



THE US-CHINA BUSINESS COUNCIL
美中贸易全国委员会

1818 N Street, NW, Suite 200, Washington, DC 20036
Tel: 202-429-0340 | Fax: 202-775-2476 | E-mail: info@uschina.org | www.uschina.org

**Statement of the US-China Business Council
to the**

**Senate Committee on Finance’s Hearings
“Opportunities and Challenges in the US-China Economic Relationship” and
“Risk and Reform: The Role of Currency in the US-China Relationship”**

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A BALANCED APPROACH

The US-China Business Council (USCBC) is the leading organization for US companies doing business in and with China. Founded in 1973, USCBC represents its more than 250 US corporate members by providing advocacy and information services through its offices in Washington, DC, Beijing, and Shanghai.

USCBC advocates a balanced approach to trade policy toward China—one that recognizes the tremendous benefits that trade and investment with China bring to the US economy, yet at the same time focuses on eliminating market barriers and other unfair trade practices that affect US companies doing business with China. We support the rules-based resolution of trade disputes in a manner consistent with our World Trade Organization (WTO) obligations, just as we expect China to abide by its WTO commitments.

The most obvious benefit of trade with China is the rapidly growing exports of US companies. In 2006, China and Hong Kong combined ranked as the third-largest US export market, with exports of goods totaling more than \$73 billion.¹ US exporters sold more only to Canada and Mexico—neighboring countries with which the United States has a free-trade agreement. Furthermore, exports to China are growing far more rapidly than exports to any other major market. US exports to China in 2006 were 240 percent higher than in 2000, the last full year before China’s WTO entry. Of the top 10 US export markets in 2006, the second-fastest-growing market for US goods during this time was the Netherlands, with cumulative growth of 42 percent.

The prospects for increased exports of services to China is also encouraging. In 2005, the United States enjoyed a services trade surplus with China of \$2.6 billion—small, of course, when

¹ Individually, China is the United States’ fourth largest export market at \$55 billion, and Hong Kong is the 15th largest at \$18 billion.

compared with the large goods deficit. As US companies take advantage of service sector openings mandated by China's WTO entry agreement, however, the US services trade surplus is projected to grow to \$15 billion by 2015, according to *The Prospects for US-China Services Trade and Investment*, a report by Oxford Economics, published in 2006 by the China Business Forum.² If China were to open its service sectors fully to foreign participation, Oxford Economics projects that the US services trade surplus could be as much as \$60 billion.

More broadly, according to research conducted in 2005 by Oxford Economics for the China Business Forum study *The China Effect: Assessing the Impact on the US Economy of Trade and Investment with China*,³ US trade and investment with China will, by 2010, result in a 0.7 percent increase in US gross domestic product and a 0.8 percent decrease in US prices—the combined effect of which will be an annual increase of up to \$1,000 in real disposable income per US household. Furthermore, by 2010, trade and investment with China will boost the productivity of US workers by 0.7 percent and that of the manufacturing sector by 0.3 percent annually. The commercial relationship with China clearly benefits the US economy as a whole.

PRIMARY CONCERNS OF US COMPANIES

National treatment

Since China joined the WTO in 2001, phased-in market openings have provided new opportunities for international businesses. Nonetheless, USCBC member company executives report departures from the WTO's national treatment principle, which requires non-discrimination against foreign companies exporting to or operating in, WTO member economies. These examples can generally be grouped into three areas.

- **Administrative licenses and business approvals** In the 2006 USCBC member survey, executives at USCBC member companies ranked problems encountered when applying for business and product licenses and other forms of government approval as the top hindrance to US companies operating in China.⁴ In some cases, these problems simply result from resource and coordination challenges faced by PRC regulators that slow the processing of applications.

But in other cases, executives at US firms believe PRC officials may be using their regulatory authority to prevent or delay the entry of foreign competition into a market to protect domestic companies. Examples of sectors that have reported such practices include agriculture, banking, chemicals, construction, express delivery, insurance, retail, and telecoms. In these sectors and others, China appears to meet the letter of WTO-mandated market openings in certain sectors but establishes new barriers that, in effect, prevent foreign companies from participating in the sector—while at the same time facilitating domestic competitors.

