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THE US-CHINA BUSINESS COUNCIL

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CHINA AND THE US ECONOMY: ADVANCING A WINNING TRADE AGENDA

Recommendations for the New Administration and Congress

January 2009

The USCBC (www.uschina.org) is the leading organization of US companies engaged in business with the People's Republic of China. Founded in 1973, the USCBC provides extensive non-partisan China-focused information, advisory, program, and advocacy services to roughly 250 US corporations operating within the United States and throughout Asia.

An Agenda for the 21st Century

Few issues loom as large on America's economic and foreign policy agendas as our relationship with China. The current global environment may offer more immediate crises clamoring for attention, but China is the enduring challenge – and opportunity – for the United States that has emerged in the new century. There is much to be gained, in both economic and strategic terms, if we get the relationship right – but economic and strategic difficulties lie ahead if we don't.

A careful look at the facts shows that while China is rapidly making its way up the ladder of global economic and political importance, it is still at a stage where its domestic and international practices are being shaped. America's economic opening to China three decades ago and the careful relationship that has been established since then are great assets upon which to build.

China is now the third-largest buyer of US exports. US companies are establishing roots in China to sell to the Chinese market, and in the process they are bringing high-quality global standards and business practices to China's still-evolving social order. Though much is made of China's rise, realizing that China's entire GDP is still no greater than that of three US states combined puts things in perspective.

And though many focus on the US trade deficit with China, the proportion of our global deficit coming from Asia, including China, is *less* than it was 10 years ago and largely reflects a change in our pattern of trade with the region. The current economic challenges may cause temporary shifts, but the long-term trends are clear – and the need for a clear-headed, stable approach to China is more important than ever.

We're not in this alone. China is in the same place – their economic and strategic success also requires working with us on major issues such as energy, the environment, consumer safety, and trade and financial policies.

The United States has an opportunity to build an enduring and constructive relationship with China. To reach that goal, we need policies that are based on facts, not fears; that foster and follow rule of law; and that bolster and then build upon the deeply rooted strengths of US industrial and technological innovation.

The US-China Business Council looks forward to working with the new administration and Congress as they develop policies that will achieve our nation's goals.

Action Plan

In our contacts with Beijing, we should

- Build on the successful foundation of the first years of the Strategic Economic Dialogue. Whatever it might be called, there is no substitute for regular, high-level, forward-looking engagement between top-level economic, trade, and other officials on major issues such as energy, the environment, food and product safety, financial and currency policies, global economics, and open investment environments.
- Keep pressing forward for a rules-based trading relationship, through bilateral contacts and established legal channels such as the World Trade Organization.
- Ensure the continued opening of China's economy in order to accelerate the rapid growth of US exports to China and enhance the role of US companies selling goods and services in the Chinese market. This helps US companies and workers by bolstering the job base in the United States. It also brings US business standards and practices to China.
- Work to bring China into a constructive and more participative role on global economic issues.

And on the home front, we should

- Further strengthen the leadership role of US companies in the international economy, especially in technologies and sectors that will become global twenty-first century leaders.
- Take steps to bolster the long-term competitiveness of the US economy by adopting smart policies on energy, education, healthcare, and innovation.
- Help displaced workers transition to growth sectors of the US economy with cost-effective programs that provide the tools to succeed in the international economy.

Executive Summary

- **US-China trade in context:** Yes, we import a lot from China. But the US trade deficit with China has increased to a great extent because of shifts in export manufacturing from other Asian economies to China. East Asia, including China, is now responsible for significantly less of the global US trade deficit than a decade ago, even though China's share within East Asia has risen. (Page 4)
- **US exports to China are up dramatically this decade.** Since 2000, US exports to China are up more than 300 percent, benefiting almost every state, county, and congressional district. The next-biggest increase was to Germany, far behind at 70 percent. (Page 6)
- **The US economy dwarfs China's.** The United States added nearly two Chinas to its economy in the past decade. China is rapidly developing, but the United States has a much stronger foundation from which to build. In fact, the US and Chinese economies are greatly interdependent and need each other to succeed. (Page 8)
- **US manufacturing faces an array of challenges, but China is not at the top of the list.** The US share of global manufacturing output has been consistently above 20 percent since 1982. China is increasing its global manufacturing position, but it is primarily taking share from Japan and others in East Asia. (Page 10)
- **US services exports to China are growing and hold the potential to get even stronger.** The United States has a services trade surplus with China, supporting high-quality, high-wage jobs in the financial, logistics, and legal sectors, to name a few. (Page 12)
- **A single-minded focus on China's currency is a distraction.** Yes, an exchange rate that better reflects trade flows is important. Yes, a multilateral, comprehensive look at global imbalances is necessary. But China's exchange rate is not the significant factor in the bilateral trade balance many make it out to be. The renminbi (RMB) has appreciated roughly 20 percent against the dollar since 2005. (Page 14)
- **US companies are a positive influence in China.** From human resources practices to environmental issues, the impact of US companies has been positive. The US business presence will continue to positively affect the development of the rule of law, civic institutions, and specific issues such as food and product safety in China. (Page 16)
- **Advancing the agenda with China:** The best way to achieve US objectives is through a combination of high-level, comprehensive engagement such as the Strategic Economic Dialogue; good faith negotiation on specific issues through existing vehicles like the Joint Commission on Commerce and Trade (JCCT); and, when negotiations fail, the use of rules-based, internationally accepted trade tools such as WTO cases when they are well-defined, supported by industry, and winnable. (Page 17)
- **Most of the answers are here at home.** To succeed in the years ahead, we need smart policies on energy, healthcare, education, and innovation to maintain the competitive leadership of American companies and workers. (Page 17)

The US Trade Deficit: Is China the Problem?

