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An Assessment of China's Trade and Industrial Policies—and How to Address Them

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Thank you for the opportunity to testify today on China's trade and industrial policies.

The US-China Business Council (USCBC) is the leading organization representing US companies doing business in China. Our membership consists of roughly 220 American companies employing more than 7 million Americans in manufacturing, services, agriculture, and resource industries. USCBC has a long history of working to eliminate market access barriers in China so that American businesses and workers can prosper from that country's tremendous economic growth. Though China's path over the past 30 years has resulted in greatly expanded commercial opportunities for US industry--particularly since it joined the World Trade Organization (WTO) in 2001--market access barriers remain that hinder the full potential of our commercial relationship.

In my testimony today, I will touch on a number of areas where PRC trade and industrial policies are impacting US companies and recommend how we as a country can work to overcome those challenges. Before doing so, however, it is important to note how the commercial relationship with China has benefited the United States. Decisions taken to address the problems must be made with full awareness and consideration of these benefits.

As we all know, 2009 was a difficult year for the global economy. US goods exports to China last year were about the same as they were in 2008, just shy of $70 billion. However, US goods exports to the rest of the world declined by almost 20 percent last year, showing the importance of the China market. China is now our third-largest export market for goods, after Canada and Mexico. Since 2000, the last full year before China joined the WTO, US goods exports to China have risen 330 percent, far faster than the 29 percent growth of US exports to the rest of the world.

This growth is continuing after last year's pause. The past two quarters of US exports to China were the highest ever. Through April of this year, US exports are up 42 percent and are running 16-17 percent higher than the comparable period in 2008, before the recession.

That's not the end of the story, however. When US exports to Hong Kong--a major through-point for US goods destined for China--are added, the 2009 export figure jumps to $90.7 billion.

Sales in China of products made in China by US-owned affiliates totaled another $84 billion in 2007, the latest year for which these statistics are available from the US Department of Commerce's Bureau of Economic Analysis. These sales are vital to US companies' operations here at home. The reality of the global marketplace is that we cannot make everything in the United States and be competitive in far away markets like China due to lead times, transportation costs, and the need for many businesses to be closer to their customers. In surveys, including USCBC's annual survey of its membership about China's commercial environment, some 90 percent of US companies investing in China cite the need to reach the China market as their primary reason for investing there, not to export back to the United States. The "made in China for sale in China" figure overlaps somewhat with US exports to China because the China operations often import parts and components from US facilities, but US affiliates' sales in China certainly add considerably to the total market size for US companies.

The services story is also one of strength, albeit one that needs to get stronger. Services exports to China hit $15.3 billion in 2009. China was our seventh-largest export market for services last year.

Add it all up, make a rough estimate to eliminate the overlaps, and China is probably a $150 billion market for US companies, growing on average at 15 percent or more a year. This is a meaningful market for US companies and, yes, for American jobs. There are plenty of problems in the commercial relationship with China, but the reality of these numbers tells us why, as one USCBC director said during our board meeting two weeks ago today, "it is worth the effort" needed to address the array of issues.

PRC Economic Policies

Though it has resulted in economic benefits, the US-China trading relationship is not without challenges. Underlying these challenges is a debate within PRC policy circles over foreign involvement in the Chinese economy. While many policymakers there embrace the benefits of market liberalization, others feel that foreign businesses play too large a role and unfairly stunt the development of domestic industry. The result is a cautiously liberalizing economy that is too often defined by protectionist tendencies.

One manifestation of those protectionist trends can be seen in China's policies to support "pillar" industries and build national champions. In USCBC's most recent annual membership survey, respondents described various ways in which China favors domestic competitors, such as standards setting, government procurement preferences, administrative and business licensing discrimination, and uneven enforcement of laws and regulations. Chinese economic policies and practices that run counter to US interests have also arisen in China's innovation policies, intellectual property rights protection, investment restrictions, and market access barriers.

Indigenous Innovation

China, like all countries, is interested in fostering innovation to drive economic growth. To achieve that goal, China launched in 2006 its "indigenous innovation" program, which has subsequently been incorporated into a range of PRC policies and regulations, including those related to intellectual property, standards, taxation, and government procurement.

In late 2009 and early 2010, China released several key rules to create lists of favored innovative products that would receive preferences in government procurement. This approach runs counter to international best practices and creates a system that will actually undermine true innovation, rather than enhance it. Once on a product list with market protections, a company conversely may have less motivation to continue to innovate. Managing numerous product lists at the central and local levels will be cumbersome, and such periodic lists will quickly be outdated as new, innovative products are developed. The only certain outcome from a product list is discriminatory treatment in the marketplace and substandard technologies. The answer is to do away with product lists and procurement preferences, and this must be a firm advocacy point of the US government and the private sector. In place of product lists, we should encourage China to follow international best practices for innovation incentives and use non-discriminatory tax, research and development support, and other programs to reach its innovation goals.

