Information Technology Industry Council
Leading Policy for the Innovation Economy

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China's Trade and Industrial Policies

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Chairman Levin, Ranking Member Camp, and members of the committee, thank you for the opportunity to testify today. I am Dean Garfield, President and CEO of the Information Technology Industry Council (ITI), and am pleased to testify before the House Committee on Ways and Means on the important topic of trade with China and its industrial polices. ITI represents global leaders in innovation, from all corners of the information, communications and technology sector, including hardware, software, and services.

I would like to focus my testimony today on three areas: (1) the importance of our economic and trade relationship with China; (2) the increasingly challenging nature of our work in that market; and (3) what the United States Government -- Congress and the Administration -- can do to improve the situation.

Why Continue to Engage China: The Opportunity

China has the potential to become one of the United States' most significant economic partners and a key collaborator in addressing important global challenges, including climate change. China is well on its way to eclipsing Japan as the second largest economy, and has emerged as a formidable player on the international stage. Today, China is the largest holder of foreign exchange reserves, ranks number two in world oil consumption, and is helping to lead Asia, and the world, out of global recession, chalking up an 11.9 percent growth rate for the first quarter of this year. The sheer size of the China market makes it important to the U.S. economy and the high-tech industry.

Hundreds of thousands of American jobs, including many high-wage high-tech jobs, are directly tied to robust business with China. The tech sector has long recognized that we must invest globally with a clear eye toward the benefits that cross-border trade provides locally in new jobs. China presents a current case of that principle continuing to bear fruit. Last year, U.S. exports to China were nearly $70 billion dollars, up four-fold from a decade ago. Some of the largest beneficiaries of that trade are workers and businesses, many of them small businesses, who manufacture electrical machinery and equipment or develop software. If we are ever going to be able to achieve President Obama's

ambitious goal of doubling exports of goods and services in five years, the United States will need to have fair trade with and open access to markets in China.

Therefore, getting the China trade calculus right and building a stronger bilateral relationship is more essential than ever. A critical variable will be our ability to persuade China to better integrate into the global economy, open its markets, and play by global norms.

The Challenge: Unpredictable and Unfair Industrial Policy Environment

Mr. Chairman, China's industrial policies are increasingly creating an unwelcome commercial environment resulting in significant difficulties and distortions. U.S. companies, and foreign companies generally, are increasingly being asked to navigate a gauntlet of vague, punitive rules that both unfairly tip the scales in favor of domestic industry and seek to divest foreign companies of the intellectual property (IP) they invest so heavily in creating.

China's "indigenous innovation" efforts capture the full nature of the challenge in one seemingly innocuous title. We can all agree China certainly has the sovereign right to encourage domestic innovation consistent with the trade rules we all have undertaken as members of the global trade community. It's good for China, it's good for us, and it's good for the world. China's version of "indigenous innovation," however, puts in place dynamics intended to generate innovation at home at the expense of foreign players.

For example, last November, the Chinese government issued a new set of rules to establish a national catalogue of indigenous innovation products that would receive preferences for government procurement and other special treatment. This essentially linked government procurement processes with the innovation product accreditation regime in ways that both favored products with Chinese intellectual property, and created a process that would force foreign companies to disclose their IP to Chinese firms.

These rules were unprecedented and illustrate the Damoclean choices that foreign firms often face in China -- a country where bureaucrats are to often put in the driver's seat to pick winners and losers in the markets, select national champions in industry, and decide which products are innovative and which are not.

Fortunately, intense criticism and pressure from the global community, including from the Obama Administration, has compelled China to delay for the time being and continue consultations on some aspects of this particular policy. We will very carefully watch China's next step and continue to engage with the U.S. government on this issue.

In sum, this challenge of tying government procurement to accreditation of "innovative" products and IP transfer is only beginning, not ending.

A related and equally troubling area of concern is China's approach to standards. Our industry is a strong proponent of standards that are voluntary, industry-led and global. Use of global standards is a long-established international norm that has served us well, promoting innovation, transparency, and system interoperability. With a global economy that becomes more integrated by the day, global solutions to standards setting undergirds the way we develop and build our products.

Yet, China is developing country-specific industry standards and mandating them for those who want to participate in that marketplace. When this happens, American and other foreign companies either have to create bifurcated products lines -- one for the Chinese market and one for the rest of the world -- or simply turn their backs on the market.

As an example, several years ago, China endeavored to mandate a homegrown wireless standard called WAPI, despite the existence of a technology widely used around the world known as WiFi. Under the auspices of the U.S.-China Joint Commission on Commerce and Trade (JCCT), China ultimately agreed in 2004 to take steps toward a market-based, technology neutral approach to the development of next generation wireless standards and to "suspend indefinitely its proposed implementation of WAPI as a mandatory wireless encryption standard."

Undaunted, the Chinese have pushed forward with WAPI anyway and it is now a *de facto* mandated standard enforced by using the handset "type approval process" controlled by the Ministries. To be sure, WiFi handsets are available in China now, but only if WAPI technology is built-in and enabled. Emboldened, the Chinese may now be looking to do the same thing with PCs and servers by requiring that such equipment sold in the country include a technically unknown and untested "Trusted Cryptography Module" chip -- despite the existence of an internationally developed standard known as TPM, or Trusted Platform Module.

Allowing China to create its own island in a sea of globally accepted standards sets a troubling precedent for future technology standards and represents a significant departure from global adoption of harmonized ICT standards. It also creates unnecessary technological complexity, compromises the basic principle of technology neutrality in policymaking, and undermines China's commitments under the JCCT and the WTO.

