HEARING BEFORE THE
U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION
REGARDING CHINA'S COMPLIANCE
WITH ITS OBLIGATIONS AT THE WORLD TRADE ORGANIZATION
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Introduction

Good afternoon. I appreciate being able to appear before the Commission today on behalf of the China Currency Coalition ("CCC"), a group of U.S. industrial, service, agricultural, and labor organizations that are extremely concerned with China's exchange-rate regime. In our view, as the result of manipulative policies by the Chinese government, China's currency is substantially undervalued by as much as 40 percent and perhaps more, and this undervaluation is generating dangerous and increasingly damaging economic imbalances for the United States, for the global community, and for China itself. Further, in our judgment, this undervaluation violates fundamental international legal obligations that China has assumed at the World Trade Organization ("WTO") and the International Monetary Fund ("IMF").

Acting upon this conviction, the CCC on September 9, 2004, filed a petition with the Office of the U.S. Trade Representative ("USTR"), seeking commencement of an investigation under 19 U.S.C. § 2412(a)(1) and resort to dispute settlement at the WTO absent immediate revaluation of the yuan by China. Our petition was rejected by USTR within several hours on the very same day. A comparable petition by the Congressional China Currency Action Coalition was filed on September 30, 2004, and was likewise rejected. In a notice published on December 30, 2004, at 69 Fed. Reg. 78,516, USTR conclusorily stated its view that an investigation would not be effective and "would hamper, rather than advance," USTR's efforts to address with China the currency valuation issues cited in the petitions. For the reasons set out below, we respectfully disagree.

What is urgently needed, in our opinion, in keeping with China's obligations at the WTO and the IMF, is a prompt, substantial revaluation by China to reflect the yuan's true strength in the global marketplace. Such action will greatly facilitate constructive, mutually beneficial integration of China into the world's economy. For everyone's sake, the sort of "beggar-thy-neighbor" practices that so plagued the early twentieth century should be avoided as much as possible in the twenty-first century. China, however, disputes that the yuan is undervalued and causing adverse effects and seems prepared out of perceived self-interest to continue undervaluing the yuan indeterminately into the future. USTR's strategy has led to no apparent progress. If anything, China is resisting revaluation of the yuan more than ever, and invaluable time is elapsing with nothing gained.

Historical Perspective of China's Foreign-Exchange Regime

China has long been wedded to a foreign-exchange regime characterized by significant and wide-ranging (if not complete) oversight, intervention, and manipulation by the central government. It is fair to say from this behavior that China has a deep-seated aversion to allowing the yuan to be governed by market forces. This distrust in the past was perhaps rooted to some extent in Communist doctrine, but probably has always been due primarily to the Chinese government's concerns that instability to its financial institutions and economy might occur and generate political and social unrest in a country with a low standard of living and poverty for many of its 1.3 billion people.

At least since 1979, and particularly since 1994, China's interventions in its foreign-exchange system have increasingly resulted in serious distortions and imbalances within China. Furthermore, since China's accession to the WTO on December 11, 2001, these adverse repercussions have more and more negatively affected other countries' economies as China's trade with the rest of the world has expanded.

The most distinctive and consistent feature of China's exchange-rate policies during the past quarter of a century has been intentional and persistent manipulation of the yuan, either overvaluation at times (as in the 1980s) to facilitate imports of capital goods considered necessary to China's development, or undervaluation (more recently and to the present) in order to slow the growth of imports and subsidize increased exports. The common thread throughout has been the Chinese government's attempts to strengthen China's economy, regardless of the expense to others. This policy has been most pronounced and its impact has been most damaging outside China generally and to the United States, in particular, since the end of the Asian financial crisis and China's accession to the WTO.

The emergence of financial instability in Asia can be traced to 1994 when China took two related steps in 1994 that have been integral factors over the last decade in bringing about China's ever-rising trade surpluses, foreign-direct investment ("FDI"), and foreign-exchange reserves. First, China established a much-devalued exchange rate of 8.70 yuan to the dollar. Second, to enforce that undervaluation, China renewed a requirement (since relaxed somewhat, but basically still in effect) that export earnings by domestic enterprises and foreign currency for FDI be surrendered to the Chinese government via designated foreign-exchange banks. By the end of 1995 and early 1996, the Chinese currency's pegged rate of exchange was effectively fixed at 8.28 yuan to the dollar, the rate that is still in effect today.

