EMERGENCY COMMITTEE FOR AMERICAN TRADE

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Before the U.S.-China Economic and Security Review Commission

"Hearing on Evaluating China's Past and Future Role in the World Trade Organization"

June 9, 2010

Thank you for the opportunity to appear before you on behalf of the Emergency Committee for American Trade (ECAT). ECAT is an association of the chief executives of leading U.S. business enterprises with global operations that was founded more than three decades ago to promote economic growth through expansionary trade and investment policies. Today, ECAT's members represent all the principal sectors of the U.S. economy – agriculture, financial, high technology, manufacturing, merchandising, processing, publishing and services. The combined exports of ECAT companies run into the tens of billions of dollars. The jobs they provide for American men and women – including the jobs accounted for by suppliers, dealers, and subcontractors – are located in every state and cover skills of all levels. Their annual worldwide sales exceed $1.6 trillion, and they employ more than 6.2 million persons.

ECAT and ECAT companies have played an active role on U.S.-China economic policy for several decades. ECAT co-led the Business Coalition for U.S.-China Trade that worked to ensure normalized economic relations with China and China's accession to the WTO on commercially meaningful terms that would benefit the United States. Since China's accession, ECAT has worked to promote an improved economic relationship with China, including with respect to WTO and non-WTO economic issues. ECAT has also been working intensively with others in the business community regarding what many in the business community view as one of the major international economic challenges currently being posed by China – its proposed indigenous-innovation policies. ECAT is also active in promoting a strong outcome in the ongoing U.S.-China bilateral investment treaty negotiations and in China's accession to the WTO Government Procurement Agreement.

China's accession to the World Trade Organization (WTO) in 2001 represented the culmination of years of effort to encourage China's commitment to the basic rules of the global trading system. Without a doubt, substantial progress has been achieved in integrating China into the global trading system through the WTO. China's accession was on terms that were generally at a much higher level than for any other acceding country and efforts were made then to address key issues that were particular to China, such as the role of state-trading enterprises.

Nevertheless, the economic and commercial challenges in the U.S.-China relationship continue to grow, including with China's adoption of additional market-access restrictions and its continued failure to protect fully intellectual property rights. These restrictions and policies have had a negative effect on building the U.S.-China trading relationship and have led to a reduction, rather than an increase, in certain sectors of U.S. and other foreign participation in the Chinese market, as China has used these barriers to promote the competitive advantage of its domestic firms. It is vital, therefore, that the United States fully embrace a comprehensive, coordinated and multifaceted approach to improving the U.S.-China economic relationship specifically and U.S.-Asian relations more broadly, including through:

- Employing all of the WTO mechanisms available, including the Doha Development Agenda negotiations, the WTO Trade Policy Review Mechanism, WTO committee meetings, and the dispute settlement system to promote China's compliance with WTO rules and its full participation in the global trading system.
- Working in a sustained and coordinated fashion through the Strategic and Economic Dialogue, the Joint Commission on Commerce and Trade, and other dialogues to focus on addressing priority and systemic issues in the U.S.-China economic relationship from intellectual property to market access.
- Building a stronger U.S.-China economic relationship through clearer, deeper and more far-reaching commitments where possible, including through a U.S.-China Bilateral Investment Treaty (BIT).
- Expanding the U.S. presence and participation in Asia through stronger economic ties, such as through the implementation of the Korea-U.S. Free Trade Agreement and the negotiation of a Trans-Pacific Partnership agreement.

This approach must be comprehensive and sustained, rather than the one-off type of effort that has too often characterized U.S.-China economic relations and has led to the United States negotiating and renegotiating virtually the same commitments over and over again. The United States should also refrain from taking counterproductive actions that will undermine the creation of new economic opportunities for the United States in its relations with China.

The U.S.-China Economic Relationship Today

For the United States, China is both a major market and a major competitor, given its 1.33 billion people and $2 trillion in foreign-exchange reserves and it being the third-largest economy in the world. China's domestic economic growth has been exponential. It has doubled its GDP per capita each decade over the last 30 years, rising from about $191 per capita in 1980 to $6,600 in 2009. With an expected growth rate of 9.5 percent in 2010, according to the World Bank, the China market will continue to be one of the most important growth markets worldwide. The extent of U.S. and other foreign participation in that market is not a foregone conclusion, particularly in sectors of the economy where China is using industrial policy to build up its own domestic entities, at the expense of foreign participation.

