MANUFACTURING MAKES AMERICA STRONG

Statement

of Franklin J. Vargo

Vice President, International Economic Affairs
National Association of Manufacturers

on behalf of the National Association of Manufacturers

before the **U.S. – China Commission hearing on China and the WTO: Assessing and Enforcing Compliance**

"China's Exchange Rate Practices"

February 3, 2005

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Mr. Chairman and Members of the Commission:

I am pleased to testify today on behalf of the National Association of Manufacturers (the NAM) at this hearing regarding China's compliance with its World Trade Organization (WTO) obligations. I am particularly pleased to appear today before Commissioner Patrick Mulloy, who was my boss at the Commerce Department when he was Assistant Secretary of Commerce for Market Access and Compliance.

The National Association of Manufacturers is the nation's largest industry trade association, representing small and large manufacturers in every industrial sector and in all 50 states. No other trade subject comes close to commanding the attention that China is getting from both large and small NAM member companies. China is simultaneously the greatest concern of many of our import-competing members and the fastest-growing global market for many exporters large and small and for companies that operate internationally.

This week, in fact, when the NAM released its overall 2005 trade agenda, it also released a special China trade agenda, and I would like to discuss that agenda today. The NAM seeks a positive and balanced trade relationship with China that reflects market forces as closely as possible. There is no question that the Chinese currency is seriously undervalued and is having a major effect on U.S. bilateral trade and on the trade of other nations as well. However, the undervalued currency is not the only concern with China, and I would like to address some of the other issues as well.

In so doing, I want to state up front that while the rapidly-rising trade imbalance with China is a growing factor affecting U.S. manufacturing production and employment, it is far from the largest factor. Domestic costs, slowly-recovering U.S. exports, dollar overvaluation with other currencies, structural factors, regulatory pressures, and other issues are also at work. China must not be viewed as a “scapegoat” and an excuse for not tackling the other problems. Nonetheless, the China currency situation and other factors feeding our deficit with China must be addressed.

THE NAM’S CHINA TRADE AGENDA

The NAM’s trade agenda for China is focused on strengthening manufacturing in America and improving the international competitiveness of our manufacturing industry in the worldwide economy. In pursuing this agenda, the NAM expects that U.S. and international trade law will be administered so as to effectively level the trade playing field with China in order to achieve recognizable gains for manufacturing in the United States. These measures would result in a reduced trade deficit in manufactured goods with China and the world. The trade agenda for China complements the NAM’s overall trade agenda and priorities in reducing domestically imposed costs.

China’s emergence as a leading world economy has meant significant new opportunities for many NAM members, including increased export and investment. However, these opportunities are not fully realized by all NAM members despite the many constructive steps taken during the first term of the Bush Administration to ensure China’s compliance with its WTO commitments.

The NAM believes there is substantial potential for Chinese economic growth to lead to a corresponding growth in the U.S. manufacturing economy. But that potential is far from realization. Of the $413 billion of goods China imported in 2003, only 8 percent were from the United States, including agricultural products. In contrast, the European Union (EU) and Japan have been significantly more successful selling into the Chinese market. During 2004, U.S. imports from China grew almost 30 percent, contributing to the largest bilateral trade deficit with any country, at nearly $160 billion, up almost $35 billion from 2003.

Trade generally, and with China specifically, has to be put in the context of a recovery in many sectors of the U.S. manufacturing economy over the past 18 months. But, despite this recovery, a number of manufacturing sectors that have borne the brunt of China’s emergence as an industrial power have continued to lose revenue and jobs. Thus the China challenge not only continues to be at the center of the NAM’s trade agenda, but also is central to how U.S. manufacturing defines its own future.

We believe full implementation of the NAM’s China trade agenda would open markets, improve productivity and begin to slow the growth of the China trade deficit and reduce it to more sustainable levels, and be beneficial to China as well insofar as China would begin to focus more on domestic-led growth rather than export-led growth.

While it is important that the U.S. government address our overall trade deficit, our deficit with China is so huge that an overall reduction cannot be done without examining our substantial imbalance with China. An essential objective of U.S. trade policy and trade diplomacy must be to undertake concrete steps aimed at improving U.S. competitiveness that will achieve a substantial and sustained reduction in the global and China trade deficits.

Accordingly, after extensive discussion over a period of months, NAM member companies, including both large and small companies, multinationals and local producers, agreed on pursuing a China trade agenda comprised of the following elements:

- Revaluation of the Chinese Yuan To Reflect Economic Fundamentals
- Enforce and Enhance Intellectual Property Laws
- Retain China's Non-Market Economy Status as Negotiated in PNTR
- Eliminate Chinese Administrative, Regulatory and Standards Barriers
- Expand Exports to China
- Promote Fair Competition

CHINA'S WTO COMPLIANCE

The NAM worked very hard to support and obtain China's accession to the World Trade Organization (WTO). When China joined the WTO, it committed to lower trade barriers significantly and to take far-reaching market-opening moves. This was basically cost-free to the United States, which was already open to China and did not change its import policies at all when China joined. Thus, China's accession to the WTO for the first time began to level the playing field for American companies. Prior to that time, the U.S. market had been open to Chinese products, but China's market had been among the most closed in the world to U.S. products.

In fact, there is no doubt in my mind that had China entered the WTO 10-15 years earlier, we would not have a trade deficit with China nearly as large as we actually do. Had we had access to China earlier, by now our exports to China would have been much larger than they are today.

China's accession to the World Trade Organization in December 2001 was an important positive development because it brought China under the same international trade rules as the United States and almost all of our other trading partners. China has made progress in implementing its WTO commitments and market-opening pledges but problems persist and some are of a very serious nature that have far-reaching effects on U.S. manufacturers.