China's single-mindedness in manipulating the yuan over the last two and one-half decades and particularly since 1994 is underscored (1) by the ill-matched type of exchange arrangement that China has adopted under Article IV(2)(b) of the IMF's Amended Articles of Agreement, (2) by the disequilibria that have resulted in China's trade surpluses, foreign-direct investment, and foreign-exchange reserves, and (3) by the lengths to which China has been forced to go – and has been willing to go – in order to maintain the yuan's undervalued, fixed peg to the dollar.

With respect to China's chosen exchange arrangement, there are altogether about thirty countries, including China, that have opted to peg their currencies to a single foreign currency. There also are ten additional countries that peg their currencies to a basket of two or more foreign currencies. In either case, whether a given currency is pegged to a single foreign currency or to a basket of foreign currencies, such an exchange arrangement is considered a "conventional-fixed peg." For some years, China inaccurately and confusingly referred to its peg of the yuan to the dollar as a "managed float," but since 1999 the IMF correctly has classified China's exchange arrangement as the "conventional-fixed peg" that it is.

The first point to be highlighted here is that China's exchange arrangement is atypical. With the exception of China, the forty or so countries that employ a "conventional-fixed peg" are small, generally lesser-developed nations that have insignificant trade flows with the United States and that are dwarfed by China. By the same token, China is the only one of the top trading partners of the United States – such as Japan, the European Union, Canada, and Mexico – that does not have some kind of floating exchange regime vis-à-vis the U.S. dollar. In both contexts, China is going against the current.

Second, China's "conventional-fixed peg" of the undervalued yuan to the dollar is unsuitable to achieve the sort of balanced growth in international trade that both the WTO and the IMF are meant to foster for all member states. Instead, due to China's size and economic importance, China's policies increasingly have contributed to destabilizing extremes.

Perhaps the most dramatic excesses attributable to the undervalued yuan are China's substantial and increasing annual trade surpluses. It appears that China's own reported data consistently have understated its surpluses. In order to obtain a solid grasp of the size of China's annual trade surpluses, both with the United States and globally, it is necessary to turn to the data reported by China's principal trading partners. Why is the accuracy of China's trade data so important? Simply put, trade data serve as the basis for determining whether and to what degree a currency is undervalued. If a country consistently underreports its trade surplus, estimates of undervaluation are significantly understated.

Attached to this statement are tables setting forth (a) in Table 1 China's balance of trade with the United States since 1995 and (b) in Table 2 China's balance of trade between 1999 and mid-2004 with its top forty-one trading partners (identified in Table 4), including the United States, that together accounted for approximately 89 percent or more of China's total trade in each year during that period. These tables compare China's own reported data to the data reported by the United States and then by China's top forty-one trading partners.

Review of these data shows that China invariably has reported the respective values of its exports to the United States and to the forty-one countries in the aggregate as having been considerably less than the values that the United States and the forty-one countries have reported for their corresponding imports from China. At the same time, China (with one small exception as to the forty-one countries in 1999) has reported the respective values of its imports from the United States and from the forty-one countries in the aggregate as having been somewhat more than the values the United States and the forty-one countries have reported for their corresponding exports to China.

The first major result of these discrepancies is that – in each of the years covered – China's own reported data show only relatively modest trade surpluses with its top forty-one trading partners in aggregate, while the data of the United States and China's top forty-one trading partners' aggregated data consistently reveal far greater trade surpluses for China.

Thus, for example, Table 1B details that between 1995 and 2003, data compiled by the U.S. Department of Commerce record China's annual trade surplus with the United States as having ranged from U.S. $33.8 billion in 1995 to U.S. $124.9 billion in 2003, while China's data in Table 1A record China's annual trade surplus with the United States as having ranged from just U.S. $9.4 billion in 1995 to U.S. $60.3 billion in 2003. During the first half of 2004, the divergence was similarly striking, with U.S. data reporting China's trade surplus with the United States as U.S. $69.1 billion and China's data reporting China's trade surplus with the United States as being far lower at U.S. $32.5 billion. Cumulatively, from 1995 through June 2004, Table 1B's U.S. data show China's trade surplus with the United States at U.S. $715.1 billion, but China's data in Table 1A report China's surplus with the United States at U.S. $280.5 billion, a difference of U.S. $434.6 billion.