Moreover, companies face manifold rules and regulations that are overlapping, unnecessary and onerous. We see a lot of this in compliance requirements related to safety and other testing. And there is an increasing trend to impose burdensome testing and certification regulations on information security products that are inconsistent with global norms and requires disclosure of sensitive information that make them unworkable to nearly all foreign players. The far-reaching Multi-Level Protection Scheme, for example, would place completely unworkable testing requirements on nearly all high-tech products going into critical infrastructure systems in China. In fact, the program appears to be aimed at putting a

large part of the Chinese economy out of competition from foreign providers of goods and services.

In sum, whether in government procurement, standard setting, cyber-security, or safety testing, the two common threads running through most of our challenges with China are polices that advantage domestic companies at the expense of foreign firms and that attempt to force the transfer of technologies, including intellectual property.

The Way Forward

The challenges on the ground in China are forcing much of the business community to recalibrate its approach to China. It would be useful for the U.S. government to do the same by taking steps on two fronts. First, the United States should continue working with the private sector and with other governments to develop a clear, coordinated strategy for encouraging China to adopt global norms. When we have been most successful in dealing with China it has been the result of close cooperation among governments and between our government and the private sector. And this needs to be an on-going, results-based effort.

For example, Beijing ultimately saw the wisdom in stepping back from mandating the Green Dam Internet filtering software last July. Over the past year, it has significantly reduced the scope of testing and certification requirements for a range of information security products under a new regime that went into place this spring, though we remain concerned with many aspects of the requirements that remain.

At the U.S.-China Strategic and Economic Dialogue (S&ED) in May, China put on hold for the time being its plans to go forward with its indigenous innovation product list. It committed to "innovation policies consistent with strong principles, including nondiscrimination, intellectual property rights protection, market competition, and no government interference in technology transfer." And it agreed at the S&ED "to launch expert and high-level bilateral innovation discussions with all relevant U.S. and Chinese agencies and to take into account the results of these discussions in formulating and implementing it innovation measures." We urge the Administration to ensure those discussions are meaningful, sustained and focused on concrete outcomes.

Going forward, we will need an increased focus on developing strategies for China that involve a consistent public- and private-sector emphasis on holding China accountable for its international commitments.

China has been in the WTO for nearly ten years and is still not a signatory to the Government Procurement Agreement (GPA). At the recent S&ED meeting, it committed to submitting a robust revised offer to accede to the GPA. As you know, a growing number of the problems we are having with China are manifesting in the government procurement realm. As China moves through the GPA accession process, we expect that it will adopt policies and measures that facilitate its entry, rather than erect new barriers.

While we recognize China's GPA accession won't fix everything, it will be a step in the right direction, provided it results in a strong, market-opening agreement. We, therefore, urge the Administration to continue to press Beijing to live up to this commitment. We also need to ensure China honors the bilateral commitments it has made under the JCCT.

Second, realizing the potential of a strong partnership will also depend on us taking steps here in the United States to improve our competitiveness. Looking east for solutions should not be our only priority. We must also do some work here at home to ensure our workforce and economy remains competitive with China and our other global trading partners.

We will not continue to grow innovation-based sectors if we treat science, technology, education and math (STEM) education as a secondary priority. Without a sense of common purpose and energy around this issue, we will fall further behind. The Obama Administration has provided significant leadership in this area. But it's going to require taking a broad and honest look at how deeply our educational system is failing us -- from graduate programs for tomorrow's innovators and scientists, to K-12 classrooms. Through initiatives like Change the Equation, the tech-sector is proving its willingness to step up and provide private sector leadership in this area. Congress can help by authorizing full funding for the "COMPETES Act."

Congress also urgently needs need to address our tax structure to ensure that it fosters investments in innovation. We can start by renewing the R&D tax credit, which expired last December, and by addressing international tax reform in a comprehensive rather than piecemeal fashion.

We need to begin planting the seeds today for the economy of the future by transitioning to a clean energy economy and improving energy efficiency through better utilization of information technology, including smart grid, smart transportation, smart buildings, cloud computing and the like. To the point, we should build in R&D funding and incentives proportionate to those planned in competing economies. China already plans new direct investments in these areas totaling between $440 and $660 billion over ten years.

Finally, global norms and best practices have been essential to U.S. industry in its ability sell into markets around the world. Whether related to standards, cybersecurity, protecting intellectual property, or product testing, it is critical to our competitiveness that we continue to be a pace setter in this regard by adopting policies at home that do not encourage others to go their own way with country-specific solutions.

Simply put, we have our own work cut out for us to remain globally competitive.

Remaining Hopeful on China

To be sure, China presents myriad challenges today and it will continue to do so for the foreseeable future. China's economic system relies heavily on the decisions of its

bureaucrats rather than its markets, lacks the transparency and inclusiveness of other capitalist economies, and has an unacceptable record when it comes to addressing counterfeiting and piracy of intellectual property. A thicket of vague rules, regulations and mandatory standards thwart U.S. trade and investment with China and call into question its position as an aspiring global leader. These policies hinder China's leadership evolution in the global economic community and limit the flow of cutting-edge products to China's economy and its people.

I, however, remain hopeful because, as a practical and strategic matter, we simply need to get China trade right. The Chinese economy is too big and too influential to have it any other way. Its market is too important to the United States.

China is not a monolith. It is a diverse, complicated country that includes recidivist forces determined to go their own way through the implementation of problematic policies, such as indigenous innovation, which are discriminatory and protectionist.

But, there are also Chinese forces of change in government and industry that recognize if China is ever going to reap the full benefits of its economic might, it must vector toward fuller integration into the international economy, adopt global standards and regulatory practices, and fall in line with other widely accepted norms. Through sustained, firm, and sensible engagement, we need to identify these forces, work to empower them, and collaborate with them to effect positive change.

I am confident that with your help, the support of the Administration, and the assistance of like-minded economies around the world, we can successfully chart this course. Too much is at stake to do otherwise. Thank you.