Two of the most serious problems relate to lack of effective enforcement of intellectual property protection and the central government's policy of currency undervaluation, which we believe violates the WTO principles. Additionally, we have concerns about the application of China's "CCC" mark and its compatibility with China's obligations in technical barriers to trade.

The NAM will continue to participate in the USTR's annual review of China's WTO commitments and welcomes the dedication of both the Bush Administration and the Chinese government to accelerating progress. The NAM believes both governments should continue to increase the resources they dedicate to the bilateral Joint Commission on Commerce and Trade (JCCT). Nevertheless, we believe bolder steps are required to improve the situation and allow American companies to compete effectively with China in the global and U.S. economies. There is a growing sense of urgency that many dimensions of the Chinese relationship need renewed attention in the early days of the second term of the Bush Administration.

These are covered in detail in the NAM's trade agenda for China. I will focus my statement today on China's currency, and will cover the other elements of the NAM's strategy only briefly. I have, however, appended this agenda in its entirety to my statement; and I urge the Commission to review it carefully.

CHINA'S UNDERVALUED CURRENCY

China's currency has been fixed at an exchange rate of 8.27 yuan per dollar since 1994. The NAM believes that the yuan is undervalued by as much as 40 percent. The undervalued yuan effectively taxes U.S. exports and subsidizes imports from China, exacerbating the growing bilateral trade deficit. In 2004, the bilateral trade deficit with China was close to $160 billion, the largest with any country and, at current growth rates, will almost triple in five years. Furthermore, the undervalued yuan makes foreign investment in productive capacity in China cheaper and more attractive, thus encouraging the migration of investment to China.

China devalued its currency by about 30 percent in 1994 and has maintained that value for the last ten years -- despite a huge increase in production capability, productivity, quality, production range, foreign direct investment inflows, and other factors that would normally be expected to cause a currency to appreciate. The currency is controlled by the government, and there is no marketplace for the yuan. The degree of upward pressure that the yuan would feel, however, is amply indicated in the amount of reserves that the Chinese government has to accumulate to maintain its artificial peg.

Foreign exchange reserve accumulation has been accelerating. Reserves grew a phenomenal $200 billion last year – to a total accumulation of $610 billion. The growth of foreign exchange reserves requires China to convert those holdings to yuan, thereby increasing the money supply by 15-20 percent annually. Increases of that magnitude have accelerated inflation, expanded bank lending and fueled growth to more than 9 percent annually, contributing to an overheated economy.

I would like to put China's reserve accumulation in the perspective of China's economy – which is about $1.5 trillion. That means China's $600 billion of currency reserves (mostly in dollars) is equivalent to 40 percent of China's entire annual output of goods and services. That is an enormous amount to have in Treasury securities earning a couple of percentage points when China could be using those funds internally to build up the poorer parts of its economic infrastructure and stimulate domestic-led growth. Moreover, the $200 billion that China added to its reserves in 2004 significantly exceeded China's entire increase in GDP that year. Yet China has no choice but to continue this huge buildup of reserves so long as it insists on maintaining such a sharply undervalued currency.

It should be noted that, while a currency peg *per se* does not contravene International Monetary Fund (IMF) requirements, IMF Article IV proscribes "manipulation of exchange rates to gain unfair competitive advantage over other members - and this includes protracted large-scale intervention in one direction in the exchange market." With foreign currency reserves more than $600 billion, China's action is clearly incompatible with the intent of IMF Article IV.

The NAM believes that eliminating the severely undervalued yuan is essential to creating more balanced and sustainable trade flows and giving U.S. companies a more stable period to adjust to changing economic relationships. In addition, a revaluation of the yuan to reflect underlying economic fundamentals would create more favorable conditions within Asia, enabling other countries to free their currencies to better reflect market conditions. These multiple currency misalignments artificially depress U.S. exports to a substantial portion of the world economy and reduce the competitiveness of U.S.-based manufacturing in the U.S. market.

The Chinese currency is the key, not just because of the huge bilateral imbalance, but also because other Asian countries are all looking over their shoulders at Chinese competition and are reluctant to allow their currencies to move up against China's. Once China's currency appreciates, though, they will be less reluctant to allow theirs to move upward as well.

Would a considerably stronger Chinese yuan have beneficial effects? Many of our member companies tell us that a 20 percent or more price shift would change the competitive situation dramatically. Others say their problems go beyond that. Some commentators state that Chinese wages are so low that no amount of appreciation would make a difference. Labor costs, however, are only one factor in the production process. In fact, production worker wages and benefits are only 11 percent of the cost of U.S. manufactured goods, on average. An exchange rate reflecting market forces would shift the competitive equation so that some Chinese industries would remain extremely competitive, while others would find their artificial advantage diluted. U.S exports would also grow more rapidly, helping to bring about a more sustainable trade position.

Additionally, it is important to recognize that not all of China's rapid export growth to the U.S. market necessarily competes with U.S. production. For example, Japan's share of U.S. imports has fallen as China's has risen -- implying the possibility of considerable substitution of Chinese for Japanese goods.

The Administration recognizes the importance of having a Chinese currency that reflects market forces, and the NAM applauds last week's statement by the President that China's pegged currency remains a top priority. We also appreciate the work that Treasury Secretary Snow has been doing to obtain progress, and hope that the London G7 meetings this weekend will result in China gaining a sufficient understanding from U.S. and other G7 country officials that the time has come to act.

Certainly the preferred step by China would be to allow the yuan to be market determined, by ending the practice of pegging it to the dollar and by ceasing its huge sustained purchases of dollars. Chinese officials have said this is their eventual goal, but have expressed great concern that all the problems with their banking and financial system must be fixed first.