As China continues to develop and grow its economy, it is vital that the United States be a full participant to ensure new economic opportunities for U.S. farmers, manufacturers, service providers and their workers. Already, U.S. exports to China have quadrupled since 2000, making it America's fastest-growing export market.[1] Between 2000 and 2008 (before the recent

[1]U.S. merchandise exports to China have more than quadrupled, growing by $53.4 billion, from $16.2 billion in 2000 to nearly $69.6 billion in 2009. U.S. exports to China now exceed U.S. exports to Japan, Germany, the United Kingdom, and Korea. Last year, U.S. merchandise exports to China declined modestly by $157 million – far less than the decline in U.S. exports to the other top U.S. export markets, such as Canada, Mexico, Japan, Germany, the United Kingdom and Korea. In 2009, nineteen U.S. states exported more than $1 billion in agricultural and manufactured goods to China, and 29 states exported more than $500 million in goods to China. Major U.S. exports

economic downturn), U.S. exports to China grew 341 percent – faster than U.S. exports to any other major export market in the world. China has grown from our 11th-largest export market in 2000 to our third-largest export market in 2009. Even during the recession, U.S. exports to China outperformed U.S. exports to the rest of the world. Since the start of the economic downturn, U.S. goods exports to China have rebounded and are now 20 percent higher than they were two years ago (while overall U.S. exports remain lower than they were two years ago).

In a substantial portion of these cases, U.S. investment in China has accelerated U.S. export growth, including through the investment in major distribution channels, including U.S.-branded retail stores, that use U.S.-produced technologies as part of their infrastructure and accelerate U.S. exports of food and consumer goods. Investment in services also accelerates cross-service exports as well as support major service operations in the United States. U.S. foreign direct investment in China totaled $45.7 billion in 2008, with annual flows that year of $15.7 billion. Inbound investment from China into the United States equaled $1.2 billion in 2008, with annual flows that year of $368 million.[2] Contrary to investment being the zero-sum equation that too many mistakenly assume, U.S. investment overseas is largely about reaching foreign customers, ***not*** about outsourcing for re-sale back to the United States as some claim. Of the $4.7 trillion in sales made by foreign affiliates, less than $500 billion (or 10.5 percent) of all sales is made back into the United States. The foreign-invested affiliates of U.S. companies generate more than half of the total revenue of U.S. globally engaged companies, with less than 21 percent of their total employment. The lion's share of activities by U.S. globally engaged companies remains in the United States, with the U.S. parents accounting for 74.1 percent of capital investment and 85.1 percent of research and development here at home.[3]

At the same time, China, as a major trader and foreign investor, will continue to challenge the United States economically throughout the world. U.S. imports from China almost tripled, from $100 billion in 2000 to $296.4 billion in 2009, displacing in many cases exports from other parts of the world. Notably, U.S. imports from China fell by $41 billion between 2008 and 2009.[4]

Focusing just on imports and exports, however, too often leads to a very simplistic view of a highly complex economic relationship. For example, research by a number of different economists has documented that a high proportion of China's exports are made of up foreign content and inputs. For example, one 2008 study estimated that the share of foreign content in China's exports was above 50 percent overall and was much higher in sophisticated products,

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to China include information-technology products (including components), machinery, agricultural products, aircraft, plastics, medical equipment and iron and steel. **Source:** U.S. Department of Commerce, Trade Stats Express (tse.export.gov).

[2] Bureau of Economic Analysis, U.S. Direct Investment Abroad, Capital Flows and Historical Cost Basis, accessed at http://www.bea.gov/international/index.htm#iip.

[3] **Sources:** *Global Investments, American Returns (GIAR)* (1998 and 1999 Update), Matthew Slaughter, Published by Emergency Committee for American Trade; *U.S. Multinational Companies: Operations in* 2006, Raymond J. Mataloni, Jr., BEA (Nov. 2008); *How U.S. Multinational Companies Strengthen the U.S. Economy: Revised Update* (2010), Matthew Slaughter, Published by Business Roundtable and United States Council Foundation.

[4] Major imports include machinery, toys, furniture and footwear. Source: U.S. Department of Commerce, Trade Stats Express, accessed at tse.export.gov.

such as electronic devices (where about 80 percent of the content was foreign).[5] And while some imports from China compete with U.S. industries, that is not the case for all of them. Indeed, it is also widely noted that U.S. imports from China have also come substantially at the expense of other Asian exporters.[6] As well, imports from China (and elsewhere) are important for the United States to increase the variety and availability of products to all Americans, increasing U.S. purchasing power and our standard of living.

And focusing on goods, without considering services, would also be a mistake. In 2008 (the latest year for which annual data are available), U.S. services exports to China totaled $15.9 billion, representing a $10.7 billion increase in, or tripling of, U.S. services exports of $5.2 billion in 2000. In 2008 alone, U.S. services exports to China rose over $3 billion or 30 percent. U.S. services imports from China totaled $9.8 billion in 2008.[7] China is now our ninth-largest services export market.[8] Many of these exports are from key knowledge-based industries, including telecommunications, express delivery, computer and related services, and financial services. In each of these sectors, however, significant barriers remain.

