Is China Playing By the Rules? Free Trade, Fair Trade, and WTO Compliance
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Statement of
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Mr. Chairman and Members of the Congressional-Executive Commission, Thank you for giving the National Association of Manufacturers (the NAM) to testify on a subject of great interest to U.S. manufacturers.

The NAM represents 14,000 manufacturing companies, both large multinational corporations and over 10,000 small and medium-size firms. I can tell that we hear more from our members about trade with China than with any other foreign country.

Trade with China is of immense importance for U.S. manufacturers both because China's growing economy of 1.2 billion consumers offers a major market for U.S. products and because China is also an increasingly vigorous competitor in the U.S. and global marketplace.

The Chinese market is set to become one of the largest in the world within the next several years. Chinese imports are expected to exceed $380 billion in 2003, making China the world's third largest importer after the United States and Germany. At the same time, China is rapidly becoming a major exporter of industrial goods, and the range of industrial products exported has continued to grow at a rapid pace. China's expanded participation in the global marketplace, then, offers both new commercial opportunities as well as challenges resulting from increased competition in the U.S. and foreign markets.

Many NAM members, notably large multinational corporations, have developed important commercial relationships in China and seek to expand their share of the Chinese market. At the same time, a large number of members, particularly small companies, have expressed concern about increased import competition from China in the United States and currency and trade practices that give Chinese producers an unfair advantage.

In several meetings on China over the past year, our members have told us that they want the United States to have a positive trade relationship with China. However, they also want a level playing field for competition. Manufacturers want the U.S. government to deal firmly with unfair Chinese trade and currency practice. And they want the U.S. government to advance the long-term goal of providing U.S. companies with the same kind of access for U.S. goods and services in the Chinese market that Chinese goods and services enjoy in the U.S. market.

U.S. manufacturers view China's membership in the WTO, which became effective in December 2001, as an important positive development. As a WTO member, China has now committed to abide by the same international trade rules that apply to the United States and most other countries. In addition, it has made significant commitments to open its internal market to foreign products and services in areas were the U.S. is highly competitive. The NAM supported China's membership and Permanent Normal Trade Relations (PNTR) status on the condition that China would adhere to these commitments and become a responsible participant in the international trading system.

As China concludes its second year as a WTO member, its compliance record is decidedly mixed. While U.S. exports to China continue to increase (by 24 percent in Jan.-June 2003) and a growing number of U.S. companies are trading and investing there, the NAM has also received far more complaints about unfair Chinese practices than in the previous year.

NAM members recognize that China is still in transition to a market economy and in the process of phasing in certain WTO market-opening commitments. However, because China has quickly become such an important global importer and exporter, it is vital that the United States work to ensure that China complies with all WTO obligations and particularly those that have a significant impact on U.S. economic interests.

Chinese Policies that Provide Unfair Advantages and Create Nontariff Barriers

In a recent survey, our members identified a variety of policies that have provided Chinese exporters with unfair trade advantages and created significant nontariff barriers that hinder market access for U.S. products in China. In the view of many manufacturers, China's undervalued currency is the single most important factor because it affects all Chinese exports and imports. Other policies also serve to limit U.S. exports to China and give Chinese products in the United States a competitive advantage. Taken together, these policies are making a significant contribution to the U.S.-China trade imbalance, which was $103 billion in 2002 and could reach $130 billion in 2003. The following section provides more details on individual issues of concern.

--Currency Manipulation

By far, the NAM has received the greatest number of complaints about China's deliberate policy of undervaluing its currency to gain unfair competitive advantage over U.S. producers and those of other WTO member countries. Economists have estimated that China's currency could be undervalued by 40 percent or more. The Chinese yuan has remained pegged to the dollar at 8.28 for the past eight years despite an extended period of robust economic growth, continuing trade surpluses and a large build-up in foreign exchange reserves, which exceeded $350 billion in July 2003. This level of foreign exchange reserves is, according to IMF analysis, far in excess of what would be required to cushion China's balance of payments from normal fluctuations in trade and investment flows.