A comparable picture emerges from Table 2 of China's trade surplus with its top forty-one trading partners, including the United States, during the years for which data to make this comparison are available. Thus, between 1999 and 2003, the forty-one countries' aggregated data in Table 2C record China's trade surplus with the forty-one countries as having ranged from U.S. $139.7 billion in 1999 to U.S. $209.9 billion in 2003, while China's data in Table 2B record China's annual trade surplus with the forty-one countries in aggregate as having ranged between just U.S. $28.0 billion in 1999 and U.S. $29.9 billion in 2003 after hitting a peak in 2002 of U.S. $31.8 billion. During the first half of 2004, the divergence was even more extreme, with the forty-one countries' aggregated data reporting China's trade surplus with the forty-one countries as U.S. $112.6 billion, but China's data reporting China's trade surplus with the forty-one countries in aggregate as being a mere U.S. $2.5 billion. Cumulatively, from 1999 through June 2004, the forty-one countries' aggregated data in Table 2C show China's trade surplus with the forty-one countries at U.S. $990.8 billion, but China's data in Table 2B report China's surplus with the forty-one countries in aggregate at U.S. $148.9 billion, a difference of U.S. $841.9 billion.

The second major discrepancy in these two sets of data is, if anything, more striking than the first. As summarized in Table 3A, China's own reported data show that between 1999 and mid-2004 China had a modest annual trade surplus (in 1999) and thereafter an increasing annual deficit in aggregate with its top forty trading partners apart from the United States. It is these data reported by China and the resulting trade surplus and deficits on which the IMF and the U.S. Treasury Department, as well as China, have been relying in good measure for the proposition that the yuan is not undervalued and that the low U.S. savings rate accounts for the U.S. trade deficits with China.

These claims, however, are undercut when China's trade balance with its top forty trading partners is calculated from the aggregated data of China's top forty-one trading partners less the data reported by the United States on its trade with China.

Thus, in 1999, China's own reported data in Table 3A show a surplus by China of U.S. $4.4 billion in aggregate with its top forty trading partners, but the data of those top forty trading partners in Table 3A show an aggregate surplus by China of U.S. $70.7 billion, a difference of U.S. $66.3 billion per Table 3B. This disparity has grown substantially over the last several years. Since 1999, according to China's own reported data in Table 3A, China has had a string of annual deficits with its top forty trading partners in aggregate of U.S. $0.2 billion in 2000, of U.S. $3.3 billion in 2001, of U.S. $12.3 billion in 2002, of U.S. $30.4 billion in 2003, and of U.S. $30.0 billion during the first half of 2004. In sharp contrast, the reported data of China's top forty trading partners in Table 3A have shown a string of large surpluses by China of U.S. $86.4 billion in 2000, of U.S. $85.1 billion in 2001, of U.S. $84.4 billion in 2002, of U.S. $85.0 billion in 2003, and of U.S. $43.5 billion during the first half of 2004. As noted in Table 3B, China's rising deficits as reported by China's own data since 2000, of course, compared to China's substantial and relatively steady surpluses since 2000, as reported by China's top forty trading partners, display a greater and greater divergence. In 2003, for example, the disparity was U.S. $115.4 billion. During the first half of 2004, the disparity was U.S. $73.5 billion.

The conclusion drawn from Table 3 is that the data of China's top forty trading partners (excluding the United States) confirm that China has been running a very sizeable surplus annually with those countries since at least 1999, in contrast to the modest surplus in 1999 and increasing annual deficits since 2000 that China's own reported data suggest. Cumulatively, from 1999 through June 2004, the forty countries' aggregated data show China's trade surplus with the forty countries at U.S. $455.2 billion, but China's data report a combined deficit during this period by China with the forty countries in aggregate of U.S. $71.8 billion, a difference of U.S. $527.0 billion.

Thus, China's trade surplus with its top forty trading partners between 1999 and mid-2004, as reflected in the data reported by those forty countries, is in addition to the trade surplus that China has had with the United States during that same period and that is reflected in the data reported by the United States. Based upon the data in Table 1A reported by the United States, China's cumulative trade surplus with the United States from 1999 through June 2004 was U.S. $535.6 billion. As set forth in Table 3A in data reported by China's top forty trading partners apart from the United States, China's cumulative trade surplus from 1999 through June 2004 with those forty countries was U.S. $455.2. The sum of these two cumulative surpluses is equal to China's total cumulative surplus of U.S. $990.8 billion with its top forty-one trading partners between 1999 and mid-2004, as confirmed by the data reported by China's top forty-one trading partners in Table 2C.

Just recently, in an article by "Inside U.S. – China Trade" on January 12, 2005, it was reported that officials of the U.S. Treasury Department are working with representatives of the Chinese government (who are said in the article to have admitted that China's collection of trade data needs to be better) in order to improve China's reporting of its trade data in the hope of leading to greater international confidence in the accuracy of China's reported data. These efforts are to be applauded and should be helpful to the extent they prove to be successful. In the meantime, reliance should be placed upon the data of the United States and of China's other forty-one top trading partners, and these data document extremely worrisome trade surpluses by China with both the United States and with China's other forty-one top trading partners.