- **Discriminatory laws and policies** Recent public policy debates in China have indicated a dampening of enthusiasm in some quarters for foreign participation in the economy. Some in China also appear to want to expand the government's role in directing the economy and in

² See www.chinabusinessforum.org/pdf/us-china-services-trade.pdf

³ See www.chinabusinessforum.org/pdf/the-china-effect.pdf

⁴ See www.uschina.org/public/documents/2006/08/member-priorities-survey.pdf

developing internationally competitive Chinese enterprises, while also restricting the role of international companies in certain sectors.

Protectionist sentiments were evident in a series of policy notices China's State Council issued in 2006 regarding China's technological development through 2020. Separately, the State Council Opinion on the Revitalization of the Equipment Manufacturing Industry, issued in June 2006, envisions greater state intervention in a number of economic sectors and could create new hurdles for foreign acquisitions of domestic enterprises that build engines, power generating equipment, integrated circuits, shipping equipment, and in several other industries. In August 2006, the Ministry of Commerce released new regulations on mergers and acquisitions that would submit for government approval foreign acquisitions of "well-known" Chinese companies and brands, and give the ministry a broad authority to block transactions that adversely affect "national economic security," a term left undefined in the regulations. Statements in early 2007 from the head of China's State Asset Supervision and Administration Commission further echoed these themes.

- ***Unequal enforcement*** US businesses operating in China continue to describe an unequal enforcement environment that places them at a disadvantage to their Chinese competitors. For example, while US companies generally hold themselves to the highest environmental, health, workplace safety, and other standards—often going beyond what is required by PRC law—many Chinese competitors appear to fall short of PRC law in these areas, enabling them to minimize investment and other costs associated with full compliance. Enforcement authorities, mainly at the local and provincial levels, appear to focus more of their attention on US and other foreign companies. Similarly, while US companies in China typically comply with their PRC tax obligations, domestic enterprises appear to be able to avoid full compliance without repercussions. Looking ahead, a key concern of US companies regarding China's forthcoming Antimonopoly Law is that PRC regulators will target foreign companies that meet the law's criteria for market dominance more aggressively than domestic firms of similar size in China. Although it is difficult to establish with certainty the presence of a policy of unequal enforcement, the need exists to impress upon China the importance of equal enforcement of business regulations.

Intellectual property rights

Like all WTO members, China is required to provide legal protection against intellectual property infringement and to provide penalties for enforcement that are sufficient to deter future violations. Despite this obligation, inadequate protection for intellectual property continues to impede US companies in China.

It is important to point out that the term "intellectual property rights" (IPR) encompasses several distinct areas, including copyrights, trademarks, patents, and trade secrets. In each of these areas the nature and severity of the problem are different, as are the policy needs and protection measures available to companies. Accordingly, companies view the IPR problem differently depending on their industry. For some companies, particularly in the media sectors, IPR problems are aggravated by market-access restrictions that limit the availability of legitimate products to Chinese consumers. A differentiated approach to the IPR problem in China—one that

accounts for the unique problems and solutions in the various areas—is the most productive way to achieve advances for US companies on this issue.

The ineffectiveness of China’s IPR enforcement regime stems in part from China’s primary reliance on administrative authorities, which are able to impose only very low penalties to enforce IPR laws, instead of the court system, in which civil suits and criminal prosecutions could lead to higher penalties on IPR infringers. While government agencies are generally responsive to the requests of IPR holders to take administrative actions against infringers, the low penalties these government bodies can impose without court authorization serve as only a minimal deterrent to future infringements.