Intellectual Property Rights (IPR)

As this committee well knows, China's IPR regime remains problematic. China's poor record of IPR protection influences what products foreign companies are able to sell in China's market; counterfeit products made in China often show up in other markets as well. Only one-third of respondents in USCBC's most recent survey of China's business environment say that the poor IPR environment does not impact them. And, for companies in certain sectors, like movies and software, the issue is without doubt their top problem in China and needs to be addressed.

Some areas of China's IPR enforcement regime have seen slow improvement over the years. The severity and nature of the problems are also very different for various industries and whether copyrights, patents, trademarks, or trade secrets are involved; some areas are seeing progress, others are not.

For example, in January of last year, the United States won a WTO case dealing with aspects of China's copyright and customs rules that were found to be in violation of its obligations under the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs). Earlier this year, China announced that it had revised its laws to comply with the ruling. Time will tell whether these changes are useful in addressing piracy.

One broad policy action that must be taken is the adoption of tougher deterrents in China, with criminal penalties applicable in cases of piracy on a commercial scale.

There is also a sense among some observers that the PRC government is not paying the same level of attention to this issue as in years past. It may be time for US stakeholders to consider a new advocacy strategy to engage the Chinese government effectively on this issue, especially for the copyright industries, which have been impacted most.

Standards

Another top concern of USCBC companies is China's desire to develop and use product standards unique to the Chinese market, which could be used to block market access for US companies. Standards development was the top area identified by companies in USCBC's membership survey as showing indications of protectionism. Many USCBC companies continue to report limitations in their ability to participate adequately in China's standards and conformity assessment system, with less than one-quarter of those surveyed who participate in standards-setting describing their ability to participate as "good."

As part of its effort to support indigenous innovation, China has promoted the development of standards unique to the country and has restricted participation of some foreign companies in the standards-development process. In addition, China requires that the vast majority of products sold in China be tested for compliance by a Chinese certification body, rather than allowing companies to self-certify or to use a foreign certification company as is common in other countries. An additional concern is the process for developing and mandating standards. Unlike in the United States where many standards are first developed by industry, the top-down approach used by PRC standards regulators and a lack of clarity about the role of industry-developed standards in China's standards system often causes problems for foreign companies. Ironically, while these policies may help Chinese companies in their domestic market, they may inhibit Chinese companies from their goal of competing in the international marketplace.

Investment Restrictions

As previously noted, US companies report that they invest in China primarily to serve the Chinese market. In 2007, for example, sales to the China market accounted for 72 percent of total sales by US majority-owned Chinese subsidiaries, according to the Department of Commerce's Bureau of Economic Analysis.

US investment in China is therefore an important market access strategy. But the opportunities for foreign investment in China are uneven across industries. In many sectors, China allows US and other foreign companies to establish wholly foreign-owned enterprises (WFOEs); in fact, 75-80 percent of US investment going in to China is in 100-percent US-owned facilities, not joint ventures. In other key sectors, however, foreign companies are limited to minority ownership or face other restrictions. Agriculture, chemicals, automobiles, securities, telecommunications, and express delivery companies all face these limits, for example.

China's Catalogue Guiding Foreign Investment in Industry, last revised in 2007, lays out categories where foreign investment is encouraged, restricted, or prohibited in sectors across the economy. China is in the process of revising the catalogue and USCBC has already submitted recommendations to key agencies of the Chinese government that most restricted or prohibited sectors be further opened to foreign investment.

In addition to selectively restricting areas for foreign investment, China also factors in "national economic security" during reviews of mergers and acquisitions (M&A) that involve foreign companies. China's Antimonopoly Law also has provisions that could be used to promote domestic companies at the expense of foreign enterprises. China should ensure that all of its

M&A reviews and antitrust actions are conducted in a non-discriminatory and transparent manner.

We should keep in mind that China is also encouraging its domestic companies to invest in the United States and other overseas destinations. Any US governor or mayor will affirm the value of foreign direct investment in creating jobs and economic growth: US states and cities continually organize delegations to China to attract investment to their local economies. We should ensure that China's central and local government officials and company executives understand the mutual interest in maintaining open and fair investment and trading regimes; treatment of foreign companies in China's economy will influence treatment of Chinese companies here. To solidify this mutual interest, we should move forward with negotiations on a meaningful bilateral investment treaty with China--one that includes strong national treatment provisions, applies to new and existing investments ("pre-establishment"), and applies to all investments except those specifically excluded in the agreement ("negative list" approach).

