Committee On Finance

Max Baucus, Ranking Member

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Speech of U.S. Senator Max Baucus at the U.S.-China Business Council
"The U.S.-China Relationship in 2005: Priorities and Predictions"

INTRODUCTION

"I'm very happy to be here today to share my thoughts on China and the growing U.S.-China economic relationship.

The problem with giving a speech at the beginning of the New Year, and at the start of a new session, is that I am usually expected to make predictions for the year to come. Predicting the future is a tricky business. I have found that after more than a quarter century in the Senate, I have been entrusted with many powers. Unfortunately, clairvoyance is not one of them.

I believe we have much to look forward to, and many accomplishments we can celebrate. Let me begin by looking back at our achievements in 2004. I would then like to outline what I believe should be the priorities for 2005 and beyond, both for the United States and for China.

LOOKING BACK AT 2004

Looking back, 2004 for China was yet another year packed with breathtaking economic progress. The Chinese economy again expanded by over 9 percent, as it has each year for over a decade. Foreign direct investment, the engine of this growth, again hit record levels – over $60 billion last year, making China the world's principal destination for foreign investment two years running.

Everyone knows that China has become a major export power – nearly six percent of all exports last year were Chinese. But China is increasingly a major importer and an important engine of global economic growth. Its growing middle class – now estimated at 230 million people – purchases goods and services not only from Taiwan, Japan, and Korea, but also from Brazil, Germany, and the United States.

Chinese companies are stepping up plans to expand their global footprint. The most talked about recent business deal is not some mega-merger between two Western giants. It is Chinese PC-maker Lenovo's $2 billion acquisition of the IBM PC business.

How did this banner year for China affect the United States? China is now our fifth largest export market and our second largest source of imports. Both imports and exports are growing at twice the rate of world trade.

Three out of four U.S. firms doing business in China were profitable last year. That has led twice as many companies as last year to plan an expansion of their Chinese operations. A recent survey found that for nearly one-third of U.S. companies, China was their number one priority. Half ranked China among their top three.

A recent poll found that American consumers by and large understand the positive impact China has on the U.S. economy. They recognize that increased productivity in China improves their welfare by lowering the price of goods and making their dollars go further. U.S.-Chinese relations have improved to the point where many Americans view China as an ally, not an adversary.

U.S. CHINA POLICY LOOKING FORWARD: REINFORCE, REENGAGE, RETOOL

I am confident that we can replicate the successes of 2004 and meet even more ambitious goals in 2005 and beyond. But first we must have a strong sense of our priorities and a clear idea of the policies necessary to realize them. We should reinforce our current success in China, reengage in Asia to match growing Chinese economic and political clout, and retool our own economy to meet the challenges posed by an increasingly internationally competitive China.

Reinforce Our Successes with China

First, we should reinforce our successes in China. The philosopher Simone Weil said: “The future is made of the same stuff as the present.” If your present is successful, your ambition is to make this true.

Our present successes should be part of our future with China. We can begin by reinforcing and even replicating successful channels of communication like the U.S.-China Joint Commission on Commerce and Trade. As you no doubt recall, last year’s JCCT meeting was critical in resolving a difficult issue involving China’s proposed wireless encryption standard. The JCCT should continue to unravel these knots in our bilateral relationship, and we should reinforce its formula of reconciling differences before they become disputes.

We should also reinforce our efforts to ensure China’s compliance with all of its WTO commitments. On trading and distribution rights, on transparency, and above all on intellectual property – we should not be hesitant to enforce our rights.

That does not mean we can't be creative or proactive in resolving potential disputes. In fact, creativity and forward thinking are critical for dealing with complex issues like technical standards and regulation and sanitary and phytosanitary issues. If we do it right, tomorrow's disputes should end up on today's agenda.

Reengage Asia

Second, we should reengage Asia. In recent years, I believe the United States has allowed Chinese power and influence to grow in Asia to the detriment of U.S. power and influence. A strong, healthy, and confident China is in everyone's interest. But there is no reason why a stronger, more influential China should mean a weaker America.

How do we reengage Asia? We can begin by forging closer trading ties with Asian countries on a bilateral, multilateral, and sectoral basis. Malaysia is the wealthiest Muslim nation in Asia and was among our top ten trading partners last year. It is well placed as a springboard to other Asian markets, and its government is eager to forge closer economic ties with the United States. In my view, it is a prime candidate for free trade negotiations.

Negotiations with Japan and Korea would be more difficult, but the potential benefits are greater. Japan is the world's second largest economy, and by far the largest in Asia. An FTA would help U.S. companies finally penetrate the protected Japanese market and help pull Japan – once and for all – out of its economic doldrums.

Korea is the eleventh-largest economy in the world and our seventh largest trading partner. It is a huge market for U.S. products. Many U.S producers now face high hurdles to enter this market, but Korea finally appears serious about reforming its agricultural and other economic sectors. I understand that the United States and Korea have begun tentative discussions on what a U.S.-Korea free trade agreement could entail. I applaud this effort wholeheartedly. It won't be easy, but if we never try, we'll never succeed.

Regional trade agreements also offer opportunities to forge closer ties with Asia. One ready vehicle is the Asia Pacific Economic Cooperation group with its 21 member states, including China. APEC member economies comprise a third of the world's population and approximately 60 percent of world production. In recent years, APEC summits have focused more on security than on trade. We should return APEC's focus to its core economic mission, perhaps by accepting the challenge of negotiating an APEC-wide free trade agreement.