Pegging the yuan to the dollar appears to be part of a deliberate strategy to support Chinese industry and boost exports. This kind of currency undervaluation for commercial gain goes against the intent of the General Agreement on Tariffs and Trade (GATT), which seeks to remove trade barriers and allow markets to determine trade flows. Article IV, for example, states that "Contracting Parties shall not, by exchange action, frustrate the intent of the provisions of this Agreement…" China's undervalued currency acts as an additional trade barrier to U.S. exports and an unfair subsidy for all Chinese exports. We believe that Chinese exchange rate policies are not in accord with WTO obligations.

The NAM appreciates efforts by the Bush Administration, particularly Treasury Secretary John Snow, to raise the importance of market-based exchange rates with Chinese leaders and obtain unprecedented support from other finance ministers in the G-7 and APEC. We are confident that a more flexible market-based exchange rate would result in a significant appreciation of the yuan against the dollar and help to level the playing field with Chinese producers both here at home and in the global marketplace. We strongly urge the Administration to continue to press the Chinese government to break the current peg and allow the yuan to move up to its true market value.

--Subsidized Exports

We continue to receive reports from different industries (e.g., tool-and-die, metal forming, steel and chlorinated isocyanurates) that Chinese products are being sold in the United States at prices so low that they could not even cover the cost of raw materials and shipping much less full production and marketing costs. A tool-and-dye company, for example, reports that a Chinese competitor was selling a product similar to one made in the United States for $40,000, compared to the U.S. producer's price of $100,000. The U.S. company maintains that the cost of the raw materials alone would amount to $40,000, not including shipping, duties and other costs. A U.S. producer of chlorinated isocyanurates, which is used as a cleaning agent in swimming pools, reports a similar situation. As a result of pricing which appears to be below cost, Chinese exporters are expected to increase exports of this product by 400 percent in 2003 over 2002 levels.

These reports suggest the possibility of widespread use of subsidies, either direct or indirect, to help Chinese exporters gain unfair competitive advantage in the U.S. market. They merit further investigation by USTR and the Department of Commerce. One source of indirect subsidy is continued bank lending to money-losing and insolvent Chinese manufacturers, often state-owned or state-controlled enterprises. Since the Chinese banks providing these loans are either state-owned or state-controlled, the Chinese government bears responsibility for their lending practices. U.S. steel producers note that the Chinese steel industry is the largest recipient of interest-rate subsidies authorized by the national government. Since many of the companies that benefit from either directed bank lending or subsidized interest rates are engaged in international trade, they have an unfair competitive advantage vis-à-vis U.S. based companies, which must rely on private financing at market rates.

--Counterfeiting and Ineffective Enforcement of IPR Protection

While Chinese laws on intellectual property rights (IPR) have improved considerably, the lack of effective enforcement of the IPR protection remains a serious problem. Violations of trademarks through product counterfeiting is rampant and on a massive scale. The violations involve a wide range of products, including consumer hygiene and health care products, athletic footwear, pharmaceuticals, food and beverages, motorized vehicles and even entire automobiles. Pharmaceutical counterfeiting is now, according to U.S. industry representatives, a serious public health concern in China. We believe that the lack of criminal penalties for counterfeiting, including jailing, prevents effective enforcement of trademark and labeling violations.

We are also concerned about reports that local government authorities are actually promoting the expansion of local industry dedicated principally to counterfeiting. At a minimum, local authorities are knowledgeable of counterfeit production and taking no action to halt it. There appears to be no mechanism for the national government to prevent local governments from aiding and abetting counterfeiting by local industry. In addition, a member has reported that the Chinese customs service has not cooperated in blocking exports of counterfeit products even when solid evidence of counterfeiting was provided. It is claimed that, since the "exporting" of counterfeit products does not constitute a "sale" of the products, the relevant Chinese law did not apply.

Other IPR violations are also common. They include unauthorized duplication of computer software, music and films; copying of designs; unauthorized use of patented technology; and unauthorized use of U.S. product certification logos. The makers of air conditioning and refrigeration equipment note that the ARI (Air-Conditioning and Refrigeration Institute) certification symbol was being used without authorization by a Chinese company. Efforts to have the Chinese government stop this unauthorized use proved ineffective.