Others disagree, pointing out that currency flexibility and capital account liberalization are two different things and need not be implemented simultaneously. Capital account liberalization may indeed be a step that must await banking system reform, but currency flexibility can be implemented without capital account liberalization. This argument is laid out, for example, in a recent International Monetary Fund (IMF) Policy Discussion Paper entitled, "Putting the Cart Before the Horse? Capital Account Liberalization and Exchange Rate Flexibility in China."

China could take several actions immediately, including unpegging the yuan from the dollar and relating it instead to a basket of major trading partner currencies, establishing a large band around its current rate, and moving its peg upward. When we talk about revaluation, we see significant moves in this direction as being most desirable, but believe as a minimum that China could simply repeg its currency upward to a significant degree.

China's action in sustained one-way purchases of dollars to maintain its peg are inconsistent both with its obligations in the IMF to avoid currency action for purposes of gaining a trade advantage, as well as with its obligations in the WTO to avoid frustrating trade liberalization through exchange rate action and to avoid subsidization of exports or impairment of trade benefits.

The NAM urges the Administration to work with China and other countries to realign exchange rates and thus avoid the dangers that misaligned exchange rates pose to the United States, China, Asia and the global financial system. The G7 meetings later this week in London pose an excellent opportunity for seeking a change in China's policy.

Additionally, we will press the Treasury Department to recognize currency manipulation in its semi-annual report to Congress. It has declined to do so in earlier reports, but we believe China's massive currency purchases in 2004 clearly fall within the definition of manipulation. We also believe the Treasury Department should urge the International Monetary Fund to exercise its surveillance authority over exchange rates. We hope this will result in positive action, but if it does not, the IMF should be prepared to cite China under Article IV if progress is not made in consultations.

OTHER ELEMENTS IN THE NAM'S CHINA TRADE AGENDA

Let me again call the Commission's attention to the NAM's China Trade Agenda, which is attached to my statement. I will briefly summarize some of the main points in that agenda and state that the NAM looks forward to working with the Commission on this in the future.

Strengthen and Enforce Intellectual Property Laws -- Next to the exchange rate, the most serious problem NAM members have with China is its failure to curb intellectual property theft – particularly copyright piracy and product counterfeiting. China has become the world's epicenter of counterfeiting, costing billions of dollars, thousands of legitimate jobs, and threatening health and safety as individuals purchase bogus products that do not do what they are supposed to.

Despite bilateral and multilateral agreements with China to protect intellectual property rights, China's record of enforcement has been inadequate and seriously flawed. China has been taking positive steps, particularly in working with the energetic initiatives proposed by the U.S. Trade Representative and the Commerce Department. China's Vice Premier Wu Yi has succeeded in getting some beneficial changes that lower the threshold for criminalization of intellectual property theft, but we need to see these new tools actually used, with counterfeiters thrown in jail and the volume of counterfeiting significantly reduced.

Retain Non-Market Economy Status -- The NAM believes that the Administration should proceed carefully in its examination of China's status as a non-market economy country. China's economy has significant distortions that prevent market forces from acting efficiently and effectively at the present time.

Eliminate Administrative, Regulatory and Standards Barriers -- While tariffs have fallen significantly, U.S. manufacturers doing business in China still face many administrative, regulatory and standards-related barriers that are difficult and costly to overcome. The NAM urges the U.S. Government to give a high priority to removing these barriers by pressing Chinese authorities to streamline administrative and regulatory processes, making them more transparent and open to stakeholder input, and applying regulations consistently throughout the country. The NAM is particularly concerned that China's CCC Quality Mark system is in effect a trade barrier, and urges the Commission to look into this closely, with a view toward generating positive suggestions that would facilitate trade and particularly U.S. exports.

Expand Exports to China -- The Chinese marketplace holds vast potential for U.S. manufacturers. With annual growth rates in the 8-9 percent range for more than a decade, China is the fastest growing economy in the world and one that is increasingly open to trade with the world.

China is the third largest import market in the world, after the United States and Germany, with more than $500 billion in imports. The United States, however, captured only 8 percent of that market or $35 billion in 2004, substantially less than either Japan or the European Union and a decline from the 9% of market share in 2002.

To reverse this trend and help U.S. manufacturers reach their export potential in China, a new and greatly expanded export promotion initiative is needed. Current U.S. Government export promotion programs offer useful assistance but are not on the scale needed to make a sufficient difference in overall export trends. The U.S. Government and private sector must work together to launch a more ambitious program that provides more on-the-ground assistance in China and more trade outreach to potential U.S. exporters.

We believe that if this is done, we could see an increase in U.S. exports of 33 percent annually during the next four years - or a three-fold increase - to more than $100 billion by 2008. We believe this is attainable, but only with a major new public-private effort. To implement a program of this scale, the NAM will seek to obtain a doubling of the Commerce Department's China-specific trade promotion budget for FY2006.

The NAM also believes that, as part of this effort, expanded export financing is needed and the United States should seek to eliminate China's still high industrial tariffs to levels comparable to the United States, the EU, and Japan – utilizing the Doha Round of WTO negotiations.

Open China's Public Procurement and Internal Market -- China committed in its WTO accession agreement to negotiate entry into the government procurement agreement. The NAM urges the United States to give high priority to promoting China's government procurement accession with the objective of making China's government procurement practices more transparent and open, in which a diversity of manufacturers and exporters can compete on a level playing field with the widest possible range of product options being made available.

Improve the Export Administration Act and Procedures -- The U.S. government imposes export controls on a wide range of goods and technologies, particularly those destined for China, on grounds of national security. The current control system is inefficient and costly to our economy, and the NAM seeks updated export administration procedures that meet U.S. needs in the post-Cold War era.

Address Visa Delays for Chinese Business Visitors -- Changes since 9/11 in U.S. procedures for obtaining visas have made it increasingly difficult for Chinese business and government officials to visit the United States for meetings with U.S. companies, business conferences and trade fairs. As a result of visa difficulties, many Chinese companies appear to be turning to other non-U.S. suppliers for their purchases of manufactured goods.