It seems like a given that China is the cause of the massive US trade deficit, but a smart trade policy has to be based on facts. Though there is no disputing that we buy more goods from China than we sell there, a look at the facts presents a more complex picture—and a more accurate one.

Three key trends help to put the US-China trade picture into perspective:

First, many of the goods the United States used to get from Japan, Taiwan, and other Asian economies now come from China because Asian companies have shifted their export manufacturing base there. As China's share of the US trade deficit has risen with this shift, the share of the US deficit from the rest of East Asia has declined (see figure below).

Think of it this way: Ten years ago when you bought a Sony TV, the label probably read "Made in Japan" and the TV was an import. Today, the TV is "Made in China" – and is still an import.

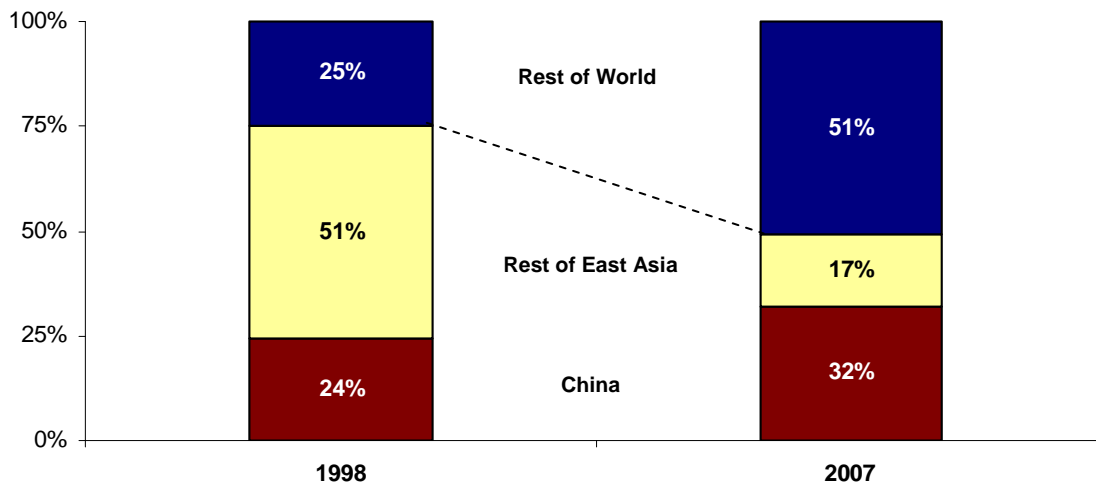
To suggest, as some have, that if an item were not imported from China, it would be made in the United States is misleading, at best.

In addition, East Asia's share (including China) of the US global trade deficit has declined as our trade deficit has increased dramatically with all regions of the world. Petroleum is a big share of this deficit growth, but the United States has also seen its non-oil trade deficit grow across the board with its major trading partners.

Second, though a lot of what China exports is manufactured in China, a significant amount is just assembled there from materials and components shipped into China from elsewhere, including the United States. The trade figures say the full value was imported from China, but the money flow says otherwise.

For example, do you know someone who owns an Apple iPod? It was assembled in China, but assembly accounts only for a fraction of the product's value. Much of an iPod's value is made up of components made in the United States and other Asian locations and shipped to China. According to one study, fully half of the value is in the design and marketing work of Apple employees in the United States. Yet, the full value of an iPod shows up as an import from China in US trade statistics.

Composition of the US Global Trade Deficit



The US trade deficit increase is largely from outside China and East Asia.

Sources: Data compiled from US Department of Commerce, US Department of the Treasury, and US International Trade Commission (ITC) tariff and trade data.

Or, back to that Sony TV example, “Made in China” ...but the factory is still owned by Sony, and much of what is paid to import that TV from China actually ends up in Japan.

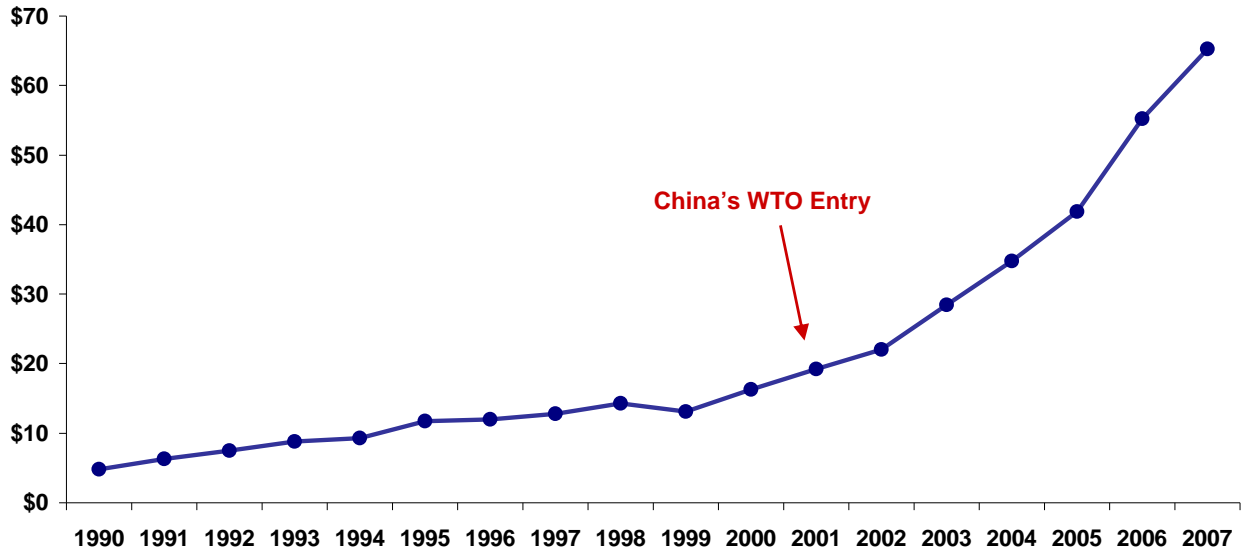
Third, while we fixate on burgeoning imports from China, we sometimes miss the fact that US exports to China are booming as well, notwithstanding the negative impact of the global economic downturn on trade flows during the past few months. In fact, China is now America’s third-largest export market – \$85 billion in 2007, when Hong Kong is included. Every state has seen a dramatic increase in exports to China – often approaching or exceeding 300 percent – since 2000. For information on exports from all 50 states and 435 congressional districts, see www.uschina.org/public/exports/congressional.