The second serious imbalance to which the yuan's undervaluation has contributed is the burgeoning annual foreign-direct investment in China that has occurred since 1994, from U.S. $33.77 billion in 1994 to U.S. $40.72 billion in 2000 (a jump of almost 21 percent), and from U.S. $40.72 billion in 2000 to U.S. $53.51 billion in 2003 (a further jump of 31 percent). Last week, China reported a record level of foreign-direct investment during 2004 of U.S. $60.63 billion, an increase of 13 percent over the previous annual high in 2003. This further rise occurred despite restrictions initiated by China last year on investment in certain sectors such as the steel industry.

The third serious imbalance due to the yuan's undervaluation follows from both China's trade surpluses and the foreign-direct investment that has been taking place in China. This imbalance is China's rapid accumulation of foreign-exchange reserves since 1994. By 1996, within two years after the yuan's undervaluation was instituted in 1994, China's foreign-exchange reserves had tripled from U.S. $26 billion to U.S. $78 billion. These sums have only multiplied on a larger absolute scale since then. As reported by the "Wall Street Journal" on January 12, 2005, China's foreign-exchange reserves jumped during 2004 by more than U.S. $200 billion to almost U.S. $610 billion. This figure includes U.S. $95 billion in speculative inflows anticipating a revaluation of the yuan. As reported by the "Financial Times" on January 26, 2005, however, it now appears from a statement by Li Deshui, head of China's National Bureau of Statistics, that China has no intention of revaluing the yuan to coincide with the G-7 meeting of finance ministers and central bankers later this week on February 4th and 5th.

In short, China's selection of a "conventional-fixed peg" with an unrealistically undervalued yuan has led to huge and growing imbalances in China's trade surpluses, foreign-direct investment, and foreign-exchange reserves. Rather than allow the market to correct these imbalances, China has been printing greater and greater quantities of yuan to exchange for the surfeit of dollars that must be turned over to the state-owned banks. In turn, these banks at the Chinese government's direction have been removing this flood of yuan from circulation, at least temporarily, through the issuance of domestic bonds. It was reported in the "Wall Street Journal" on January 12th that China undertook its biggest "sterilization" to date on January 11th by debt issues of 95 billion yuan (U.S. $11.5 billion). In addition, last week China's National Bureau of Statistics announced that China's economy grew by 9.5 percent during 2004, its fastest pace in eight years. China has proceeded with its strategy and remains willing to assume risks such as inflation and an over-heated economy in order to gain the benefits it seeks from keeping the yuan at its undervalued rate of 8.28 yuan to the dollar. Among these advantages in China's judgment has been China's ability to disburse periodically large amounts of its foreign-reserve dollars to shore up state-owned banks burdened by onerous and extensive non-performing loans.

As long as China insists upon manipulating its currency by maintaining a fixed peg of 8.28 yuan to the dollar, the trends of the past ten years' imbalances can reasonably be expected to become more pronounced, and China will be left to take the same sorts of measures it has been engaging in, namely, printing yuan to exchange for the dollars from exports and foreign-direct investment, followed by the issuance of yuan-denominated government bonds to control the quantity of yuan in circulation in China. How long this pattern can be sustained by China, and the repercussions once it cannot, remain to be seen. In the meantime, the Chinese government gives every indication of an unwavering intent to continue relying upon its undervalued yuan to subsidize exports and domestic sales by China's companies and to spur foreign-direct investment in China.

China's Failure to Uphold Its International Legal Obligations

China presents an extreme and unique case of currency manipulation. The sheer magnitude of China's economy, the far-reaching repercussions and huge and destabilizing imbalances that the undervalued yuan is causing in China and around the world, and China's political importance and obdurate persistence in maintaining the yuan's substantial undervaluation are proving to be a potent combination. From an international legal perspective, this unprecedented predicament poses a challenge to the WTO's agreements that govern international trade as well as to the IMF's Articles of Agreement that focus on international monetary matters, including orderly exchange arrangements.

Under the circumstances, the temptation might be to see China's undervalued yuan either as a trade issue for the WTO or as a monetary issue for the IMF. The trade and monetary aspects of the yuan's manipulation, however, are so intertwined that both the WTO and the IMF have their respective responsibilities and roles to fulfill. Indeed, it is evident from the texts and underlying negotiations of the General Agreement on Tariffs and Trade (the "GATT") and the IMF's Articles of Agreement that their drafters recognized that currency manipulation could have terribly harmful effects on both international trade and monetary affairs at the same time. As a result, the drafters incorporated in these documents provisions designed to avert and, if necessary, discipline currency manipulation.