Apply Countervailing Duty Laws to China -- There are concerns that China's industrial development may benefit from a wide array of subsidies, including currency manipulation, government bank lending to enterprises without creditworthiness, export-based tax incentives, and the discriminatory application of tax rates and rebates. The WTO Subsidies and Countervailing Measures (SCM) agreement allows countervailing import duties to offset such subsidies.

While these provisions apply to imports from nearly all WTO members, the Department of Commerce, based on a decision in 1984, does not apply countervailing duties against imports from non-market economy countries such as China.

The NAM supports reversal of the Commerce Department's 1984 decision in light of the SCM Agreement and the terms of China's accession to the WTO, and supports legislation such as that which was introduced last year in the House by Rep. English and Davis and in the Senate by Senators Collins and Bayh.

Apply Safeguards and Make Trade Cases More Affordable -- Because China's economy is still in transition from a command economy to a market economy, trade with China will be characterized by periods of market disruption in various commodities. Special provisions were incorporated in China's accession to the WTO to address the disruption that documented surges in China's exports to other markets may cause. The NAM believes these provisions should be used when the circumstances fit the requirements, for without relief from market disruption, small manufacturers face surges in imports from China because China does not have the market mechanisms in place to prevent overproduction and overcapacity.

Many smaller U.S. companies cannot afford the high costs of preparing and filing trade cases. The Department of Commerce and other relevant agencies should consider self initiation of trade cases when small companies or the industry is not financially in a position to prepare and file a trade case, and should explore other ways of making the provisions of U.S. trade law more practically available to smaller firms.

CONCLUSION

I want to conclude by reiterating that we will not succeed in preventing the migration of our manufacturing base to China and other foreign countries if we do not address the high cost of manufacturing in the United States. A fairly valued Chinese currency is important, but we must not forget that the bulk of our problems are home-grown. U.S. industry is burdened by legal and regulatory systems that retard growth and destroy jobs.

Rapidly rising health care costs are a constant worry, particularly for small manufacturers. Uncertainty over sources of energy supply has led to price volatility. Research and development need to be expanded to assure U.S. technological leadership. And shortages of skilled workers have many manufacturers wondering how they can expand in the future.

Additionally, bilateral, regional and WTO trade agreements must be negotiated as quickly as possible to get foreign trade barriers eliminated, or at least down to our own low level. U.S. tariffs on manufactured goods average less than 2 percent, while in many parts of the world U.S-made goods face tariffs 10-15 times higher -- or even more.

Unless these challenges are also addressed, we can expect a significant further erosion in the U.S. industrial base. Competition from China will only accelerate the trend. However, if we begin to act now, with both a refocused and positive trade policy toward China and a concerted strategy on economic growth and manufacturing renewal, we can restore the dynamism and competitiveness of U.S. industry and ensure the global leadership that is so central to our economic and national security.

Thank you, Mr. Chairman.

THE NAM TRADE AGENDA FOR CHINA
2005

The NAM trade agenda for China is focused on strengthening manufacturing in America and improving the international competitiveness of our manufacturing industry in the worldwide economy. In pursuing this agenda, the NAM expects that U.S. and international trade law will be administered so as to effectively level the trade playing field with China in order to achieve recognizable gains for manufacturing in the United States. These measures would result in a reduced trade deficit in manufactured goods with China and the world. The trade agenda for China complements the NAM's overall trade agenda and priorities in reducing domestically imposed costs.

- **Revalue the Chinese Yuan To Reflect Economic Fundamentals**
- **Enforce and Enhance Intellectual Property Laws**
- **Retain China's Non-Market Economy Status as Negotiated in PNTR**
- **Eliminate Chinese Administrative, Regulatory and Standards Barriers**
- **Expand Exports to China**

  Expand and Strengthen Export Promotion Programs Toward China

  Expand Export Financing

  Eliminate China's High Industrial Tariffs

  Open Public Procurement and China's Internal Market

  Improve Export Administration Act and Procedures

  Reduce Visa Delays for Chinese Business Visitors
- **Promote Fair Competition**

  Apply Countervailing Duty Laws To China to Address Subsidies

  Apply China Safeguard (Section 421)

  Make Trade Cases More Affordable

The National Association of Manufacturers is the nation's largest industry trade association, representing small and large manufacturers in every industrial sector and in all 50 states. Headquartered in Washington, D.C., the NAM has 10 additional offices across the country. Visit the NAM's award-winning web site at www.nam.org for more information about manufacturing and the economy.

China is the single most important trade challenge facing U.S. manufacturing growth and competitiveness. China's emergence as a leading world economy has meant significant new opportunities for many NAM members, including increased export and investment. However, these opportunities are not fully realized by all NAM members despite the many constructive steps taken during the first term of the Bush Administration to ensure China's compliance with its WTO commitments.

The NAM believes there is substantial potential for Chinese economic growth to lead to a corresponding growth in the U.S. manufacturing economy. But that potential is far from realization. Of the $413 billion of goods China imported in 2003, only 8 percent were from the United States, including agricultural products. In contrast, the EU and Japan have been significantly more successful selling into the Chinese market. During 2004, U.S. imports from China grew almost 30 percent, contributing to the largest bilateral trade deficit with any country, at nearly $160 billion, up almost $35 billion from 2003.

Trade generally and with China has to be put in the context of a recovery in many sectors of the U.S. manufacturing economy over the past 18 months. But, despite this recovery, a number of manufacturing sectors that have borne the brunt of China's emergence as an industrial power have continued to lose revenue and jobs. Thus the China challenge not only continues to be at the center of the NAM's trade agenda, but also is central to how U.S. manufacturing defines its own future. Full implementation of the NAM's China trade agenda would open markets, improve productivity and begin to slow the growth of the China trade deficit and reduce it to more sustainable levels.