Market Access Barriers

Numerous barriers limit the products and services foreign companies can provide to the Chinese market. USCBC details these in our annual submissions to the US government in advance of the meetings of the Joint Commission on Commerce and Trade (JCCT) and in our testimony for the administration's annual review of China's WTO compliance record. Many of these barriers are technical and include China-specific product standards that limit the types of goods that can be sold in China. In other instances, foreign companies cannot receive the necessary licenses to provide their goods or services. All of these are individual trade issues that must be addressed.

Foreign companies face significant restriction in China's services sector. Notably, however, increasing the participation of foreign companies in this sector would benefit China's economy and help it meet its own goals on creating employment and rebalancing its economy away from export-oriented and resource-consuming manufacturing industries. For example, allowing greater foreign access in China's logistics and legal services industries would have a multiplier effect for businesses across the board by creating a more efficient commercial environment in China. Insurance and financial industry reforms and openings would help promote domestic consumption and move the country toward a more market-oriented exchange rate. Closer alignment with international standards--and increased market access for foreign conformity assessment bodies--would increase the quantity and quality of product testing and certification, and better integrate China into the world economy.

As China seeks to move itself from being the world's low-end manufacturer to a more modern, balanced economy, it should view the opening of its services sector to foreign participation and competition as an integral part of that transformation, rather than as a threat to domestic Chinese companies.

Government Procurement

As noted previously, access to China's government procurement market is currently a top issue for US companies. USCBC members are particularly concerned about procurement policies and trends that seem designed to promote "national champions" with protected market positions and preferential treatment. Adding another layer to government procurement discrimination in China are "buy local" policies issued by several provincial- and municipal-level governments.

There are two developments worth noting that deserve priority advocacy attention. China agreed at last month's Strategic and Economic Dialogue (S&ED) to submit in July a revised offer to join the WTO Government Procurement Agreement (GPA). It remains to be seen if this offer will be meaningful, but GPA entry would help US-based companies gain better access to China's government procurement market. In order to be meaningful, such an offer should include a more comprehensive list of government agencies covered, procurement thresholds closer to international norms, and a timelier implementation schedule than in China's previous offer.

China is also revising its government procurement rules in ways that will impact market access for US companies operating in China. The indigenous innovation preferences described above, new draft rules on domestic content requirements, and draft regulations that affect the treatment of foreign-invested companies as domestic enterprises are all being considered.

USCBC, other associations, US companies, and the US government are all working to steer China toward a non-discriminatory government procurement regime. We need to move China away from using product lists and toward following international norms for government procurement and international best practices for innovation incentives.

Recommendations for Action

Listing the problems is one thing; effectively addressing them is another. Achieving policy results in China is not easy and often frustrating and time consuming. As we consider ways to improve on that record, however, we should keep in mind that contemplated unilateral actions that might help one group of Americans frequently threaten to adversely affect another group of Americans. Picking winners and losers among ourselves to address problems with China seems counterproductive and usually results in divisive policy options.

USCBC, with its 37 years of experience, believes that the best course of action consists of 1) a stepped-up advocacy effort involving the US government, the private sector, and a multilateral approach, and 2) the continued use of effective, WTO-consistent trade remedies when good faith negotiations fail. I will address both of these below.

More Effective Advocacy

If there were a single agency or official that controlled China's trade and industrial policies, it would be easy to structure and target our advocacy efforts. Unfortunately, the bureaucratic owners of these policies are many and diffuse throughout the PRC government. We therefore need to continue to pursue continuous, sustained bilateral dialogue and expand it to include the range of senior officials and agencies that devise and impact trade and industrial policies. The Obama administration is moving in this direction and should be encouraged in this process.

Three key bilateral dialogues illustrate the sustained and continuous approach under development:

- The US-China Strategic and Economic Dialogue (S&ED) is a valuable high-level, multiagency dialogue that provides an important opportunity to coordinate macroeconomic policies with China and sets policy guidance for the more detailed commercial negotiations via other channels. It also is the primary channel for addressing financial sector issues.

- The Joint Committee on Commerce and Trade (JCCT) is the foremost and traditional channel for addressing specific trade and commercial disputes, but it needs to be expanded to address the investment and trade policies that the S&ED lacks the capacity to handle. The Obama administration this year has made two important changes to the JCCT that deserve mention and support:
  - Establishment of an industrial and competition policy dialogue with the PRC Ministry of Industry and Information Technology to extend the bilateral dialogue to an important agency guiding China's industrial policies that was not previously included in formal talks;
  - Establishment of a deputy-level "mid-year review" with the PRC Ministry of Commerce and other agencies to increase senior engagement on the issues beyond the previous once-a-year JCCT format and increase the ability of the JCCT's working groups to address problems throughout the year. The first such review was held in late May.

- A lesser-known but important third channel to address key commercial issues is the US-China Investment Forum. This deputy-level dialogue addresses the range of investor issues with another important agency not previously included in the formal bilateral commercial dialogue structure, the PRC National Development and Reform Commission. Nearly all of the issues listed above in my testimony--innovation, government procurement, standards, services market access, etc.--can be raised in this channel.