We should also pursue sectoral initiatives like the hugely successful Information Technology Agreement, which itself grew out of APEC. With Asia's rapidly aging population, a sectoral agreement to reduce tariffs and other barriers to trade in advanced medical equipment seems a natural candidate. The potential benefits for patients as well as for medical equipment manufacturers seem irresistible.

Retool the U.S. Economy

Finally, it would be wrong to address our future with China without discussing the challenges the future will inevitably bring. As China improves its efficiency and continues its capital investments, U.S. companies and their workers will have to adjust to the increased competition. America must retool its policies to meet this challenge.

How do we retool? We begin with education and training. For over forty years, the government has been helping retrain trade-impacted workers from manufacturing companies and giving them the skills they need to find new jobs through trade adjustment assistance. In 2002, we expanded eligibility to new categories of workers, created a new health coverage tax credit, and helped older workers with a new wage insurance benefit. Last year nearly 150,000 workers were helped by these programs, but there is more we could do.

Service industries like computer programming or calling centers also face competition from China and elsewhere, but service workers are not eligible for TAA. With over 80 percent of the U.S. economy comprised of service sector industries, I believe it is only a matter of time before we re-write TAA to add benefits for service workers.

Retooling also means investing in today's ideas for tomorrow's innovations. Multi-billion dollar industries have sprung from federal research and development dollars – fiber optics, radar, wireless communication, nanotechnology, ultrasound and even the internet were all made possible with public sector funding.

This lesson is not lost on China. As a percentage of GDP, China is now the third largest spender on research and development – behind only the United States and Japan. In the United States, meanwhile, federal investment in the physical sciences and engineering, as a percentage of GDP, has actually declined by nearly one-third over the last two decades. We should reverse this trend. The money we spend will come back to us many times over in the creation of new jobs in new industries making products yet to be invented.

Retooling also means investing in basic education that will help unleash the creativity of our citizens and helps prepare them for the jobs of the future. We've got our work cut out for us. A recent study ranked U.S. math students 24th out of 29 industrialized countries. We've simply got to do better. In particular, we should adopt policies to promote the training of more scientists and engineers. They play a critical role in the development of new jobs and new industries. Yet we train only half as many engineers as Japan and Europe, and less than one third as many as China.

Finally, retooling means adjusting our immigration policies to take account of post-9/11 realities while still being sensitive to the needs of business. A U.S.-China Business Council study last year noted that delays in processing visa applications for business travelers to the United States cost U.S. companies $30 billion between July 2002 and March 2004. We on Capitol Hill are hearing more and more about this issue, despite Administration claims that visa processing times are declining.

These three Rs – Reinforce, Reengage, Retool – should be key priorities for the United States in the upcoming year. My prediction is that as the competitive pressures from China's development build in the United States, the chorus of those calling for changes like these will grow ever louder. That will create the political will to make some of these badly needed adjustments. Now let me give you my impressions about the coming year priorities for China.

LOOKING FORWARD TO 2005 – CHINA

I see at least three important issues for China in 2005 – all crucial for growth, continued foreign investment, and solidifying China's place as a constructive partner in the world trading system.

First – and most importantly – real action is necessary on intellectual property rights enforcement. China must follow up its legislative changes increasing penalties for counterfeiters with genuine and aggressive enforcement on its borders, in illegal factories, and in the infamous and abundant markets. Businesses operating in China point out continued – and often egregious – cases of piracy and counterfeiting. Nothing is safe from this theft, be it software, optical media, clothing, roses, auto parts, even entire passenger cars, electrical switches, medicines, and processed foods.

I sense that we may have reached a tipping point on this issue. More articles are appearing in the press about IP violations in China. Business Week's cover story this week focused on it. Many of my colleagues are asking more questions about it.

The drumbeat for stronger IP rights is increasing within China, too, as more and more innovative Chinese companies seek to protect their investments. China simply cannot hope to be a modern economy unless it protects intellectual property. If China fails to establish adequate protections, its high-value added manufacturing industries will ultimately falter, fail, or move to safer shores.

Second, timely compliance with China's WTO commitments is critical. Considerable problems remain not only in enforcement of intellectual property rights, but also in the areas of transparency, telecommunications, services, and taxation. Just yesterday, there were reports that China has delayed indefinitely adoption of the already overdue regulations governing foreign-funded direct sales companies. Repeated failure to meet its obligations will hurt China's reputation and entail significant political risk.

Third, China's monetary policy must change. When China first pegged the RMB to the dollar in 1994, China was a relatively small player on the world stage. A peg may have made sense. But now that China is a true global economic power, the peg is distorting currency flows and aggravating the U.S. current account deficit. I hear conflicting reports of China's intentions this year. It is in China's interest – both substantively and politically – as well as in the interest of the United States for China to revalue its currency.

Finally, I feel compelled to emphasize the link between prosperity and stability. Above all, trade and investment partners around the world want stability. I am heartened by the resumption of direct flights between Taipei and Beijing, and to read yesterday about China's gesture in sending senior officials to Taipei for the funeral of Taiwanese politician Koo Chenfu. Further improvements in cross-straits tensions can only be an economic positive for China in the long-term.

CONCLUSION

I am optimistic about the coming year. I am confident that focusing on these priorities will bring us into 2006 once again astounded by what the past year has witnessed.

In closing, I would like to leave you with a challenge. Let this be the last year your speaker discusses merely the upcoming year with China. Let us challenge ourselves to view our potential economic relationship with China in terms of decades and not merely years. I guarantee you that's how the Chinese are viewing their relationship with the United States.

In 2005, let us think big on China. I am certain that if we do so, we will spend far less energy predicting the future and more energy shaping it."