Among the concerns our membership repeatedly cites with respect to China trade are its unsustainable currency practices, inadequate intellectual property safeguards and subsidies. When these China-specific factors are combined with increasingly burdensome U.S. structural costs, many segments of the U.S. manufacturing economy find constant "restructuring" and "reinvention" inadequate to allow them to be competitive.

The NAM believes that addressing a wide range of bilateral trade issues is as critical for China as it is for the United States. It is a priority for the NAM, and we believe should continue to be a priority for the second Bush Administration. While it is important that the U.S. government address our overall trade deficit, our deficit with China is so huge that an overall reduction cannot be done without examining our substantial imbalance with China. An essential objective of U.S. trade policy and trade diplomacy must be to undertake concrete steps aimed at improving U.S. competitiveness that will achieve a substantial and sustained reduction in the global and China trade deficits.

The President's Export Council (PEC) is currently undertaking an analysis of the U.S.-China trade imbalance, an important step in understanding the measures needed both in the manufacturing sector and in partnership with the government to address the causes and devise the cures. An important part of that study should be an analysis of the U.S. sectors being most adversely affected and the reasons why U.S. exports to China have not grown as rapidly as those of other high cost economies like the EU and Japan.

During the first term of the Bush Administration, China made significant progress towards fulfilling its WTO accession commitments and, while deficiencies still exist, progress is continuing. The NAM will continue to participate in the USTR's annual review of China's WTO commitments and welcomes the dedication of both the Bush Administration and the Chinese government to accelerating progress. The NAM believes both governments should continue to increase the resources they dedicate to the Joint Commission on Commerce and Trade (JCCT).

We believe bolder steps are required to improve the situation and allow American companies to compete effectively with China in the global and U.S. economies. There is a growing sense of urgency that many dimensions of the Chinese relationship, especially those listed in this document, need renewed attention in the early days of the second term of the Bush Administration.

Revalue the Chinese Yuan to Reflect Economic Fundamentals

China's currency has been fixed at an exchange rate of 8.27 yuan per dollar since 1994. The NAM believes that the yuan is undervalued by as much as 40 percent. The undervalued yuan effectively taxes U.S. exports and subsidizes imports from China, exacerbating the growing bilateral trade deficit. In 2004, the bilateral trade deficit with China was close to $160 billion, the largest with any country and, at current growth rates, will almost triple in five years. Furthermore, the undervalued yuan makes foreign investment in productive capacity in China cheaper and more attractive, thus encouraging the migration of investment to China.

The effects on China are equally disruptive. Foreign exchange reserves have grown to almost $610 billion, over one-third of China's GDP. The growth of foreign exchange reserves requires China to convert those holdings to yuan, thereby increasing the money supply by 15-20 percent annually. Increases of that magnitude have accelerated inflation to more than 5 percent (compared to the previously deflationary period in the late 1990s), expanded bank lending and fueled growth to more than 9 percent annually, contributing to an overheated economy.

It should be noted that, while a currency peg *per se* does not contravene International Monetary Fund (IMF) requirements, IMF Article IV proscribes "manipulation of exchange rates to gain unfair competitive advantage over other members - and this includes protracted large-scale intervention in one direction in the exchange market." With foreign currency reserves more than $600 billion, China demonstrably violates the intent of IMF Article IV.

The NAM believes that eliminating the severely undervalued yuan is essential to creating more balanced and sustainable trade flows and giving U.S. companies a more stable period to adjust to changing economic relationships. In addition, a revaluation of the yuan to reflect underlying economic fundamentals would create more favorable conditions within Asia, enabling other countries to free their currencies to better reflect market conditions. These multiple currency misalignments artificially depress U.S. exports to a substantial portion of the world economy and reduce the competitiveness of U.S.-based manufacturing in the U.S. market.

The NAM urges the Administration to work with China and other countries to realign exchange rates and thus avoid the dangers that misaligned exchange rates pose to the United States, China, Asia and the global financial system.

NAM Key Objective:
Immediate revaluation of the yuan by up to 40 percent

Actions:

- ***Press the Treasury Department to urge the International Monetary Fund to exercise its surveillance authority over exchange rates and cite China under Article IV if progress is not made in consultations.***

- ***Encourage the Administration to work with the G-7, G-20, APEC and other international organizations to press the Chinese government to revalue the yuan.***

- ***Press the Treasury Department to recognize currency manipulation in its semi-annual report to Congress.***

Strengthen and Enforce Intellectual Property Laws

The NAM welcomed China's announcement in December 2004 that it will more aggressively pursue criminal prosecutions for counterfeiting and copyright piracy while raising fines and penalties. While this is a significant step forward, these actions do not totally resolve the problem of Chinese counterfeiting. There is still much to be done enforcing tough anti-counterfeiting laws, particularly at provincial and local levels. The Administration must press China to put into practice this new interpretation of its anti-counterfeiting laws in an effective manner, with real prosecution of counterfeiters.

Despite bilateral and multilateral agreements with China to protect intellectual property rights, China's record of enforcement has been inadequate and seriously flawed. The lack of transparency and cooperation with government agencies, high thresholds for prosecution, weak administrative sanctions, local protection and corruption, coupled with a general lack of resources and training, have weakened China's enforcement of its laws and regulations governing intellectual property rights. The April 2003 visit of Vice Premier Wu Yi yielded some positive commitments on enforcement efforts in China. In addition, the Administration instituted the Strategy Targeting Organized Piracy (STOP) that establishes a more comprehensive approach to addressing piracy, particularly for the import of pirated products into the United States.

