<u>Testimony before the US-China Economic and Security review Commission of Ed Kowalewski, Director of International Trade Programs, Empire State Development/NYS Department of Economic Development 23 July 2009</u>

<u>Panel II: The Impact of Chinese Competition on Local Companies and Communities.</u>

Let me begin by thanking the Commissions' consideration of an upstate New York location for a field hearing and for selecting Rochester as hearing location. I am aware and attentive of the commissions' mandate to assess the key dynamics of the US- China relationship and report back to Congress and I am pleased to provide testimony in support of your mandate.

International trade is a key component to New York State prosperity. Exports sales contribute as much as seventy billions of dollars to New York's economy. As a representative of a state government agency charged with assisting firms in entering or expanding into international markets, China is particularly important to New York. China is a buyer as well as a seller. Global trade, along with the free movement of capital, is at the heart of today's international and New York's economy. What makes global trade different today and quite likely into the future is the unprecedented speed and depth of change: firms reorganizing and extending their enterprises, establishing of global supply chains, instantaneous communications and a new competitive dynamic where every part of the global economy is effectively in competition with every other part.

The Commission indicated a particular interest in gathering information and better understanding the impact of Chinese competition on local companies and communities. There is hardly a firm in New York that has not been touched or impacted by Chinese made products. China is the world 's new industrial powerhouse. It is also a large and rapidly growing market for raw materials, industrial goods, capital equipment, consumer products and technical services. As such, it remains a market of significant interest for many New York manufacturers and service providers.

China's exports have grown dramatically over the last three decades. China is now a leading manufacturer, not only of textiles and consumer products, but of increasingly sophisticated electronic equipment, software, and other technologies as well. It is competing not merely on basis of low costs but increasingly on the basis of high-end value-added products, as well as costs, using some of the world 's best technologies and drawing from a pool of highly skilled talent and it competing against NY firms.

Faced with the rapid expansion of low-cost production capacity in China, New York manufacturers continue to experience competitive pressures. Throughout the past decade, they have also seen the emergence and development of large export-oriented industry sectors in Southeast Asia and South Korea, Mexico, and South America. Now India is a competitor, particularly in the fields of software and business services. China while a being fierce business competitor is not the only low cost competitor affecting New York business.

China's excess industrial capacity and cost advantage have dramatically lowered the price of manufactured goods being sold around the world. NY firms have had to react to lower priced goods. For a number of NY firms, the reaction was to jettison low cost/low value products for products with higher value added and producing higher profits margins. In many other cases the response from firms was to innovate a newer and better product.

China, in addition be being a competitor, is a source of dynamic market growth for NY firms having the appropriate products. Business interest by NY firms in Chinese markets and the demand for state trade assistance in China has resulted in our agency opening of three trade offices in China. Our agency continues to improve access to markets in China on behalf of NY firms. With some satisfaction I do report to the commission that many New York firms are finding success in markets in China. Almost three billion dollars of export sales have been reported in 2008.

As analysts of two way trade between the US and China we are not naïve in our understanding of the market dynamics. For some New York manufacturers, low cost components produced in China represent a means of cutting product costs, improving supply chain efficiencies, buoying profits upwards, and lowering prices for customers. This is a key point as NY manufacturers continue to be under price assault by many low cost manufacturing locations. For many firms, this is their secret to survival.

We are always concerned that in addition to following their customers to overseas locations, NY firms consider pulling up the flag and leaving the state completely. This is not just an international phenomenon or just a Chinese challenge, as we are under constant pressure by other US states to keep firms in New York. We to the best of our ability activity seek our those firms to work to retain them in the state. Where competitive situations exists between location in and out of New York and there is the potential that a firm might leave, we do attempt to offer incentive to keep the target firm in the state. These incentives have produced investment opportunities for China. One only needs to tour a Chinese industrial park and read the list of American firms that have established operations in the that park to appreciate the return on that incentive offered.

We are aware of incentives offered by various levels of Chinese government to NY firms to have them consider a relocation of high technology activities (including R & D) to China. We share a joint desire to develop economic prosperity through industries and products of the future. Chinese incentive offered range from tax exemptions on machinery, rapid depreciation of equipment and subsidies on real estate and leases. NY firms are increasingly offered; a housing resettlement subsidy for key business officials; preferential rental of apartment (owned by government) for key technical personnel (typically 70% of market price) and salary subsidies in the range of RMB1000-3000 /month for key company officials.

New York State fiercely competes for investments from manufacturers and other businesses that can choose from any number of other attractive investment locations. China’s rising financial status makes it an interesting candidate as a potential investor in NYS. China’s outward investment comes partly from a national policy, not just from Chinese companies seeking profits overseas.

During the late 1990s and early 2000s, China’s Ministry of Foreign Trade and Economic Cooperation selected some thirty to fifty top Chinese companies to take the lead in overseas investment. As they looked to invest overseas, these national champions enjoy more advantaged by benefits that helped them compete, including low-interest funding from Chinese banks, many of which are controlled by the government. While China has a cheap, effective manufacturing base at home, and has few globally recognized brands this situation is rapidly changing. Chinese firm's are now making overseas investments in everything from footwear, garments, electronics, and appliances. This increase can be tied to Chinese companies wanting to secure the complimentary assets that they need to become internationally competitive. We are also cognizant that in many industry sectors the domestic US market (and in turn NY markets) are key driver for investment considerations.

As an Economic Development agency, we are hopeful that the level of Chinese investment in New York will increase. We can already account for Chinese investment in the forms of real estate and other financial industry investments. We activity seek and have received inquiries from potential (Chinese) investors in many industry sectors but we are particularly interested by potential investment in knowledge based industries such as solar energy, biotech and pharmaceuticals. A key agency task remains to identify, track and engage potential Chinese investment to secure that investment and create jobs in New York.

While NY competes and collaborates across global economic and industry arenas, we must not forget that the most important competition is being fought in the arena of ideas, learning, and delivering new kinds and levels of value to the marketplace. NY's strategy for success has been articulated by the executive and invested in by the legislature. Increased funding in education, and the establishment of Centers of Excellence lay the ground work for innovation in key industries. Innovation generates the productivity that economists estimate has accounted for large portions of U.S. GDP growth over the past 50 years. Innovation gives rise to new industries and markets; fuels wealth creation and profits; and, generates high-value, higher-paying jobs. In a world in which many nations have embraced market economies and can compete on traditional cost and quality terms, it is innovation – the ability to create new value – that will confer a competitive edge in to New York and New York's firms in the 21st century.

I conclude my remarks and would be happy to respond to questions.

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