Testimony of Congressman Tim Ryan
Hearing on China's Military Modernization and Its Impacts on the United States and Asia Pacific
March 29th, 2007

Good Morning. First off, I would like to thank Commissioner Wortzel, Commissioner Reinsch, and the rest of the U.S.-China Economic and Security Review Commission for all of your hard work on these important issues. Each year the Commission fulfills its congressionally mandated duty with professionalism and accuracy, and your annual reports provide a sobering look at our current trade crisis, and the national security implications of record trade deficits with the People's Republic of China. This morning, the Commission will explore China's military modernization and discuss the implications for the region and the World. There is no question that the PRC has a military that is growing in capability, and seeking to become the dominant force in the region. There is no doubt that China is using U.S. dollars to finance this expansion and modernization, and currency misalignment is to blame. It is my hope that this Congress will take action on legislation to address this issue and slow China's unsustainable policies, and questionable military expansion.

Let me be clear. I believe that a free and fair trade relationship with the PRC would be greatly beneficial to the citizens of both countries. However, *we are not dealing with an open or fair trading partner* in China. The Chinese government provides its industries with a series of subsidies that places U.S. companies at an insurmountable disadvantage. Among the most damaging of China's predatory trade practices is currency misalignment. As the Commission is aware, China's currency misalignment acts as a subsidy on goods exported to the United States to the tune of about 40 percent. Here is how it works. When buying Chinese goods, U.S. importers pay Chinese exporters in U.S. dollars. Then the Chinese sellers must trade in their surplus dollars at roughly 7.8 yuan for each U.S. dollar to the Chinese government. Because of the enormous trade deficit and foreign direct investment (FDI), there is an excess supply of yuan. Without China's currency peg, the yuan would rise in value against the dollar because of its formidable demand, and the rapid development of the Chinese economy over the last 10 years. If the yuan appreciated in a market-driven manner, it is estimated that the value relative to the dollar would rise by approximately 40 percent. Since the Chinese do not allow this to happen, it amounts to a 40 percent subsidy. With this appreciation of the yuan, the price of Chinese products would rise, Chinese exports would drop, and exports to China from domestic American companies would increase. However, China does not allow this to happen because it would risk disrupting its strategy of maintaining artificially high economic growth through export driven development and investment in foreign reserves. As a result of these manipulative strategies, the United States and China share the most imbalanced bilateral trade relationship in the world, at significant cost to our workers and manufacturers. All totaled, China alone accounts for nearly $200 billion or 27% of the United States' nearly $730 billion trade deficit.

The Chinese conduct this illegal currency misalignment by simply printing money and sterilizing about half of their currency oversupply by issuing bonds and giving subsidies to state owned companies. To maintain its peg, amid a huge inflow of foreign capital, the Chinese government has amassed over $600 billion in foreign exchange reserves.

Allowing China to collect massive currency reserves is not only a concern for the U.S. economy, but also for our national security. As my friend and colleague Duncan Hunter Ranking Member on the House Armed Services Committee "China is arming itself with weapons it purchased with the dollars earned from its massive trade surplus with the United States." Further, according to an article dated March 23, 2007 in the Washington Times, China has announced double-digit military spending increases each year for the past two decades. The new and advanced weapon systems being purchased by the Chinese military are being financed by the massive reserve in U.S. dollars owned by the Chinese government mainly as a result of their currency misalignment.

To address these threats to both our economy and our national security, Congressman Duncan Hunter and I introduced the Fair Currency Act of 2007 or, as it has commonly been referred to, the Ryan-Hunter bill. In summary, this bill will allow a U.S. industry to use the anti-subsidy (countervailing duty) law to seek relief from the injury caused by imports that benefit from a subsidy in the form of foreign exchange-rate misalignment. It defines "exchange-rate misalignment" as a foreign government's maintenance of an undervalued currency by means of protracted large-scale intervention in currency markets, regardless of the intent of the foreign government. The bill clarifies that exchange-rate misalignment meets all three WTO tests for a prohibited export subsidy: governmental financial contribution; benefit; and specificity. Ryan-Hunter gives guidance to the Commerce Department on how to determine whether a countervailable subsidy due to exchange-rate misalignment exists, and the level of its magnitude. The bill implements the WTO's agreements on subsidies in U.S. domestic law in two ways: (1) by explicitly adding exchange-rate misalignment as a countervailable subsidy under U.S. law; and (2) by clarifying that the U.S. countervailing duty law applies fully and equally to subsidies in both market and non-market economies, such as China.