Nevertheless, intellectual property piracy in China continues at excessively high levels and, because China is a major world exporter, those pirated products are appearing in markets throughout the world. An inadequate IPR enforcement structure within China will also hamper the development and success of Chinese branded products in the future. Moreover, counterfeit products create health and safety hazards not only for Chinese citizens but for unwitting consumers around the world. The Administration and the NAM need to ensure that China continues to reduce and eliminate piracy and counterfeiting by increasing enforcement at the central, provincial and local government levels in China and at its borders to prevent those pirated products from being exported or imported.

NAM Key Objective:
A dramatic acceleration of initiatives to reduce and eliminate Chinese intellectual

property rights violations

Actions:

- ***Encourage the Administration to press China to put into practice the newly announced interpretation of its anti-counterfeiting laws***.

- ***Declare China a Priority Foreign Country and consider taking it to the WTO if the out-of-cycle Special 301 Review being done by the USTR in early 2005 does not show sufficient Chinese progress in meeting JCCT and WTO commitments.***

- ***Engage other countries to implement a program comparable to the recently announced U.S. STOP program to address Chinese counterfeiting.***

Retain Non-Market Economy Status

The NAM believes that the Administration should proceed carefully in its examination of China's status as a non-market economy country. China's economy has significant distortions that prevent market forces from acting efficiently and effectively. For example, the closed capital market in China prevents the adoption of a more market-determined exchange rate. These market imperfections mean that China is more prone to excess capacity, excess production and excess exports that adversely affect foreign markets. U.S. companies, particularly small and medium sized companies (SMMs), need to employ alternative methodologies in order to determine anti-dumping margins when they are being injured by unfairly priced imports from China. Since China's economy is not governed by market forces (*e.g*., exchange rates are not determined by underlying economic fundamentals), using Chinese prices that are not market determined would disadvantage U.S. manufacturers in the United States when faced with competition from Chinese products that are sold at less than fair value.

NAM Key Objective:
Retain China's non-market economy status (NME) for the full 15 year period negotiated in PNTR unless statutory requirements for market economy status are fully and consistently met.

Actions:

- ***The U.S. government should set up an industry advisory group on NME status to include the NAM.***
- ***Congressional oversight of China's progress in fulfilling its statutory requirements should be established. The Commerce Department should provide the appropriate congressional body with an annual report of its progress.***

Eliminate Administrative, Regulatory and Standards Barriers

While tariffs have fallen significantly, U.S. manufacturers doing business in China still face many administrative, regulatory and standards-related barriers that are difficult and costly to overcome. The NAM urges the U.S. Government to give a high priority to removing these barriers by pressing Chinese authorities to streamline administrative and regulatory processes, making them more transparent and open to stakeholder input, and applying regulations consistently throughout the country. In reforming administrative and regulatory processes, China should take into account internationally accepted norms and practices to the fullest extent possible. This would make it easier for U.S. firms, particularly small and mid-size manufacturers (SMMs) in regulated industries, to sell their products in China. The U.S. Government also needs to be alert to the development of national technical standards and conformity assessment procedures that deviate from international practice or otherwise create unreasonable restrictions on trade.

NAM Key Objective:
Undertake a vigorous, sustained effort to eliminate the growing number of barriers resulting from trade-related administrative directives, regulatory policies and technical standards, make the process more transparent, and apply regulations uniformly across the country.

Actions:

- ***Establish a U.S.-China regulatory policy and standards forum to facilitate dialogue on technical trade barriers, promote openness and transparency in regulatory and standards development, and encourage harmonization where possible.***

- ***Press for reforms of China's CCC quality mark system to permit U.S. testing bodies to offer CCC certifications and make the process timelier and less costly to U.S. exporters, particularly small and mid-size companies.***

Expand Exports to China

Expand and Strengthen Export Promotion Programs toward China

The Chinese marketplace holds vast potential for U.S. manufacturers. With annual growth rates in the 8-9 percent range for more than a decade, China is the fastest growing economy in the world and one that is increasingly open to trade with the world. China is the third largest import market in the world, after the United States and Germany, with more than $500 billion in imports. The United States, however, captured only 8 percent of that market or $35 billion in 2004, substantially less than either Japan or the European Union and a decline from the 9% of market share in 2002. U.S. imports from China, on the other hand, continue to grow rapidly. More than 30 percent of all Chinese exports go to the United States. The U.S. trade deficit with China, as a result, reached a new record in 2004, close to $160 billion.

To reverse this trend and help U.S. manufacturers reach their export potential in China, a new and greatly expanded export promotion initiative is needed. Although China has reduced its external tariffs and opened its internal market to U.S. and other foreign businesses, it is still an unusually challenging market, particularly for small and mid-size manufacturers (SMMs). Current U.S. Government export promotion programs offer useful assistance but are not on the scale needed to make a sufficient difference in overall export trends.

The U.S. Government and private sector must work together to launch a more ambitious program that provides more on-the-ground assistance in China and more trade outreach to potential U.S. exporters. Key elements include:

1) New American Trade Centers in major interior commercial centers;
2) Greater support for U.S. exhibitions at China trade fairs;
3) A robust Global Supply Chain Initiative;
4) An expanded China Business Information Center (CBIC);
5) Expansion of the Market Development Cooperator Program that provides U.S. industry associations with partial grants to open market-development offices in China;
6) Support for Export Trading Companies in specific manufacturing sectors;
7) Additional funding for feasibility studies that the Trade Development Agency could undertake in partnership with NAM member companies; and
8) More joint government-private sector outreach to potential U.S. exporters.

We believe that, if this is done, we could see an increase in U.S. exports of 33 percent annually during the next four years - or a three-fold increase - to more than $100 billion by 2008. We believe this is attainable, but only with a major new public-private effort. To implement a program of this scale, the NAM will seek to obtain a doubling of the Commerce Department's China-specific trade promotion budget for FY2006.