At a time of economic challenge, encouraging and supporting export expansion to the fastest growing market for US products makes sense – for manufacturers, service providers, farmers, and workers.

Action Plan

- Prioritize the continuation of a regular, top-level bilateral dialogue that focuses on issues of strategic and economic importance such as energy, the environment, food and product safety, financial and currency policies, global economics, and open investment environments.
- Work at all levels to continue the opening of China’s economy to US companies and exports in both the manufacturing and services sectors.
- Use multilateral dispute settlement mechanisms, such as WTO cases when appropriate and winnable, and bilateral trade remedy tools consistent with international rules to eliminate unfair advantages and level the playing field for US companies.

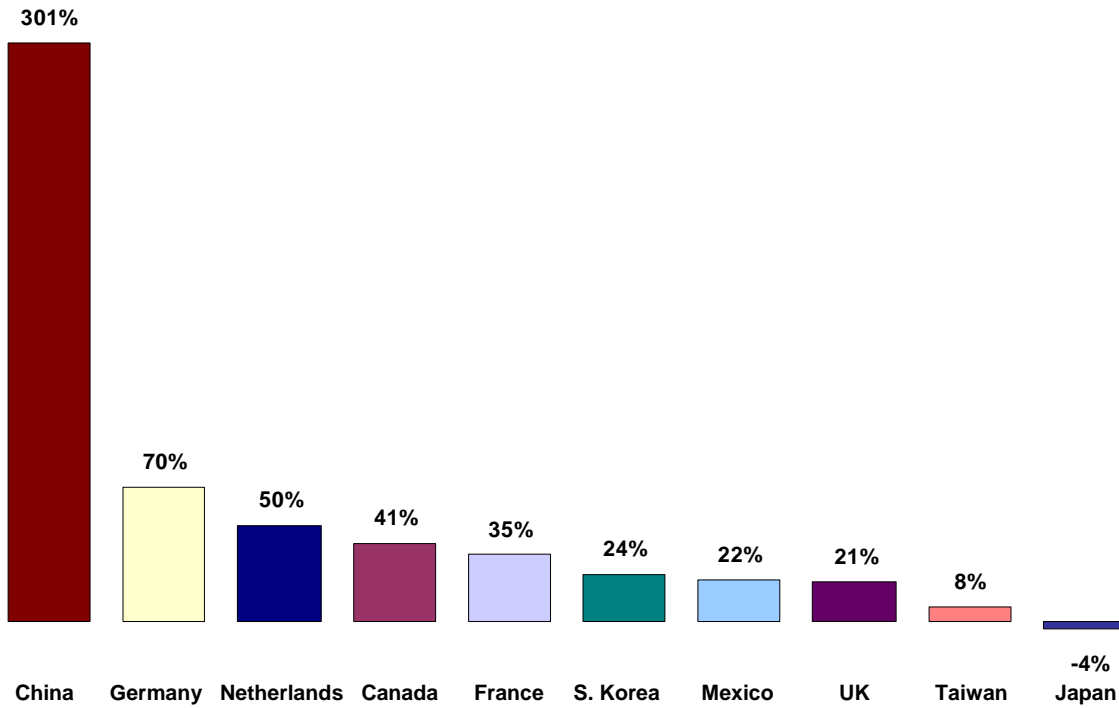
US Exports to China (\$ billion)



China's WTO entry has accelerated US export growth.

Sources: US Department of Commerce, US Department of the Treasury, US ITC

Growth in US Exports to Top 10 Markets, 2000–07



US exports to China are growing far more rapidly than those to other markets.

Note: Top 10 markets based on exports in 2007

Sources: US Department of Commerce, US Department of the Treasury, US ITC

Top 10 US Export Markets, 2007 (\$ billion)

China & Hong Kong Listed Separately			China & Hong Kong Combined		
1	Canada	\$248.4	1	Canada	\$248.4
2	Mexico	\$136.5	2	Mexico	\$136.5
3	China	\$65.2	3	China & Hong Kong	\$85.4
4	Japan	\$62.7	4	Japan	\$62.7
5	United Kingdom	\$50.3	5	United Kingdom	\$50.3
6	Germany	\$49.7	6	Germany	\$49.7
7	South Korea	\$34.7	7	South Korea	\$34.7
8	The Netherlands	\$33.0	8	The Netherlands	\$33.0
9	France	\$27.4	9	France	\$27.4
10	Taiwan	\$26.4	10	Taiwan	\$26.4

China is now the third-largest US export market.