Ryan-Hunter also amends the China-specific safeguard mechanism that will remain in effect until December 2013 as part of China's terms of accession to the WTO. The safeguard provides for possible relief from import surges from China that are found to disrupt the U.S. market. Ryan-Hunter instructs the U.S. International Trade Commission to evaluate whether exchange-rate misalignment exists in determining if market disruption is present in such cases. If market disruption is found, the President may "proclaim increased duties or other import restrictions" with China "for such period as the President considers necessary to prevent or remedy the market disruption."

Ryan-Hunter also contains a national security provision requiring the Secretary of Defense to inform the ITC whether the injured U.S. producers make components that are critical to the U.S. defense industrial base. If so, and if those components are like or directly competitive with the imports from China found to be injuring the U.S. producers, the Secretary of Defense will be prohibited from procuring those defense products from

China unless the President waives this provision based on the national security interests of the United States.

Title II of Ryan-Hunter amends the Exchange Rates and International Economic Policy Coordination (IEPC) Act of 1988, which requires the Secretary of the Treasury to submit to the Congress semi-annual reports regarding U.S. trading partners' exchange-rate and economic policies. Under the act, consistent with the International Monetary Fund's Articles of Agreement, if a trading partner is found to be "manipulating" its exchange-rate for purposes of preventing effective balance of payments adjustments or gaining an unfair competitive advantage in international trade, the Secretary is instructed to engage in negotiations, either bilaterally or in the International Monetary Fund, to correct the problem unless the Secretary determines and informs the Congress that such negotiations would have a serious detrimental impact on vital U.S. economic and security interests.

Title II of Ryan-Hunter also enhances existing law by establishing that the Secretary's semi-annual reports to Congress also shall evaluate whether any other country engages in "fundamental misalignment" of its currency, defined as a form of exchange-rate manipulation that exists when there is a material, sustained disparity between the observed levels of an effective exchange-rate for a currency and the corresponding levels of an effective exchange-rate for that currency that would be consistent with fundamental macroeconomic conditions based upon a generally accepted economic rationale. If the Secretary finds manipulation or "fundamental misalignment" that causes or contributes to a material adverse impact on the U.S. economy, the United States shall oppose a proposed change in any international financial institution's governance arrangement that would benefit the country involved for as long as it continued to engage in the manipulation or "fundamental misalignment."

I want to be clear; this legislation seeks solely to ensure a healthy and fair trade relationship with China. It is believed that if China and other Asian countries were to phase out currency market intervention, the U.S. trade deficit would be cut by about half. U.S. GDP would increase by as much as $500 billion, and employment would expand by as many as 5 million new jobs. In addition, solving these misalignments would also benefit China. Yuan revaluation would raise incomes and living standards immediately, and permit the Chinese government to spend more on much needed social investments. Longer-term, more balanced trade and a more rapidly growing U.S. economy would create a more secure and rapidly growing market for Chinese exports in the United States.

Again, I want to thank the Commissioners for holding this hearing today, and for all their efforts to provide the Congress with the information that we need to develop a comprehensive strategy with regard to China. This will ensure a safe and prosperous Chinese trading partner, and provide domestic manufacturers with a market to export their products and grow the U.S. economy. One thing is clear; the Chinese have a clear plan as to how to deal and trade with the United States, and how to become an economic superpower. It is up to the Congress and the President to work together to do the same for the citizens of this country. It is long past the time for action on this topic; the House of

Representatives must pass the Ryan-Hunter bill and begin the process of providing for a fair trade environment.