China’s central government has taken a number of steps in an attempt to address these and other issues in order to improve the effectiveness of its IPR enforcement. These steps generally have been in response to the US government’s persistent pursuit of improving IPR protection via the Joint Commission on Commerce and Trade (JCCT) process. In March 2006, China’s National IPR Working Group, an interagency body under the State Council that is chaired by Vice Premier Wu Yi, issued its 2006 IPR Protection Action Plan. Though much of the plan focuses on ways to promote innovation, it also expresses an intention to boost enforcement activities.

Stemming from the action plan, China’s Supreme People’s Procuratorate, the Ministry of Public Security (MPS), the Ministry of Supervision, and the Leading Group on National Rectification and Standardization of Market Order jointly issued an opinion in March 2006 to facilitate the transfer of IPR cases from administrative agencies to public security bureaus for criminal investigations. MPS and the General Administration of Customs in March 2006 also jointly issued rules to boost coordination in IPR cases involving products scheduled for export. The Ministry of Culture issued in November 2006 regulations giving local culture authorities more tools to address piracy of recorded music and cinema products. In December, the Beijing Number One Intermediate People’s Court ruled that Pfizer, Inc.’s patent on the drug Viagra is valid, thereby reversing an early ruling that had revoked the patent and had allowed Chinese producers to legally manufacture what were, in essence, counterfeit pills. In early 2007, China’s Supreme People’s Court issued an opinion that could streamline judicial proceedings on IPR cases and make them more accessible and cost effective for companies that seek to protect their rights.

These are welcome steps, but China’s legal capacity to effectively protect IPR remains limited. China’s use of value thresholds to determine whether IPR infringers may face criminal charges reduces the efficacy of Beijing’s recent steps to facilitate criminal prosecutions of IPR violators. These thresholds, although lowered in China’s Supreme People’s Court December 2004 judicial interpretation, provide a loophole for IPR infringers to escape criminal prosecution by, for example, keeping the value of inventory stored at any one location below the threshold level. Moreover, calculations to determine whether the thresholds have been met are based on the price of the counterfeit product rather than that of the legitimate—and higher priced—product it imitates. China’s use of numerical value thresholds appears to be inconsistent with its commitments as a signatory of the WTO Agreement on Trade Related Aspects of Intellectual Property (TRIPS), which calls for criminal sanctions in all cases of IPR violations on a “commercial scale.”

For its part, USCBC has urged the PRC government to take this course. In numerous meetings in 2006 with Vice Premier Wu Yi and other senior and working-level PRC officials in various agencies, USCBC advocated the abandonment of thresholds and the adoption of the “commercial scale” criteria. USCBC complemented these meetings with a written submission to several PRC government bodies suggesting detailed changes to PRC laws that would provide for an enhanced legal framework for enforcing IPR protection.⁵ Adopting the “commercial scale” criteria and other changes to its laws governing IPR enforcement are important steps the PRC government can take to benefit companies in a broad array of sectors.

Transparency

Limited legislative and regulatory transparency creates uncertainty and confusion for US companies in China. There can be no question that China’s legislative and regulatory processes are today far more transparent than ever before. Nevertheless, as US companies expand their business operations in China, the need to have a clear understanding of China’s legal and regulatory environment has substantially increased.

Most of the problems in obtaining licenses noted above are exacerbated by the opacity of China’s regulatory bodies. In addition, regulations affecting US companies sometimes come into force without the government seeking input. For example, in July 2006, the Ministry of Information Industry imposed without advance notice new rules for the value-added telecom service sector. The China Insurance Regulatory Commission issued in July 2006 qualification requirements for senior managers of insurance companies without soliciting public comment. In addition, the Ministry of Commerce imposed in August 2006 without prior notice requirements regarding the training and recruitment of direct sales agents.

There were some important instances of increased transparency in 2006. China’s National People’s Congress (NPC) solicited comments in March 2006 on the proposed Labor Contract Law and in June 2006 on the proposed Antimonopoly Law (although in the latter case only from members of the China Association of Enterprises with Foreign Investment, or CAEFI). In addition to the request for comments via CAEFI, the NPC has held an ongoing dialogue with foreign companies and experts on the Antimonopoly Law. China’s government ministries and agencies also at times sought comments from international companies.