Sources: US Department of Commerce, US Department of the Treasury, US ITC

What the United States Buys from and Sells to China

Products the US buys from China		Products the US sells to China	
1	Electrical machinery and equipment, including consumer electronics	1	Electrical machinery and equipment, including components
2	Power generation equipment	2	Power generation equipment
3	Toys and games	3	Air and spacecraft
4	Furniture	4	Oil seeds and oleaginous fruits
5	Footwear	5	Plastics
6	Apparel	6	Optics and medical equipment
7	Iron and steel	7	Iron and steel
8	Plastics	8	Copper
9	Leather and travel goods	9	Organic chemicals
10	Vehicles and parts	10	Wood pulp

Integrated trading relationship: US imports from China often have US content

Source: US ITC

Is China's Economy Really about to Surpass the US Economy?

In a word, no—not even close.

The US economy is about four times bigger than China's. On a per capita basis, the US economy is about 20 times bigger. The current economic challenges facing the world's economies will slow economic growth for both the United States and China, but the longer-term trend shows that the United States has added the equivalent of nearly two Chinas to its economy in the past decade.

Or looked at another way, China's entire economy is about the size of California, Texas, and Washington state combined.

In addition, the United States has a significant stake in seeing China's economy continue to prosper. US manufacturing, agricultural, and services exports will only grow as China's economy develops and more Chinese move into the middle class.

In fact, the growth of China's domestic market opens up a major new avenue for US companies to gain strength by selling goods and services in China. Many of these goods may be made in China, because distance and lead times mean we cannot serve every customer in China from our US base. But even these product and service sales require design or service support, or component supply, from US facilities; these sales strengthen companies' core operations—and job bases—in the United States.

In addition, streamlining the visa process for legitimate customers of US goods and services will not only help increase sales for US companies, it will also provide additional sales for US airlines, restaurants, and other service sector companies who cater to business clients.

There is much to be gained from a trade policy that encourages China to be more open to US companies,

especially when the US domestic economy is seeking to gain sounder footing.

In fact, the US and Chinese economies are greatly interdependent. For instance, the US is China's second-largest export market; China is our third-largest export market. US companies have invested \$56.9 billion in China, primarily to reach China's domestic market; China in turn holds \$585 billion of US government debt.

Some might try to suggest that China's debt holdings are a source of leverage over America's economy, but that would mean that China is willing to throw away its own prosperity to try to make a political point. In fact, China's investment in US Treasury securities is just another indication of how our economies are bound together. For China's economy to grow and create jobs for its citizens, the US economy must prosper as well.

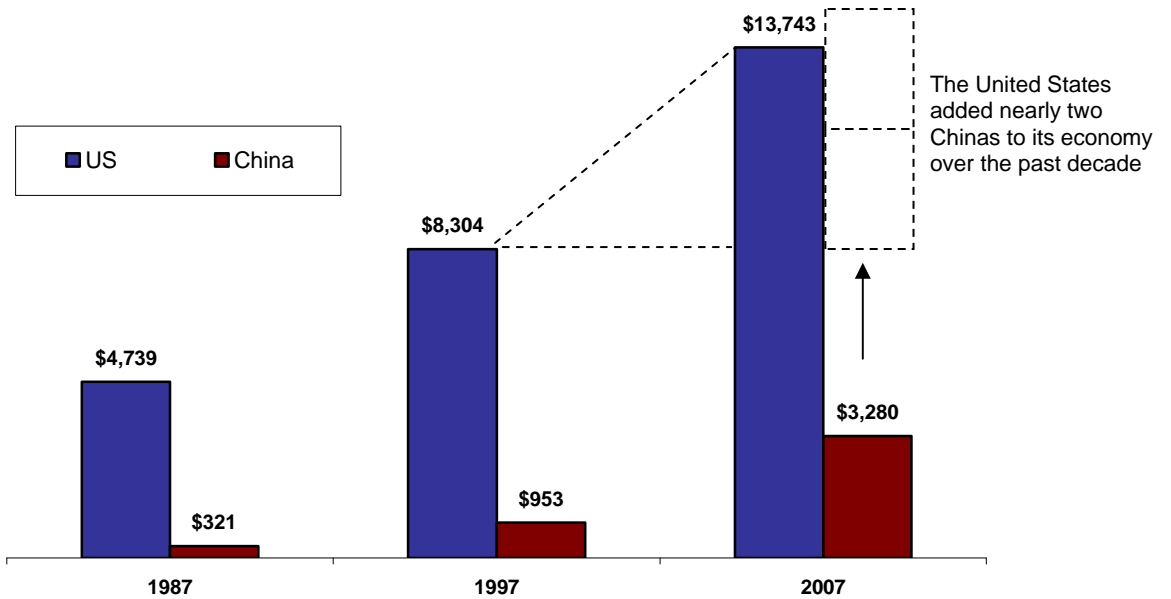
The conclusion should be obvious: our economic success in the years and decades ahead is mutually dependent. We need *more* engagement and cooperation with China, not less.

Action Plan

- Increase emphasis on further opening of China's economy to US exports and China-based operations.
- Encourage China's constructive involvement in global economic policy issues.
- Streamline the visa application process for legitimate customers of US companies to make it easier for them to visit the United States to buy our products and services.

US and China GDP Comparisons, 1987–2007

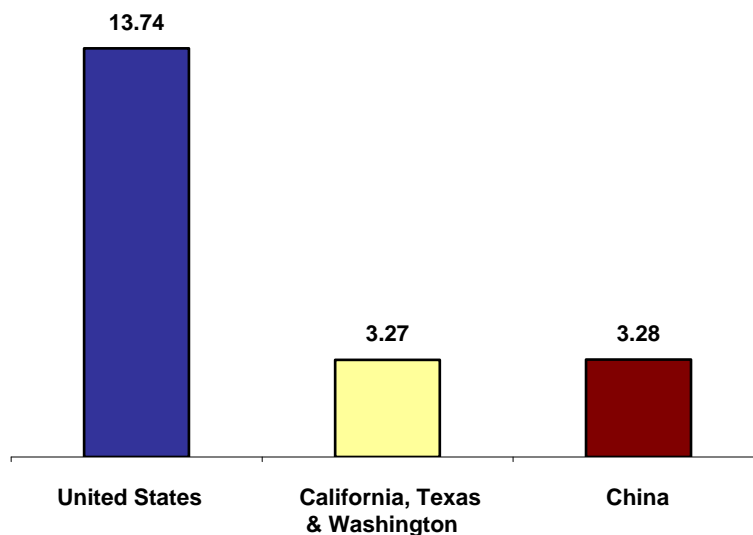
(GDP, \$ billion)



The US economy is four times the size of China's.