From the standpoint of the GATT and the WTO and its other agreements, China's manipulation of the yuan runs directly counter to and seriously weakens and impairs a series of the basic principles that have been the cornerstones of the international trading system since World War II.

First and foremost, the yuan's undervaluation constitutes a prohibited export subsidy. Every good and every agricultural product exported from China to the United States or anywhere else in the world effectively receives from the Chinese government a financial contribution derived from the yuan's manipulation. The benefit enjoyed from this financial contribution is equal to the difference between what the yuan would be worth if its value were set by the market and its understated value as the result of China's manipulation. Moreover, receipt of this subsidy occurs only if there is exportation, and so is specifically contingent upon exportation. China's currency-manipulation scheme is a prohibited export subsidy, therefore, under Articles VI and XVI of the GATT, Articles 1, 2, and 3 of the Subsidies and Countervailing Measures Agreement, and Articles 3, 9, and 10 of the Agriculture Agreement

China's undervaluation of the yuan also violates Article XV:4 of the GATT. This Article proscribes exchange action that frustrates the intent of the GATT's provisions and proscribes trade action that frustrates the intent of the IMF's Articles of Agreement. In the past, there have been only a relatively few occasions on which Article XV:4 has been considered or invoked, essentially because there never previously has been a situation that has been remotely of the magnitude of China's manipulation of its currency. Likewise, there has been little amplification in practice upon Article XV:9 of the GATT, which states generally that the GATT does not preclude the use of exchange controls or exchange restrictions that are in accord with the IMF's Articles of Agreement.

What evaluation and use of Article XV:4 there have been in the past, however, indicate that (a) measures that are monetary in form but that have some effect on trade can be considered under the GATT's rules as far as the trade effect is concerned; (b) even when a monetary measure is regarded by the IMF as being necessary, that measure can be considered and treated under the GATT as an inappropriate, trade-restrictive measure; and, correlatively, (c) a measure that is arguably both financial and trade in character will be subject to scrutiny to ensure that it is consistent with both the GATT and the IMF's Articles of Agreement. In addition, the relationship between Article XV:4 and Article XV:9(a) of the GATT is a question that has been left for empirical consideration if and when particular points arise that have a bearing on that relationship, and general principles on that relationship have yet to be set. Within this framework, analysis demonstrates that China's undervalued exchange-rate regime violates Article XV:4.

Thus, under Article I of the GATT and its principle of most-favored-nation ("MFN") status, imports into China from the United States are to be treated no less favorably than imports into China from any other Member State of the WTO. China's undervalued exchange-rate regime, however, undercuts this principle of non-discrimination. While the U.S. dollar has been losing strength over the last year or so against most other countries' currencies, to the extent the U.S. dollar does appreciate against a third country's currency, the yuan automatically appreciates as well against that third country's currency, but not against the U.S. dollar due to the strict pegging of the yuan to the U.S. dollar. As a result, the third country's products become more attractively priced and competitive than U.S. products for export to China. Imports into China from the United States consequently are disadvantaged vis-à-vis imports from other countries and denied MFN treatment.

Similarly, under Article II of the GATT, China's tariff bindings are not to be exceeded. China's ad valorem customs duties, however, when applied to the inflated, yuan-denominated prices of imports into China that result from China's undervaluation of the yuan, yield similarly inflated amounts of yuan-denominated customs duties. In a perverse fashion, the weakening of the U.S. dollar means a commensurate weakening of the yuan and a corresponding increase in the amount of yuan-denominated customs duties that the Chinese importer must pay. China's tariff bindings become unacceptably elastic and uncertain and effectively exceeded as a result.

Again, under Article III of the GATT, China is obligated not to apply to domestic or imported products any laws, regulations, and requirements that affect the internal sale, offering for sale, purchase, transportation, distribution or use of products so as to afford protection to domestic production. China's inflexible and extreme pegging of the yuan to the U.S. dollar and currency controls, however, negate or erode this non-discriminatory principle of national treatment by so inflating the yuan-denominated price of imports into China from the United States that U.S. products are either excessively or prohibitively expensive and Chinese-origin products are favored and protected.

As touched upon earlier, under Articles VI and XVI of the GATT, China has committed to abide by the principle that export subsidies are prohibited. The Chinese government's persistent undervaluation of the yuan as compared to the U.S. dollar, however, acts in fact to subsidize all products exported from China to the United States.

Under Article XI of the GATT, China is barred generally from imposing measures other than duties, taxes or other charges that prohibit or restrict imports into China of any product from the United States. China's undervaluation of the yuan, however, variously serves to prohibit and restrict imports into China of products from the United States by so increasing the yuan-denominated prices of U.S. products that Chinese importers either cannot afford to import the U.S. products at all or can only import lesser quantities of the U.S. products than would be the case were the yuan commercially valued realistically against the U.S. dollar.