In a move that may in time help institutionalize the instances of transparency cited above, in April 2006, China’s State Council issued a decree requiring all government bodies to report any regulations affecting trade to the Ministry of Commerce for publication in its official gazette. This is a welcome step toward a more transparent regulatory regime, but its immediate effects should not be exaggerated. First, the decree makes no stipulation regarding when government agencies must report their regulations. Second, the decree does not give the Ministry of Commerce the authority to ensure that other agencies are submitting regulations. To date, the gazette’s scope appears far from complete. Finally, the gazette is intended for final regulations and not for drafts, so this development will not necessarily increase the opportunity for companies to provide input on policies that affect their operations.

⁵ See www.uschina.org/public/documents/2006/08/irp-law-chnages-english.pdf

Standards

China's technical, safety, and product standards, as well as the procedures for establishing these standards and ensuring a product's compliance with them, continue to concern US companies.

China is seeking to encourage the development of domestically owned technical standards in an effort to reduce its reliance on foreign technology. It is natural that China as a large producer of and market for a wide range of goods should take an increased role in establishing new international technical standards. In doing so, however, China should abide by its obligations under the WTO Agreement on Technical Barriers to Trade to adopt standards based solely on scientific criteria and not as a tool of trade or industrial policy.

In some instances, China's "homegrown" technical standards appear designed to assist domestic companies at the expense of international competitors. The most prominent example of this has been China's attempt in 2004 to impose the wireless local area network authentication and privacy infrastructure (WAPI) standard as a mandatory national standard. Although this issue was resolved at the 2004 session of the JCCT, WAPI reemerged in December 2005 when Beijing announced that products using WAPI technology should be given preference in government procurement. The effect of this policy so far appears limited, however. China's designation in February 2006 of TD-SCDMA as the "national standard" for third-generation mobile telecom technology raises concerns that Chinese mobile telecom operators will face government pressure when deciding what technology to employ in their networks. China agreed at the 2004 session of the JCCT to adhere to "technology neutrality" and to allow mobile operators to choose independently which type of third-generation technology they would adopt. Unlike WAPI, however, the TD-SCDMA standard enjoys support from some international companies. China's interest in developing a native technology for radio frequency identification devices could also create significant challenges for US businesses producing in, exporting from, and importing to China if Beijing makes it difficult for companies to use the existing—and widely adopted—international standard for these devices.

Related to but separate from these issues surrounding the development of technical standards are concerns regarding safety and product standards and the means by which products are tested for compliance. China is implementing new standards governing hazardous substances in electronic products, energy efficiency, and others. Most concerns in this regard focus on limited transparency in the process of drafting standards and possible uneven enforcement for domestic and international companies. Medical device manufacturers are particularly concerned about testing requirements. China partly addressed this issue in the wake of the 2006 JCCT, declaring that devices would be subject to just one test rather than two. But concerns remain, since two regulators will still need to certify a device's compliance. Raising more explicit concerns regarding China's adherence to WTO requirements, international companies may not participate in a program the Standards Administration of China announced in May 2006 to recruit a group of domestic companies to help draft new standards for household appliances.

Finally, US companies interested in obtaining the China Compulsory Certification (CCC) mark for their products continue to face delays, in part because of restrictions China places on foreign standards organizations to conduct CCC inspections and audits.

CHINA'S EXCHANGE RATE POLICY

One issue more than any other has captured the attention of Congress and much of the US public: the exchange rate between the US dollar and the Chinese yuan. Many say that China's government keeps the value of its currency artificially low in order to boost its exports and that this is the main cause of the bilateral trade deficit between China and the United States.

China should indeed adopt a market-determined exchange rate. Toward this end, the focus of the United States should be on encouraging China to undertake the broad financial sector reforms that will allow market forces to determine fully the value of its currency. These include opening the financial sector to more competition, introducing more financial market products, requiring greater commercial accountability from existing financial sector companies, and, of course, allowing more foreign participation in China's capital and credit markets. USCBC understands that the Treasury Department has made these reforms a central part of its engagement with China's government through the Strategic Economic Dialogue (SED). USCBC fully supports these efforts.