To help guide this export promotion initiative and our China trade policy more broadly, the NAM also recommends that the Commerce Department, in coordination with the President's Export Council, the NAM and other business groups, analyze the following: 1) Which sectors of the U.S. manufacturing economy are most adversely affected by Chinese imports? 2) What are China's largest categories of manufactured goods imports? Which countries are most successfully penetrating these Chinese markets? Are these patterns likely to be sustained? 3) Why have the European Union and Japan in particular, been more successful in exporting to China? What can U.S. companies learn from their experiences? 4) Which sectors of the U.S. manufacturing economy have strong competitive advantages and how can they best use these advantages to expand U.S. exports to China?

This analysis, which should be completed by June 2005, will help the Administration and Congress to have a better understanding of the opportunities and challenges of expanded trade with China and the kinds of export promotion programs that are likely to be most effective in significantly expanding U.S. exports to China.

NAM Key Objective:
Expand U.S. exports to China by 300 percent by 2008 (*i.e.*, to more than $100 billion), particularly higher valued added manufactured products.

Actions:

- ***Strengthen and expand export promotion and financing programs, particularly for small and mid-sized manufacturers.***

- ***Double the Commerce Department's China-specific trade promotion budget for FY2006.***

- ***Redeploy Commerce Department commercial service resources and personnel to focus on the China market.***

- ***Assist the Commerce Department to tailor export promotion programs to the needs of key manufacturing sectors.***

- ***Conclude by June 2005 analysis of 1) comparative export performance by country and manufacturing sector to better gauge China trade opportunities and challenges* (See details in text above); *and 2) techniques of the European Union, Japan and other competitors in their export promotion programs to China in order to emulate global best practices.***

Expand Export Financing

In addition to expanding Commerce Department export promotion programs, it is essential that there be increased export financing targeted specifically for U.S. sales to China. Existing Export Import (Ex-Im) Bank and Small Business Administration (SBA) programs should be expanded significantly to allow U.S. producers, especially small and mid-size companies, to take advantage of opportunities for exporting to China.

The NAM believes that Ex-Im should do special monitoring of large public works projects as well as large industrial products in China in order to ensure that foreign companies are not unfairly benefiting from tied-aid credits (subsidized financing from foreign governments) that are not available to U.S. suppliers. Special funds should be appropriated to match tied-aid credits to China from other countries. In the absence of this matching financing, China will source from manufacturers outside the United States.

NAM Key Objective:
Increased funding that matches or exceeds that available to foreign companies competing with U.S. companies in China.

Actions:

- ***Ex-Im Bank should greatly expand its programs to expedite financing for exports to China, including for smaller U.S. exporters.***

- ***Set up Small Business Administration Capital and Export Funds for expanding exports to China.***

- ***Special funds should be appropriated by Ex-Im Bank to match tied-aid credits to China from other countries.***

Eliminate China's High Industrial Tariffs

In 2001, China entered the WTO, making commitments to reduce overall industrial tariffs to about 10 percent. China implemented tariff cuts in each of the years following accession with the result that nearly all scheduled tariff reductions have been fully implemented. Only a few tariff cuts remain for products upon which extended reductions were agreed. Even with those tariff cuts, China's overall tariff level remains high, especially when considering the competitive position of Chinese products in the U.S. market. In some sectors, such as plastics, Chinese tariffs are exceptionally high. China is reported to have said that it is not prepared to make further tariff cuts considering the extensive reductions that China implemented as part of its accession agreement.

The NAM believes that the United States should seek the broadest and deepest reductions in Chinese tariffs on manufactured goods as part of the WTO Doha Round. The rising trade deficit, coupled with the slower absolute increases in U.S. exports to China (compared to imports), all indicate that China is both commercially competitive in the U.S. market and capable of opening its manufacturing market to levels comparable to industrial markets such as the United States, Japan and Europe.

NAM Key Objective:
Further reduction in China's industrial tariffs in keeping with its stature as a major industrial market.

Action:

- ***U.S. negotiators should use the Doha Round to press China to reduce tariffs and other trade barriers to levels comparable to the United States, the European Union and Japan.***

Open China's Public Procurement and Internal Market

China committed in its WTO accession agreement to negotiate entry into the government procurement agreement. The NAM urges the United States to give high priority to negotiating China's government procurement with the objective of making China's government procurement practices more transparent and open, in which a diversity of manufacturers and exporters can compete on a level playing field with the widest possible range of product options being made available.

Chinese provinces and local governments permit a variety of measures that restrict trade from outside those regions and localities. The net result is that distribution costs in China are about 16 percent compared to the average 4 percent in OECD countries. Provincial and local barriers to internal trade make it more difficult for companies to sell products within China. The NAM believes that the United States should seek agreement by China to eliminating those barriers that would expand market access for U.S. exported products and expand markets within China for all companies, Chinese and foreign.

NAM Key Objectives:
China's entry into the WTO government procurement agreement.
Elimination of Chinese provincial and local barriers to internal trade that affect market

access for U.S. exported products.

Actions:

- ***Include government procurement and internal market access barriers as part of bilateral negotiations with China.***

Improve the Export Administration Act and Procedures

The U.S. government imposes export controls on a wide range of goods and technologies, particularly those destined for China, on grounds of national security. The current control system is inefficient and costly to our economy, and the NAM seeks updated export administration procedures that meet U.S. needs in the post-Cold War era. These new procedures must promote timeliness, efficiency and transparency in the control process; exempt mass-marketed items; and recognize that unless a new control system is built upon comparably implemented multilateral agreements, U.S. national security will not be protected. Unilateral U.S. export controls on technologies available from foreign sources merely divert sales to foreign competitors and risk having technology leadership move offshore. Additionally, the NAM seeks the improvement and streamlining of licensing and other procedures implemented by the Administration, including progress in updating items on the U.S. Munitions List (USML).