By way of recapitulation as to the GATT and the WTO's disciplines, therefore, along with the undervalued yuan's constituting a prohibited export subsidy, by the expedient of manipulating and undervaluing its currency as it has, China also has dramatically frustrated the intent of the GATT in contravention of Article XV:4. This exchange action by China at once is undercutting all of the GATT's principal concepts that together have formed the backbone of the international trading system over the last half century and more. In Article XV:4's terms, China's undervaluation of the yuan appreciably departs from the intent of the foregoing provisions of the GATT. In actuality, China's refusal to set a realistic rate based on market conditions or to allow the yuan to seek its own market-driven balance against the U.S. dollar is having a most insidious impact on the GATT's principles with debilitating effects both for the United States and the global economy as a whole.

From the standpoint of the IMF's Articles of Agreement as well, China's manipulation and undervaluation of the yuan are at odds with China's international legal obligations. In 1980, China assumed Taiwan's seat in the IMF and received one seat on the Board of Executive Directors. In 1996, two years after China had unified and realigned its exchange rate, China removed exchange restrictions on its current-account transactions by accepting Article VIII of the IMF's Articles of Agreement. As observed above, since late 1995 and early 1996, China has maintained its exchange rate at 8.28 yuan per dollar, a severely and persistently undervalued pegging of the yuan and an extreme case of currency manipulation. China's policy of maintaining an undervalued exchange-rate regime violates its obligations under Articles IV and VIII of the IMF's Articles of Agreement.

Article IV requires that each IMF member shall: "(iii) avoid manipulating exchange rates or the international monetary system in order to . . . gain an unfair competitive advantage over other members." First, China's fixed exchange-rate system requires that it intervene in every export transaction in order to maintain the fixed exchange rate, constituting manipulation. In addition, China has instituted capital controls further to enforce the fixed-exchange mechanism. Evidence of the extent of the practice is the accumulation of the massive foreign-exchange reserves recounted earlier. Second, China's policy of maintaining an undervalued exchange rate has given China and particularly China's exports an unfair competitive advantage in trade with the United States and other members of the IMF. China's undervalued exchange-rate policy subsidizes China's exports to the United States and other countries and denies the United States and other countries equal treatment as provided for under Articles I and III of the GATT. China's undervalued exchange rate system causes yuan-denominated prices of U.S. products in the Chinese market to be higher than what would prevail under market conditions and causes U.S. dollar-denominated prices of China's products to be lower in the U.S. market than what would prevail under market-determined exchange rates. This subsidized practice gives China's products a powerful advantage whether competing with U.S. products in the Chinese marketplace, in the United States, or in third-country markets, contrary to the obligations under the IMF's Article IV, section 1(iii).

China's policy of maintaining an undervalued exchange-rate system also violates the IMF's Article IV, section 1(ii), which states that each member of the IMF shall "(ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions." China's policy of maintaining an undervalued exchange-rate system is creating financial instability that will eventually disrupt global financial markets unless China appreciates its currency in line with underlying economic fundamentals. The threat to the international financial system is exacerbated by the size of China's economy and by China's volume of global trade and foreign-direct investment in China. China's accelerating accumulation of foreign-exchange reserves is generating disequilibrium in the international financial system, will tend to create inflation and over-investment in China, and will lead to the conditions for another international financial crisis. Rather than permit the yuan to increase in value, the Chinese government has chosen instead to offer any amount of yuan needed to absorb any supply of foreign currency. Consequently, as larger and larger foreign-currency surpluses have flowed into the Chinese market, the Chinese government has had to flood the market with more and more yuan. Thus, if China wishes to maintain exchange-rate stability in the face of such foreign-currency inflows, it does so at the cost of its control over its domestic money supply. Along with this rapid growth in the money supply, however, there is increasing evidence that the Chinese government has fostered a speculative over-investment boom and the foundation for much higher inflation in the future. If not corrected, these trends will coalesce in an unstable bubble that, due to the size of China's economy and volume of trade, will adversely affect international trade and financial markets, contrary to the obligations in the IMF's Article IV, section 1(ii).