In the meantime, China should move more quickly to allow market influences from trade flows to be reflected in the exchange rate between the dollar and the yuan. The change in July 2005 in China's currency policy was a welcomed step. The movement of the yuan against the dollar since then has generally been consistent, albeit at a more tightly controlled pace than most would like to see.

It should be noted, however, that the effect of China's exchange rate policy on bilateral trade is likely overstated. USCBC member companies generally do not cite the exchange rate as a key business issue affecting their competitiveness in China. Many are concerned, however, about potential repercussions should the political dispute between the two countries over the exchange rate worsen. *The China Effect* study cited above indicates that even a 25 percent appreciation of the yuan against the dollar—far greater than expected—would decrease the total US trade deficit, which was more than \$800 billion in 2006, by \$20 billion.⁶

Even so, any benefit China gains from an undervalued currency—even if its actual impact on the US economy is not great—should be addressed. The best way to eliminate any such unfair advantage is to continue to push for greater market influences to be reflected in the exchange rate now, for broader financial reforms that will lead to the removal of capital controls at the appropriate time, and for a truly market-based currency in the future.

THE SED, JCCT & WTO

USCBC supports the administration's three-pronged approach to the commercial relationship with China through high-level exchanges at the SED, concrete negotiations to reach solutions to specific problems via bilateral mechanisms such as the JCCT, and the use of the WTO's dispute settlement mechanism to enforce US trade rights when solutions cannot be found through dialogue. USCBC believes this to be the most effective way to lower the market access barriers

⁶ See www.chinabusinessforum.org/pdf/the-china-effect.pdf

that US companies face in China, leveling the playing field between US and Chinese companies competing around the globe, and ensuring that China abides by its obligations as a WTO member.

The principal value of the SED is to provide a framework to guide the development of the most important economic and commercial relationship in the world. The United States and China will soon be two largest global economies and will remain that way for our lifetimes. Our two economies are already greatly intertwined. This is a relationship that both governments need to get right—and, for our government, a relationship that needs to keep moving forward in a way that meets US interests. This is especially true because the schedule for most of China’s WTO market opening requirements reached its end last year, a schedule which in essence provided a roadmap for reforms and openings of China’s economy. The SED can pick up where that roadmap ended and continue to propel the reform process and trade relationship forward. If done right, the SED framework should also provide positive momentum or “tailwind” for solving specific problems through existing forums such as the JCCT.

The first session of the SED, held in Beijing in December 2006, laid the foundation for frequent and wide-ranging, high-level exchanges between senior economic policy makers from China and the United States. The dialogue has the support and involvement of the presidents of both countries. The next session is scheduled for May 23-24 in Washington, DC. USCBC has encouraged both governments to find opportunities for members of Congress to engage with the unprecedented number of top PRC officials that will be in Washington for the SED. Such interaction would lead to a better understanding among PRC leaders of the role of Congress in US trade policy and among US lawmakers of the economic concerns and priorities of China’s government.

At times, Beijing and Washington will be confronted with issues for which a mutually satisfactory solution cannot be reached through dialogue. Disputes are a normal part of a trading relationship, and the growth and complexity of the US-China commercial relationship means that such disputes will naturally increase in frequency. The WTO provides a nonpolitical mechanism for solving such disputes when dialogue fails. In these instances, USCBC supports the enforcement of US trade rights through the WTO dispute settlement mechanism, but urges our government to ensure that such cases are well-defined and focused on clear WTO violations.

CONCLUSION

US trade and investment with China clearly benefit the US economy, both through exports and through broader effects such as lower prices and higher productivity. Nevertheless, market access barriers and other problems exist in the bilateral economic relationship. USCBC supports efforts to find solutions to these issues that are focused and do not threaten the tremendous gains to the US economy that come from trade and investment with China.