2005 that:

"The Commission finds no improvement overall in human rights conditions in China over the past year.... The Chinese government does not recognize the core labor rights of freedom of association and collective bargaining. The government prohibits independent labor unions and punishes workers who attempt to establish them. Wage and pension arrears are among the most important problems that Chinese workers face...Chinese workers continue to struggle to collect wages and benefits because relevant agencies do not enforce the regulations. Workplace health and safety conditions are poor for millions of Chinese workers...Forced labor is an integral part of the Chinese administrative detention system, and child labor remains a significant problem in China, despite being prohibited by law...."

Similarly, the State Department's 2004 Country Report on Human Rights in China concludes "The [Chinese] Government continued to deny internationally recognized worker rights,

including freedom of association” – the identical conclusion reached in the State Department’s 2003 Report.

The just-released 2005 State Department Country Report on Human Rights in China is much the same, finding that China denies basic worker rights, including freedom of association, workplace health and safety, payment of wages, rights against forced labor, and rights against trafficking in children. Peaceful labor protestors are subject to police violence, imprisonment, and torture. This report by the Administration itself concedes that these fundamental facts have not changed since the President’s assertion in 2004 that he would undertake measures to remedy China’s noncompliance. According to the State Department, regulations aimed at suppressing autonomous labor organizations grew harsher in 2005.

Following the denial of the Section 301 workers’ rights petition, the China Currency Coalition, an organization representing business and labor, including the AFL-CIO, submitted a Section 301 petition on Chinese currency manipulation on September 9, 2004. The Administration denied the petition the day it was filed. A third 301 petition, again addressing the currency issue, was filed by 35 United States Representatives and Senators. It too was summarily rejected.

In all instances, the Administration’s excuse was an ambiguous response that some unspecified action would be taken. The *modus operandi* has been and remains to talk little and do less. The President consistently sides with multinational corporate interests that manufacture in China over American working families and America’s manufacturing industries.

The results in the U.S. have been devastating: hundreds of thousands of lost jobs, countless bankrupt businesses and ruined communities. Unsafe and exploitative working conditions remain for uncounted Chinese workers.

### **Time to Act**

The administration has clearly abdicated its duty to protect American workers and industry. The onus now falls upon Congress and the U.S. China Economic and Security Review Commission to help guide our nation to swift action. We simply cannot afford another year of inaction and empty promises. We cannot afford another year of watching working conditions in China worsen and good jobs continue to leave the United States.

The AFL-CIO will continue to support measures to address currency manipulation, such as H.R. 1498, the bipartisan Ryan-Hunter China Currency Act of 2005; as well as S.295, the Schumer-Graham bill, which would impose a 27.5 percent tariff on Chinese goods if the Chinese government fails to revalue its currency in a timely fashion. And we will support legislation to address other illegal subsidies raised in this testimony. Most of all we will continue to work in every forum possible to improve workers’ rights in China.

The AFL-CIO remains committed to fighting for America’s working families and America’s manufacturing industries.

Thank you for having me here today and thank you for the important work you do.