Sources: US Department of Commerce, International Monetary Fund

GDP Comparison, 2007 (\$ trillion)



China's economy is equivalent to three US states.

Sources: US Department of Commerce, International Monetary Fund

Is US Manufacturing Losing Ground to China?

US *manufacturing has lost more than 2 million jobs to China since 2001.*

How many times have you seen that number? So many times that a lot of people think it is true. But is it? No.

This “job loss” calculation assumes that every product imported from China would have otherwise been made in the United States, which is clearly wrong—several decades wrong, in fact. Go back again to that Sony TV example. It used to be made in Japan—and was an import. Look at the label now, and it is likely made in China—and still an import. Much of what we import from China is replacing imports from other countries, not products we make in the United States today. Undoubtedly, some jobs have gone to China, but a jobs-impact study that ignores the facts undermines its own credibility.

And finally, is it true that US manufacturing is losing ground to China?

The current economic environment is throwing real challenges at US manufacturers and makes this a difficult time in which to answer a question like this, but the numbers help to bring clarity to a complex matter.

It is absolutely true that some US companies have closed up shop because they could no longer compete, and it is absolutely true that US companies face daunting tasks competing internationally even with their distinct advantage in productivity. Productivity gains do mean, however, that it takes fewer people to make the same product—we make more than ever, but we do it with fewer people. In fact, US manufacturing jobs have been in a steady, decades-long decline that reflects these productivity gains—and far predates China’s entry into the global economy.

But what is *not* true is that US manufacturing as a whole is losing ground to China, or that the problems that do exist can be laid solely at China’s door. China may be a factor at the margins, but is not the main challenge for the health of our manufacturing future.

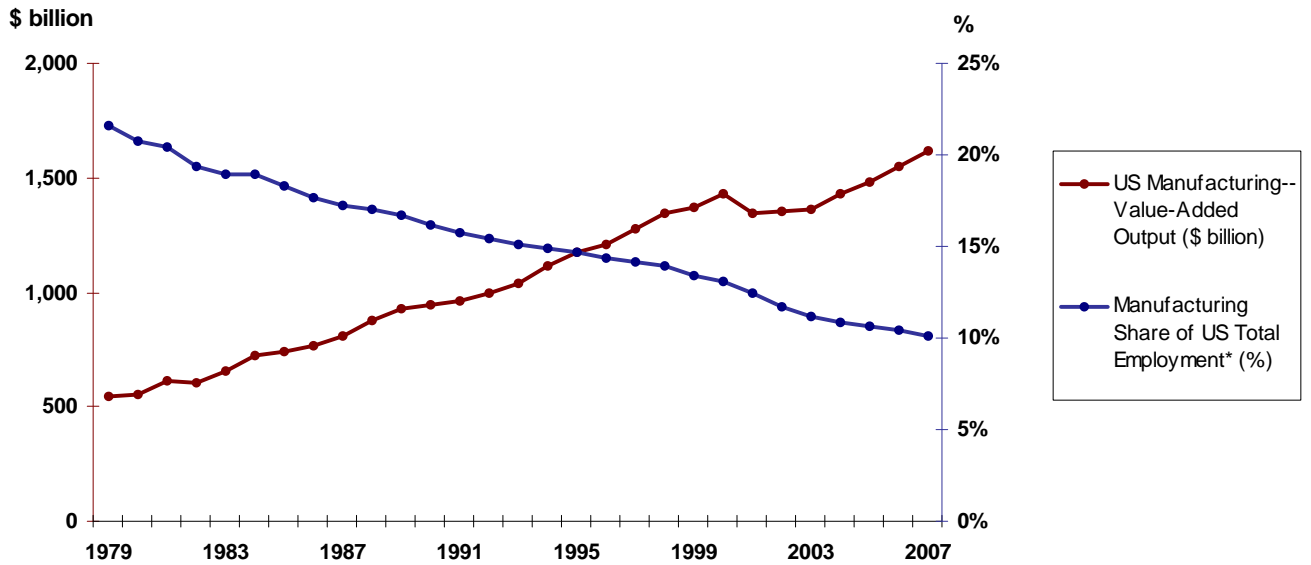
The United States is by far the world’s largest manufacturer, and its share of global output (just under 25 percent in 2007, the latest full year available) has been at least 20 percent since 1982. If China is taking a bite out of any country’s manufacturing hide, it is Japan’s (the Sony TV example, yet again).

Whether that continues to be the case in the coming decades depends more on steps taken here at home to strengthen the competitiveness of US companies than it does on China. Sensible policies on energy, healthcare, education, infrastructure upgrading, and innovation will do far more to keep us competitive than futilely trying to isolate ourselves from China and the international economy.

Action Plan

- Bolster the long-term competitiveness of the US economy and US enterprises by adopting smart policies on energy, education, healthcare, and innovation.
- Develop jobs by encouraging innovation and growth by US companies in industries that will become global twenty-first century leaders, such as technology, energy, and related sectors.
- Strengthen cost-effective programs to help workers transition to growth sectors of the US economy to help them succeed in the international economy.