The pharmaceutical industry does, however, also report improvements in intellectual property protection, notably by the promulgation of a new regulation on data exclusivity for clinical trials, as required in TRIPS and committed in China's accession package.

--Manipulation of VAT and Other Taxes

We have reports that China is manipulating the application of taxes, notably the Value-Added Tax (VAT), to both restrict imports and indirectly subsidize exports. For example, the scrap recycling industry has told us that Chinese users of imported copper and other scrap metals are deliberating undervaluing their invoices to pay less VAT on the imported metal. When the finished metal products are exported, however, Chinese producers claim a rebate of the VAT based on the metals' real import price. This results in a substantial subsidy for the exported product that translates into lower prices in the U.S. market. It also enables Chinese scrap metal users to pay higher prices for scrap metal than their U.S. competitors. Chinese customs and tax authorities have not taken action to investigate these practices.

We are also concerned about continuing Chinese discrimination in the application of the VAT on imported and domestically produced semiconductors. China levies a 17 percent VAT on imported integrated circuits. Domestically designed and produced integrated circuits are taxed at VAT rates ranging from 3-6 percent. Integrated circuits produced in China but designed abroad are taxed at 11 percent. This discriminatory treatment of domestic and foreign "like" products violates Article 3 of the GATT.

--Unjustified Labeling Requirements

In 2002 the Chinese Ministry of Health promulgated a new regulation mandating the labeling of all genetically modified (GM) food products. While the implementation of the regulation was subsequently suspended indefinitely, the fact that it remains on the books is already having significant adverse economic effects and creating barriers to trade. Some producers have ceased shipping these products in anticipation of the regulation going into effect.

U.S. food producers have questioned whether the Health Ministry's action was in conformity with China's WTO obligations. The ministry did not provide a justification for the labeling requirement based on an assessment of health risks, which is a requirement of the Agreement on Sanitary and Phytosanitary Measures. The Technical Barriers to Trade Agreement (TBT) also suggests inadequate attention to the treatment of "like products," the question of whether the labeling requirement addresses a "legitimate objective" and the requirement to base technical regulations on "performance" rather than "design" characteristics.

--Inappropriate standards and concerns about CCC mark system

Several NAM members have raised concerns about application of technical standards and the CCC Mark system. With regard to standards, China is requiring that certain products (e.g., electrical products) be manufactured only to "international standards" as determined in the ISO or IEC. Other "international standards," notably those developed in the United States and widely used in the global marketplace, are not allowed. This does not conform with the WTO TBT Committee interpretation that "international standards" need not be limited to ISO or IEC standards.

A second set of standards concerns relates to the CCC mark system. China introduced the CCC mark system to comply with WTO requirements for a single mark for like domestic and imported products. It is, in that sense, a step forward on standards and mark requirements. However, the inconsistent, non-transparent and inflexible application of the CCC Mark on a variety of products (e.g., electrical products, air conditioning and refrigeration equipment, and tires) has created market access barriers and needlessly raised the cost of importing products into China.

Generic problems include: the high cost of having Chinese inspectors audit factories in the United States and other foreign countries on compliance with the standards; continued delays in allowing U.S. testing and certifying bodies to certify compliance for the CCC mark; and lengthy delays and relatively high cost of obtaining testing and certification for the CCC mark in China.

Several other specific problems were noted. A major tire company reported that several types of its bus tires that are standard sizes in countries around the world cannot obtain the required CCC mark because these sizes are not listed in the Chinese National Standards. Another type of tire used widely on Chinese trucks is also not on the list and thus cannot be sold by the U.S. company in China. Efforts to resolve this problem with Chinese standards authorities and Chinese customs have thus far been unsuccessful. In addition, the company reports that local inspection offices appear to be abusing their authority by requiring the re-inspection of the company's Chinese-produced tires and confiscating tires which they determine to be "non-compliant" with the CCC mark standards.

--Restrictions on Trade Rights of Joint Ventures

China is not fulfilling its commitment to allow foreign joint ventures to import and sell products (e.g., tires, automobiles, auto parts and industrial equipment) in China, which was to have gone into effect on Dec. 10, 2002. A major tire company, for example, reports that the Chinese government has imposed additional restrictions on its trading rights that were not anticipated when this concession was negotiated. They include allowing only new joint ventures to have this right and requiring the Chinese and foreign partners to have separately done U.S. $30 million in trade with China over each of the three preceding years.