China's policy of maintaining an undervalued exchange-rate regime also violates the IMF's Article VIII, section 3, which broadly prohibits any discriminatory currency arrangements or multiple currency practices, except as approved by the IMF or as authorized by the IMF's Articles of Agreement. As previously discussed, China's undervalued exchange-rate policy discriminates against U.S. exports of goods and services. Due to the yuan's undervaluation, prices of Chinese goods and services in the U.S. market are lower than what would prevail under an exchange rate that reflected underlying economic fundamentals. Conversely, the prices for U.S. products in China are higher than what would prevail with an exchange rate that reflected underlying economic fundamentals. In addition, the fixed undervalued exchange rate discriminates against other IMF countries. As the U.S. dollar depreciates against other currencies, the exchange rate with China does not change, and the advantage that China has through its undervalued exchange rate remains the same. Other currencies adjust simultaneously to the yuan and the U.S. dollar because the exchange rate is fixed, but those currency adjustments must be greater than what would be required under market conditions, because the yuan is undervalued and unable to appreciate against the dollar.

The clear discrimination of China's undervalued exchange-rate regime has not been authorized by the IMF and has come under increasingly negative criticism in the reports of the IMF's recent Article IV consultations over the last few years. With reference to the latest report from November 2004, the assessment of the IMF's Executive Directors is diplomatically couched with certain qualifications about the advisability of China proceeding from a position of strength in a phased fashion with the exact timing left to China's authorities, but at the same time is quite emphatic in urging China to adopt greater flexibility in its exchange-rate regime for the sake of China and resolution of global imbalances. In an excerpt from page 3 of a press release by the IMF accompanying the report and dated August 25, 2004, it is stated that "{m}any directors therefore considered that, in view of the present favorable circumstances, it would be advantageous for China to make an initial move toward greater exchange rate flexibility without undue delay, with some Directors preferring that this move be made soon."

In short, the outcome of each of the IMF's Article IV consultations since 2000 has been that the Executive Directors have recommended that China introduce greater flexibility into its exchange-rate regime. All Directors have believed that China's undervalued exchange-rate regime imposes significant costs on China's economy, particularly greater risks associated with monetary expansion, and on the global system, and thus have urged greater flexibility by China. That China has shown no flexibility indicates that China has continued to be in violation of its obligations to the IMF under Article VIII of the IMF's Articles of Agreement.

In summary, China's undervaluation of the yuan vis-à-vis the U.S. dollar violates basic and essential principles and provisions of the WTO and its agreements as well as vital obligations of China under the IMF's Articles of Agreement. China's manipulation of its currency is undermining the rules-based international trading and monetary structure, and the magnitude of the adverse consequences flowing from China's behavior for the United States and the global economy are far-reaching and taking a severe toll.

Possible Strategy in the Time Ahead

Any decision on how best to grapple with the yuan's undervaluation should begin with an articulation of where the interests of the United States lie in this matter and how those interests can most effectively be realized. Whatever approach is adopted should also rest on the most solid factual evidence available and be informed by as detached and objective an evaluation of China's outlook and purpose for itself as history permits. Within these guidelines, several observations seem appropriate and worthy of some consideration.

First, as remarked at the outset of this statement, it is in the interests of everyone, including the United States and China, that "beggar-thy-neighbor" practices not mar the twenty-first century and that China's integration into the global economy be constructive and mutually beneficial insofar as is feasible. Defining the goal in this expansive and abstract manner presumably is unobjectionable to most nations. Whether China agrees as a practical matter in relation to its undervalued yuan is an open question with different opinions.

Second, the more sharply defined interest of the United States should be to maintain a healthy and vibrantly balanced economy that encompasses not only high-technological production and services but also basic manufacturing, which is integral to our national strength. In this last regard, the United States ultimately is no differently situated today than it was in December 1791 when Alexander Hamilton as Secretary of the Treasury advocated development of manufacturing in his "Report on the Subject of Manufactures." For our political and military security and standing in the world, we need – but are allowing to be lost – our expertise, knowledge, and industrial base built up over generations. We cannot afford to be complacent in this respect, as Dr. Scott's recent study for the Commission, entitled "U.S. – China Trade, 1989-2003: Impact on Jobs and Industries," capably illustrates.

Third, in our judgment, China's deliberate actions in tightly controlling its currency's exchange rate over the last twenty-five years or so manifest an entrenched belief by China's leadership that China will be better served if its exchange rate is set by the government rather than by the market. There is no indication that China truly intends to change this pattern anytime soon unless it decides that its self-interest warrants a shift. Such a change of heart by China seems unlikely, because, as described in the section above on the historical perspective of China's foreign-exchange regime, the undervalued yuan has brought to China jobs, huge annual trade surpluses, foreign-direct investment, and extraordinary foreign-currency reserves. Nor is it apparent that China will have the self-discipline and ability to curb itself in time before uncontrollable imbalances wreak havoc. In the IMF's Article IV consultations with China during 2004, it is evident from comments made by the Chinese authorities and noted at pages 3 and 12-14 of the IMF's report, for example, that China is extremely reluctant to wean itself from the yuan's undervaluation. The concerns cited by the Chinese authorities center on (a) the impact of a potential appreciation and large change in the value of the yuan on China's domestic economy, especially as to growth in employment, given that China must generate 20-25 million new jobs every year, and (b) risks for China's banks if the yuan is revalued. As the IMF remarked in its report on China's 2004 Article IV consultations, greater exchange-rate flexibility should not be damaging from these standpoints, and yet China remains adamant in its undervaluation of the yuan.