US Manufacturing Output and Employment, 1979-2007

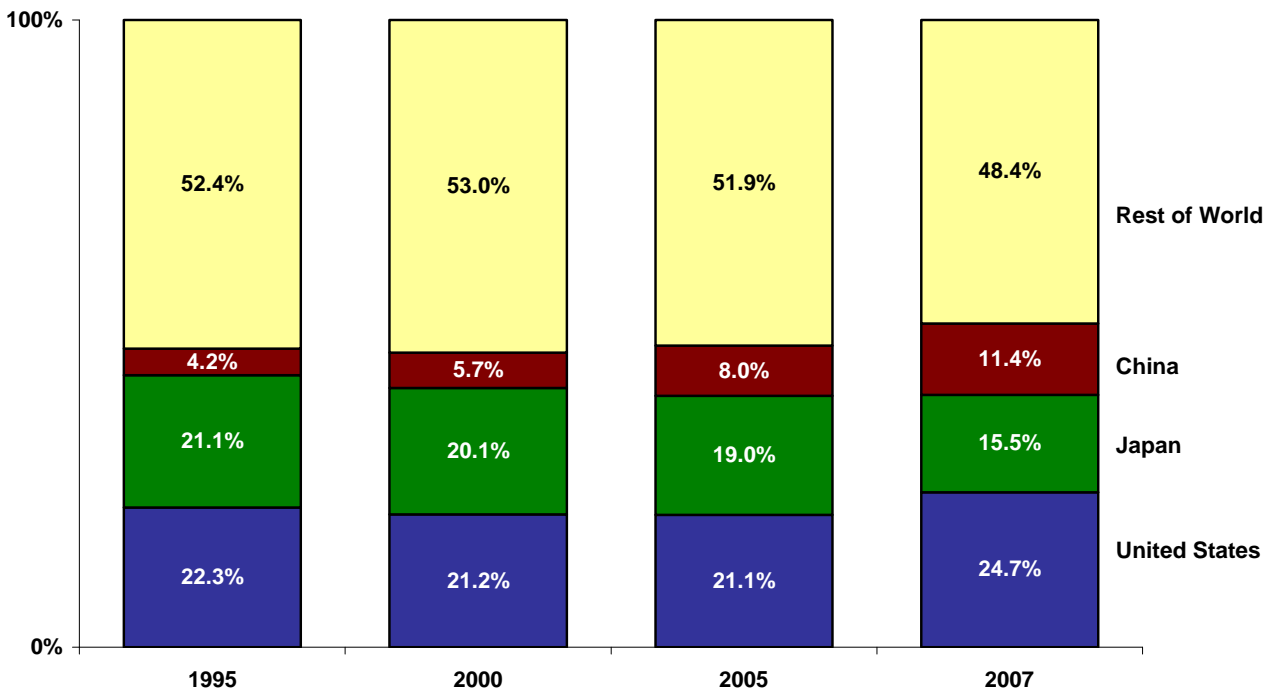


**Productivity gains have led to greater output but with fewer workers.
Employment continues its long-term shift from manufacturing to services.**

*Total non-farm annual average

Sources: US Bureau of Economic Analysis, US Bureau of Labor Statistics, Oxford Economic Forecasting

Share of Global Manufacturing Output



The United States is maintaining its share of global manufacturing; China is taking share from Japan.

Source: United Nations Industrial Development Organization (UNIDO; 2007 is a UNIDO estimate)

Trade in Services: Opportunity for Growth

Though overshadowed by issues surrounding trade in manufactured goods, the dramatic expansion of trade and investment in services between China and United States has benefited both economies substantially and will continue to do so for the foreseeable future. While trade in manufactured goods is often viewed, rightly or wrongly, as benefiting one or the other in terms of jobs and balance of payments impact, trade and investment in the services sector is overwhelmingly positive for both countries, with the United States enjoying an advantage.

In 2007, the United States exported more than \$14 billion in services to China while importing about \$9 billion, for a surplus of \$5.4 billion.

Who are these services providers? They include major US banks and financial institutions, law firms, insurance companies, and providers of tourism, business advisory, computer, express delivery, and medical and healthcare services, and others. Increasingly, these companies are being allowed to set up operations in China for sales in China. It is a major area of opportunity for the US service providers.

For the United States, the world's largest exporter of services, trade and investment in services with China translates directly into high-wage jobs and increased profits from investments in China that lead to further investment and job creation in the United States. The United States has a rapidly growing services trade surplus with China; the more the Chinese market opens to US service providers, the more US services can be sold in China.

These exports of services will contribute positively to the US balance of payments.