NAM Key Objective:
Streamline the licensing of high-technology products to China to enable U.S. manufacturers to compete against foreign suppliers while also working cooperatively to protect U.S. national security interests.

Actions

- **Reform the outdated requirements of the Export Administration Act (EAA) to improve efficiency and reflect advances in technology and changes in market availability while also protecting U.S. national security.**

- **Streamline and improve the licensing procedures for items on the U.S. Munitions List (USML).**

Address Visa Delays for Chinese Business Visitors

Changes since 9/11 in U.S. procedures for obtaining visas have made it increasingly difficult for Chinese business and government officials to visit the United States for meetings with U.S. companies, business conferences and trade fairs. Chinese business visa applicants often experience long delays in getting interviews with visa officers and in receiving a response to their application. A much higher percentage than in the past is rejected after a Security Advisory Opinion (SAO) review in Washington, apparently because their technical qualifications and/or professional interests fall within the "Technology Alert List" (TAL) criteria. The TAL is intended to screen out applicants that may be seeking access to sensitive U.S. technology. But many companies are puzzled by the rejection of Chinese business contacts and even their own Chinese staff who have no apparent access to or known interest in such technology. As a result of visa difficulties, many Chinese companies appear to be turning to other non-U.S. suppliers for their purchases of manufactured goods. The U.S. government needs to make greater efforts to improve the efficiency of the visa process and more carefully target individuals that might harm U.S. national security.

NAM Key Objective:
Improve the efficiency of the visa process and ensure that the screening process targets only those applicants that are a clear threat to U.S. national security.

Actions

- ***Seek a review of the Technology Alert List to improve the screening process and tighten the criteria.***

- ***Work with the State Department as it implements its new U.S.-China Business Initiative to see that the timeliness of the visa application process is significantly improved.***

Promote Fair Competition

Apply Countervailing Duty Laws to China to Offset the Effects of Chinese Subsidies

There are concerns that China's industrial development may benefit from a wide array of subsidies, including currency manipulation, government bank lending to enterprises without creditworthiness, export-based tax incentives, and the discriminatory application of tax rates and rebates. The size of China's industrial sector and its huge foreign exchange reserves should dictate that greater subsidy discipline be applied. Once specific, targeted benefits are eliminated, China's development can proceed on a fairer, more market-oriented basis with reduced exposure to countervailing measures by trading partners.

The World Trade Organization (WTO) recognizes that subsidies (such as government payments to reduce production costs) can distort trade flows and can cause adverse effects on competing foreign companies. The WTO Subsidies and Countervailing Measures (SCM) agreement allows countervailing import duties to offset such subsidies. While these provisions apply to imports from nearly all WTO members, the Department of Commerce, based on a decision in 1984, does not apply countervailing duties against imports from non-market economy countries such as China. The WTO SCM agreement, however, defines how to measure a subsidy and China's WTO accession agreement includes special provisions for calculating subsidies in a non-market economy country, provisions that are consistent with the WTO Appellate decisions.

The NAM supports reversal of the Commerce Department's 1984 decision in light of the SCM Agreement and the terms of China's accession to the WTO.

NAM Key Objective:
Elimination of artificially created and maintained competitive advantages through WTO-inconsistent subsidization or other means.

Actions:

- ***The Bush Administration should endorse, as a priority in the first session of the 109th Congress, legislation that would clarify the intent of Congress to apply countervailing duty provisions to both market and non-market economy countries.***

- ***The Commerce Department's new Unfair Trade Practices Group should undertake and publish an analysis of Chinese subsidization practices.***

Apply China Safeguards (Section 421)

Because China's economy is still in transition from a command economy to a market economy, trade with China will be characterized by periods of market disruption in various commodities. Special provisions were incorporated in China's accession to the WTO to address the disruption that documented surges in China's exports to other markets may cause. Those provisions were incorporated in U.S. law under section 421. This provision allows the United States to apply quotas or tariffs on a product basis when market disruption occurs. Of the five cases that have been filed, the International Trade Commission (ITC) found in favor of market disruption in three cases. However, the Administration denied relief in all three cases. The NAM believes that this provision should be used, for without relief from market disruption, small manufacturers face surges in imports from China because China does not have the market mechanisms in place to prevent overproduction and overcapacity.

NAM Key Objective:
Appropriate use of Section 421 to address documented Chinese import surges as negotiated in PNTR.

Actions:

- ***The Administration should apply appropriate 421 remedies when the ITC has ruled that requirements of the statute have been met.***

Make Trade Cases More Affordable

For many industries, the surge in imports from China has injured small and mid-sized U.S. companies such that they cannot afford the high costs of preparing and filing trade cases. The Department of Commerce and other relevant agencies should self initiate trade cases when small companies or the industry is not financially in a position to prepare and file a trade case. Section 731(a) (2) of the antidumping law authorizes Commerce to institute special import monitoring programs and self initiate cases, in limited circumstances. That provision has never been used and has no equivalent in the CVD law. The NAM believes that AD and CVD laws should be amended to remedy these shortcomings. In the interim, Commerce should, as a matter of policy, use its existing statutory authority to self initiate cases in consultation with industry. This mechanism would support domestic manufacturers' access to trade laws designed to protect U.S. industry and agriculture from surges in imports that disrupt markets.

NAM Key Objective:
Make available appropriate use of U.S. trade law when companies, especially small and mid- sized, cannot afford the high cost of bringing cases.

Actions:

- ***The Commerce Department should institute special import monitoring programs.***

- ***The Commerce Department should make use of its existing statutory authority to self initiate AD, CVD and Section 421 cases in consultation with industry.***