--Lack of action on auto financing regulations

The Chinese government has committed to publish new regulations governing the financing of automobile purchases. Several NAM member companies have expressed concern about slow progress on the regulations that were explicitly promised in China's accession agreement. The U.S. government should press for their prompt issuance to comply with WTO obligations.

--Lack of Transparency in Trade Regulatory Process

Many companies complain about the lack of transparency in the trade regulatory process and the difficulty in obtaining current laws and regulations governing trade and business operations. This is a continuing problem that should lend itself to solutions in a relatively short time frame. The U.S. government should press for concrete steps that improve transparency at all levels.

Policy Changes Needed by the U.S. Government

U.S. agencies, particularly the Department of Commerce, Office of the U.S. Trade Representative and Treasury Department, have made good efforts to advance U.S. trade interests with China. Both Commerce and USTR are actively monitoring China's compliance with its commitments to abide by WTO rules and open its internal market in accordance with the provisions negotiated in the WTO membership agreement. They have welcomed input from the business community to assist in their analysis and assessments. The Treasury Department has also made important efforts to raise manufacturers' concerns about China's undervalued currency.

The scope of the challenges in China, however, requires a much larger-scale effort than currently exists, with additional resources to address unfair trade and currency practices and support effective promotion of U.S. exports. The NAM recommends the following policy actions to meet these challenges:

1. **Seek full WTO Compliance.** The U.S. government must ensure that China complies with its commitments as a new World Trade Organization member to follow all international trade rules and open its internal market in accordance with specific benchmarks set forth in its membership agreement. Commerce and USTR need additional resources to monitor and fully investigate WTO compliance concerns and market access problems. Current resources are inadequate to the task.

2. **Stop Currency Undervaluation.** We must continue to press China to end the manipulation of its currency and allow the yuan/dollar exchange rate to be determined by the market forces. Secretary Snow's visit was an excellent start in raising the issues, but we need to keep the pressure on China and get other affected countries (e.g., our G-7 partners) to join us. The NAM is prepared to support a Section 301 trade complaint in concert with other members of the Sound Dollar Coalition as a way of underscoring the seriousness of the matter and the need for a credible Chinese response.
3. **End Subsidized and Non-Market Production.** We hear too many reports from NAM members that Chinese imports are far below the cost of production based on international prices for raw material inputs. These charges merit more detailed investigation. In our dialogue with China, we must insist that the prices of traded goods are determined by real economic costs and not costs artificially set by the government.
4. **Address Counterfeiting and IPR Violations.** We must take firm actions to end China's rampant counterfeiting of U.S. and other foreign products. Today China is the epicenter of world counterfeiting, costing us tens of billions of dollars in lost exports and the related jobs. At both the national and local levels, the Chinese government is ignoring the blatant counterfeiting of U.S. products and taking no action to prevent this. The U.S. government needs to engage in a frank dialogue with Chinese authorities on the need to address the problem of counterfeiting and other intellectual property rights violations and take action under U.S. trade law when problems are not resolved.
5. **Expand Export Promotion to Support U.S. Business.** Finally, the United States needs to undertake a large-scale joint public-private export trade effort to increase U.S. exports to China. In 2003, China is set to become the world's 3rd largest importer ($380 billion) but the United States only has an 8 percent share of all Chinese imports. U.S. companies need to increase their marketing efforts but greatly expanded Commerce Department and other promotion assistance is also needed. We recommend a network of low-cost American business centers throughout China to help U.S. companies overcome the many unique barriers to doing business in China (e.g., language, cultural, communication and infrastructure) and access rapidly growing urban areas in the country's interior.

A balanced strategy that emphasizes stricter compliance with trade rules, an end to currency undervaluation and improved market access will not only help U.S. manufacturers compete on a level playing field but also place the U.S.-China trade relationship on a more stable footing for long-term development.

Thank you for giving the NAM the opportunity to testify today.