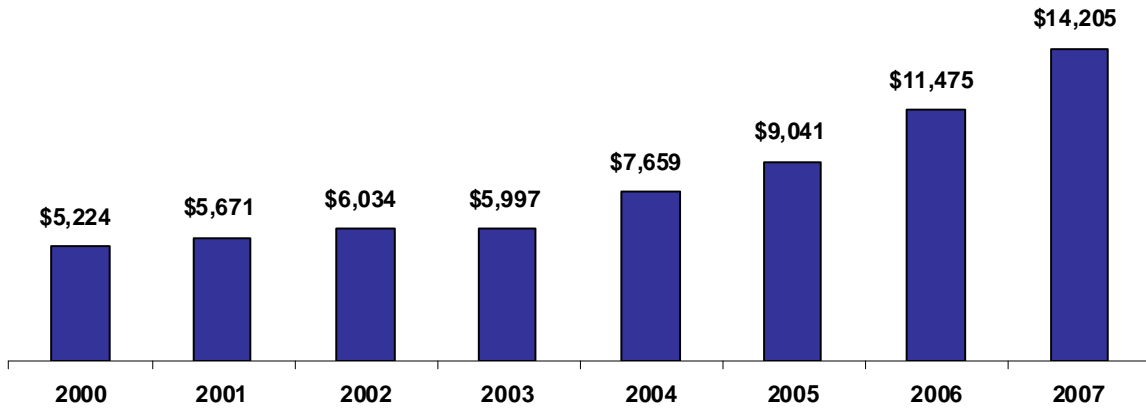
From a broader perspective, the expansion of China's services infrastructure, especially in financial services, is essential to China's integration into the global economy. For example, China's ability to provide pension and healthcare insurance to its citizens, and its establishment of a modern capital market, will help China move toward a market-driven exchange rate and will help level the playing field for US and other companies. The current financial market turmoil may lead some in China to advocate a suspension of their financial system reforms. However, China's financial system is in need of basic transformations that have nothing to do with the current global challenges – and that could do much to help address some of the imbalances that are required to be part of the solution.

In a 2006 study, Oxford Economics estimated that if the outstanding impediments to services sector growth in China were fully removed, the bilateral services trade surplus with China would increase to around \$60 billion by 2015, supplemented by extra income derived from US investments in China worth \$7 billion – boosting US GDP in the short term by about 0.3 percent and creating up to 240,000 US services-sector jobs.

Action Plan

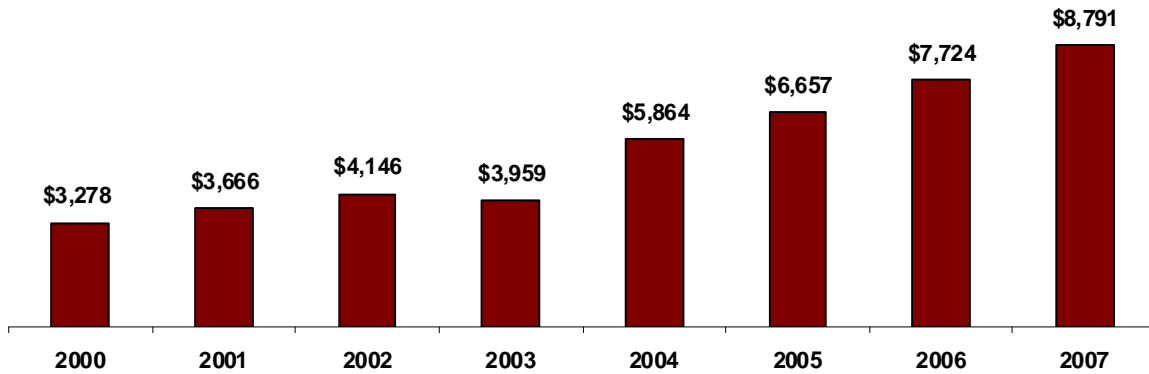
- Press for continued openings for US service companies to operate in the Chinese economy.

US Services Exports to China (\$ million)



Source: US Bureau of Economic Analysis

US Services Imports from China (\$ million)



Source: US Bureau of Economic Analysis

China's Currency

Time out!

The single-minded focus from some quarters on China's currency is a distraction. Yes, an exchange rate that better reflects and responds to trade flows is important. Yes, a multilateral, comprehensive look at global imbalances is necessary. But China's exchange rate is not the significant factor in the US trade deficit that some make it out to be.

As noted above, much of what we import from China we used to import from elsewhere. If we didn't import it from China, we would go back to importing it from Japan or South Korea or Taiwan—and pay more for it.

Further, the RMB has appreciated nearly 20 percent since 2005 as a result of steady engagement and negotiation. Raising tariffs or threatening sanctions inconsistent with international rules will likely only undermine our progress so far, if PRC leaders see themselves as being punished for having been responsive over the past three years. This is particularly true during this time of global economic stress.

In addition, despite the nearly 20 percent appreciation in the RMB, the price of imports from China has not increased significantly. Clearly, there are other factors that make China's exports to the United States cheaper than those produced in other countries or, in some cases, domestic products. If those factors are due to unfair trade advantages, we should go after them with the appropriate trade tools. But focusing on the exchange rate to solve the trade deficit is the wrong approach.

It also is important to note that US companies selling to China never cite the exchange rate as a competitive barrier—and our 300 percent growth in exports to China since the beginning of the decade

underscores that. Every year, USCBC surveys its members on the barriers that impact their business with China. The exchange rate never comes up as an issue harming their sales.

When China is found to be flouting international trade rules, we should first seek direct dialogue to resolve the issue. If good faith dialogue fails, we should use available trade tools, such as World Trade Organization (WTO) cases, when well-defined and winnable, to seek redress. The US government has done this recently with WTO cases on China's export subsidies, auto parts import barriers, financial news services market access barriers, and intellectual property rights enforcement shortcomings.