Fourth, on the subject of whether the yuan truly is undervalued and, if so, by how much, it is important to recall that the trade data reported by China are seriously inconsistent with – and show a very different picture than – the trade data reported by China's top forty-one trading partners, including the United States. Much of the defense for the position that the yuan is not undervalued depends upon the trade data reported by China that show comparatively modest trade surpluses with the United States each year and somewhat small but still significant and growing annual trade deficits with the rest of the world. Logic dictates that the data of China's top forty-one trading partners are not skewed, and these data reveal sizeable and increasing trade surpluses by China each year – both with the United States and also with China's top forty trading partners other than the United States. These last data reinforce the general consensus by economists that the yuan is undervalued. By how much the yuan is undervalued is, not surprisingly, also a subject for debate. Here, too, however, there is something of a critical mass that indicates the yuan is undervalued somewhere in the range of forty percent. Indeed, this view is reinforced by comments of the Chinese authorities themselves, who, as just noted above, in the

IMF's 2004 Article IV consultations expressed concern that a potential appreciation and large change in the yuan's value would be problematic for China's domestic economy and jobs. A proper quantification of China's trade surpluses also detracts from the argument that the problem lies with a low savings rate by the United States, not any undervaluation of the yuan. While the U.S. economy would surely stand to gain from more savings and investment, a realistically valued yuan would do far more to bring global trends into balance even while likely causing U.S. importers to curtail their spending.

Fifth, and lastly, by means of the yuan's severe undervaluation, the Chinese government at one fell swoop is doing great harm to the rules-based system of the WTO and the IMF. On the one hand, the yuan's undervaluation comprehensively subsidizes all of China's exports. On the other hand, the yuan's undervaluation – as a practical matter – variously acts as a discriminatory tax, an added import duty, and a quantitative restriction on imports into China. These far-reaching effects of the yuan's undervaluation frustrate the GATT's basic intention of opening markets. Indeed, China's utter refusal to eliminate this undervaluation immediately is causing large-scale and adverse consequences for the United States and the global economy. If China's accession to the WTO in December 2001 is to be a constructive step, it is imperative that China – as the major trading country that it is – honor its obligations. Absent any indication that China will act promptly and of its own volition to revalue the yuan, the commencement of negotiations under the auspices of the WTO's Dispute Settlement Understanding is justified in the China Currency Coalition's judgment. This step is warranted in order to buttress respect for the rule of law and in light of the pressing need to stem and reverse the weakening of the U.S. economy and the global imbalances attributable to China's manipulation of the yuan.

Finally, especially if China continues to delay a meaningful revaluation of the yuan, but even if the yuan's undervaluation is corrected, there are several other steps that the Administration and Congress can take to underscore China's accountability for upholding the obligations it assumed upon joining the WTO.

1. First, countervailing duty proceedings should be conducted against subsidized imports into the United States from China. The WTO's Agreement on Subsidies and Countervailing Measures ("SCM Agreement") provides for countervail cases against non-market-economy ("NME") countries. In our judgment, the U.S. countervail statute as it stands authorizes the U.S. Commerce Department and U.S. International Trade Commission ("ITC") to go forward with countervail cases against Chinese products. Any doubt in this respect, however, can be removed by legislative amendment. The undervalued yuan is a prohibited export subsidy, the most egregious form of trade-distorting subsidy under the WTO's rules.

2. Second, the Administration should not eliminate application to China of the NME provisions of the U.S. antidumping law. Per China's Accession Agreement with the WTO, this applicability is in effect for fifteen years and should not be diminished.

3. Third, the Administration must make clear that it is prepared to implement section 421 of the U.S. trade laws (19 U.S.C. § 2451) and to apply restrictions against imports from China when the ITC determines that market disruption has occurred. Thus far, the Administration has not

granted any relief in the several cases in which the ITC has found market disruption by imports from China.

4. The Administration should urge the IMF to convene a special meeting of the finance ministers and central banking authorities of the major countries for the purpose of developing a financial accord that will ease the pending financial crisis.

Thank you for inviting me to appear before you today.