Other key areas with commercial implications, including energy and the environment, are being addressed through additional channels.

The simple fact is that the breadth and depth of the relationship has outgrown the bilateral negotiating and dialogue structure of the past two decades, and the Obama administration is correctly pursuing a path of revamping and expanding the structure to better fit today's reality.

As this structure develops, however, several other features are needed to improve the prospects for success:

- Consistent and supportive engagement at the two highest levels of the PRC government--president and premier--on the need for a level playing field and China moving ahead with further economic reforms and openings. It is important that messaging on these broad concepts is done at the levels above the bureaucratic silos.

- Close US interagency coordination of each of the dialogues to ensure consistent, sustained engagement and negotiation throughout the year. This may require a more active White House role.
- Private sector advocacy directly to the PRC government is also important in achieving results, and USCBC will continue to play a leading role in pressing for policy changes that will level the playing field for US companies.
- Multilateral consistency on the issues is also effective. US companies are not alone in facing market access barriers in China, and the US government should not be alone in seeking to have those barriers eliminated. Coordinating messaging with other governments can work, as we have seen with some of the modifications that China has made to its indigenous innovation rules. We should build upon that model.
- Finally, it is important that the United States show leadership on investment and trade openness and not pursue protectionist policies or actions that will give China an excuse to continue on their own protectionist path.

Legally Sound Remedies

When good faith dialogue fails to resolve issues, USCBC supports using legally sound trade remedies and dispute settlement mechanisms to address concerns. US companies have the right to seek assistance by petitioning the Department of Commerce to apply antidumping (AD) and countervailing duties (CVD) to products they suspect are unfairly supported by PRC government policies. Companies are clearly using that option--there are 10 active CVD cases alone. These WTO-legal remedies are intended to provide a fair opportunity for both sides to argue over objectively established criteria. China complains about AD and CVD duties, but USCBC believes these actions are consistent with a rules-based trading system, if duplicative penalties are avoided. However, expanding the application of duties to counteract currency misalignment would in our view violate WTO rules and introduce a subjective and potentially politicized process for guessing the exchange rate value. We strongly recommend against this approach, even though we support the goal of seeing China's exchange rate move more quickly to reflect market influences.

The WTO's dispute settlement process is another tool for the US government and US companies to use when good faith bilateral negotiations fail. The Office of the US Trade Representative (USTR) has taken seven cases to the WTO against China and has won three; three others were resolved by China before WTO action was required; and one is still pending. USCBC has consistently supported WTO cases when well-defined, winnable, and supported by industry and will continue to do so in the future.

Congressional Support

Congress can help achieve results in several ways.

First, Congress should increase resources for US trade agencies. To better enforce our trade rights, Congress should increase funding to USTR and other agencies so that they can effectively pursue US rights under the WTO and through bilateral engagement. To help US companies better access the opportunities of China's market--including small and medium-sized companies, Congress should also increase funding to the US Foreign Commercial Service so that it can expand its support presence in China. Such a proposal has already been put forth in the US-China Market Engagement and Export Promotion Act (HR2310) introduced by Congressmen Rick Larsen and Mark Kirk.

Second, we should better coordinate between Congress, the administration, and the private sector to reinforce our shared goals on improved market access and the level playing field. It is vital that China hear from all three constituencies--the administration, Congress, and the private sector--on the importance of these issues. US companies are on the front lines of dealing with the policies I have mentioned today. Better coordination between the US public and private sectors on these issues will help us create a more comprehensive yet focused approach to the US-China commercial relationship.

Finally, members of Congress should directly engage with PRC government officials and their counterparts in the National People's Congress to raise these concerns. Congressional delegations that travel to China often meet with high-ranking members of the PRC government. These meetings are an important supplement to other venues of engagement and provide opportunities to explain constituent concerns to the Chinese.

Conclusion

Let me conclude by restating USCBC's view of the current state of the US-China relationship. Our companies are committed to the Chinese market but have serious concerns about the policy trends there that favor domestic companies. Our members want solutions to these specific problems, however, not sanctions that would disrupt the relationship.

Addressing the issues directly is the best way to support US businesses and workers. Unfortunately, there is no silver bullet or magic wand that will solve many of these problems easily. Resolution of these issues requires a strong overall message to China's top leadership from the administration, Congress, and business leaders and sustained and expanded engagement across the board on the various specific issues we face.

Our bilateral commercial relationship with China plays an important role in the recovery and future growth of the US economy, and it will be difficult to meet President Obama's goal of doubling US exports by 2014 without it. This relationship is "worth the effort," as challenging as it may be. I look forward to working with you on these challenges, beginning with any questions you may have today.