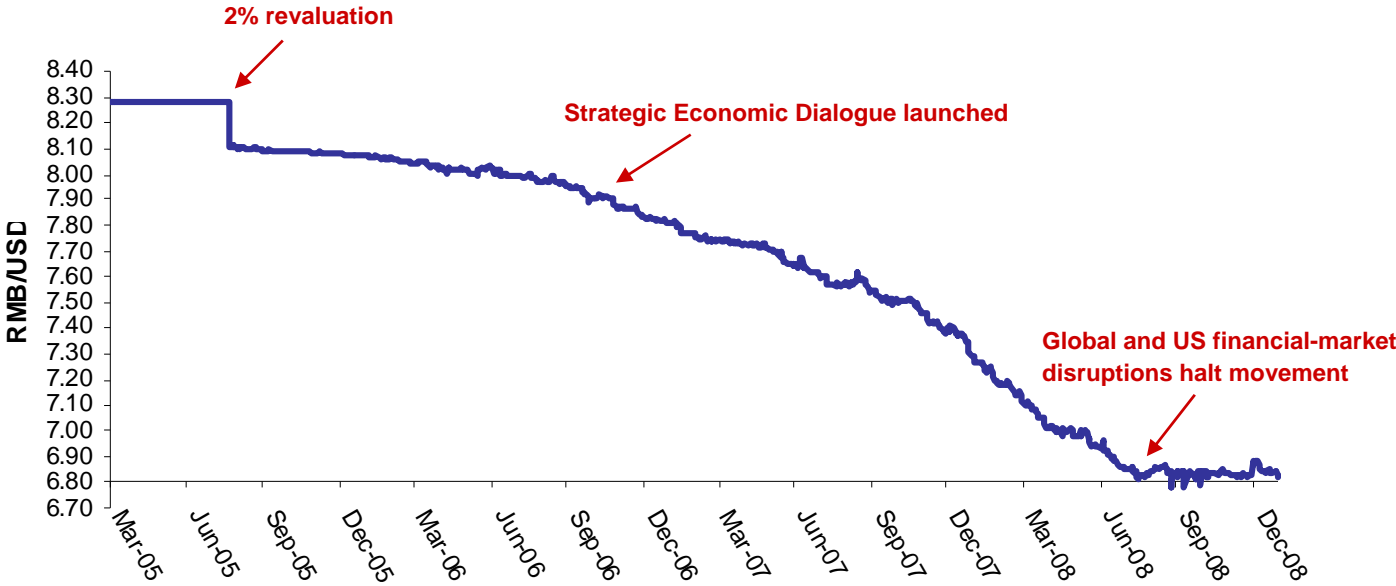
USCBC supports an exchange rate that better responds to China's global trade flows. And, China needs to be at the table for the all-important discussions on addressing the current global financial imbalances and regulatory challenges.

But we are deceiving ourselves if we think that "fixing" China's exchange rate will solve our economic challenges, eliminate the trade deficit, and reverse a decades-long decline in manufacturing jobs due to productivity increases.

Action Plan

- Increase emphasis on multilateral discussions to enhance progress already made toward bringing the RMB's value in line with the global marketplace.
- Continue to link progress on the RMB exchange rate to the development of a more robust financial services sector that would be capable of handling a more fully convertible currency.

Renminbi (RMB) Appreciation since July 2005



Total RMB appreciation against the US dollar: 18%

Note: Noon buying rates
 Source: Federal Reserve Bank of New York

US Companies: A Positive Force in China

American companies do not go to China to be role models or missionaries of change, but by their very presence they *do* offer a model for Chinese enterprises that are new to the world of modern global commerce.

This is particularly true on issues related to food and product safety, where US companies have the experience of operating under effective safety regimes. In fact, some in the consumer protection field have estimated that new safety requirements by major US companies over the past year have contributed more to the 46 percent decline in toy recalls than government action.

By simply being there, American companies and employees bring new ideas, new ways of doing things, new experiences, the best of company human resource practices, and proper environmental practices. They bring a day-to-day, working-level, unplanned, uncontrolled, but pervasive example of better ways to do things. It is not always perfect, and no doubt there are examples to the contrary, but the American company presence in China has been overwhelmingly positive.

A recent Manpower, Inc. poll showed that 75 percent of Chinese workers preferred to work for a wholly foreign-owned employer, rather than a Chinese company or joint venture. In general, the experiences of USCBC member companies have shown that the

more China becomes integrated into the international economy, the more likely China will continue to move along a path of reform and development. That is good for the Chinese people and good for us.

We should support a greater presence by US companies in China, if we want to help bring improvements to workplace labor and environmental practices and improve consumer safety.

Action Plan

- Support rule-of-law programs within China.
- Continue top-level and working-level government programs to increase China's capabilities on the food and product safety front.
- Encourage the PRC government to view US companies as part of the solution on food and product safety issues through education, training, and best practices programs.
- Allow US companies to test products sold in China for safety and compliance, not just those destined for export, to help Chinese consumers regain confidence in the products they buy.

Staying Atop the Global Competitive Pyramid

Maintaining the record of the United States as a strong manufacturing and services economy won't be easy. Last year, the costs of energy put a significant strain on even the healthiest US manufacturers, and while energy costs have recently eased, the long-term trends indicate that they will be a lasting issue. The extra burdens in the areas of pensions and healthcare carried by US companies are well documented. The need to bolster the education system to maintain US technological superiority is no secret, as is the necessity to strengthen the nation's transportation infrastructure. The incentives for innovation in new and challenging areas are also important for maintaining international leadership.

The future will belong to the country whose companies invent and develop the next great industrial breakthrough.

Where will the great breakthroughs in energy efficiency, safe extraction, and the environment come from?

Who will develop the springboard for nanotechnology?

How can we capitalize and expand upon the US lead in computer technologies and information processing?

These are not *China's* problems, however. They are *America's* problems.

A smart China policy in the coming decade will continue to focus on opening markets, ensuring transparency and building rule of law, while a smart policy for America will focus on getting our own house in order so that US companies can continue to be great.

The best way to achieve US objectives is through a combination of high-level, comprehensive engagement such as the Strategic Economic Dialogue; good faith negotiation on specific issues through existing vehicles like the Joint Commission on Commerce and Trade (JCCT); and, when negotiations fail, the use of rules-based, internationally accepted trade tools such as WTO cases when they are well-defined, supported by industry, and winnable.

But most of the answers to maintaining America's global economic leadership are right here at home.