It is also important to put our trading relationship with China into a global perspective. For example, while the United States remains the largest single-country purchaser of Chinese goods, the European Union surpassed the United States as China's largest overall goods export market in 2007 – a trend that continued in 2008 (drawing on the most recent data available from the World Trade Organization). At the same time, several other countries/trading blocs surpass the United States in terms of their sales to China, including Japan, the European Union, South Korea and Taiwan.[9]

Another increasingly important facet of the U.S.-China economic relationship is the competition faced in third-country markets. China is actively pursuing new markets throughout the world and, in several cases, negotiating free trade agreements to give Chinese goods more preferential access. On January 1, 2010, the China-ASEAN Free Trade Area entered into effect, making it the largest free trade agreement (FTA) by population in the world, covering the 1.9 million people of China, Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand. Full implementation of the China-ASEAN agreement with the ASEAN group of four (Burma, Cambodia, Laos and Vietnam) will take place by 2015. The agreement requires the elimination of most goods tariff immediately, although some agricultural products and manufactured goods will have longer phase-outs. The New Zealand-China FTA and the China-Peru FTA have also entered into force

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[5] See, e.g., Robert Koopman, Zhi Wang, and Shang-Jin Wei, "How Much of Chinese Exports is Really Made in China? Assessing Domestic Value-Added When Processing Trade is Pervasive," NBER Working Paper 14109 (June 2008), accessed at http://www.nber.org/papers/w14109.

[6] Thomas Lum and Dick Nanto, *China's Trade with the United States and the World*, **Congressional Research Report** (Updated January 4, 2007). U.S. trade data also show that U.S. imports from all of Asia (minus China) have declined from $346 billion in 2000 to $289 billion. More notably, the share of total U.S. imports accounted for Asia (minus China) has declined during that same period from 28 percent in 2000 to 15 percent in 2009. When China is included, the share of total U.S. imports accounted for by Asia (including China) equal 31 percent, which is less than the share of imports held by all of Asia in 2000 (at 36 percent).

[7] **Source:** Bureau of Economic Analysis, Trade in Services (2008), accessed at http://www.bea.gov/international/international_ services.htm.

[8] **Source:** Bureau of Economic Analysis, Cross-Border Trade in Services by Type and Country (2008), accessed at http://www. bea.gov/international/international_ services.htm.

[9] International Trade Statistics 2009, World Trade Organization, Table A22 (using 2008 data).

and China recently signed an FTA with Costa Rica. China is also in FTA negotiations with Australia and the Gulf Cooperation Council.

China's Accession to the WTO and its Implementation of WTO Commitments

The United States was the leading country in promoting China's accession on strong, commercial terms. As a result of the work of U.S. negotiators and successive U.S. Administrations, the terms for China's accession were: (1) substantial, removing major trade barriers across China's economy; (2) enforceable; and (3) designed to produce concrete and rapid results. By any measure, the terms of China's accession were substantial. It bound 100 percent of its tariff lines and reduced the average bound tariffs for non-agricultural products to 9.1 percent. This compares highly favorably with countries like Brazil and India, whose bound rates are 30.8 and 34.7 percent respectively.[10] Similarly in services, China bound its obligations to cover a much larger set of sectors and subsectors, covering 93 service sectors compared to 43 by Brazil and only 37 by India.[11]

Full and effective implementation of China's WTO commitments is one critical component in ensuring new opportunities for American goods, services, and agriculture in the world's largest and fastest-growing market. Since joining the WTO over 9 years ago, China has made significant progress in coming into compliance with many aspects of its WTO commitments, including:

- tariff reductions from a base of 25 percent to under 10 percent;
- reductions in non-tariff barriers, where China eliminated hundreds of WTO-inconsistent requirements;
- trading-rights reforms, where China implemented its commitments six months early to allow companies to import and export directly;
- distribution-rights reforms in 2005, where China now allows foreign enterprises to distribute products within China;
- new regulations on foreign-invested insurance companies and the elimination of geographic restrictions on insurance-company activity;
- TRQ implementation in 2004 for agricultural products, which was finally brought closer in line with China's commitments; and
- expanded market access in a number of services areas.

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[10] China Tariff Profile, Compiled by the WTO (2009), accessed at http://stat.wto.org/TariffProfile/WSDBTariffPFView.aspx? Language=E&Country=CN. India only bound about two-thirds of its tariff lines in entering the WTO and its average bound tariff lines for non-agricultural goods are 34.7 percent. India's applied tariff rates are 10.1 percent. India Tariff Profile, Compiled by the WTO (2009), http://stat.wto.org/TariffProfile/WSDBTariffPFView.aspx?language=E&Country=IN. Brazil has bound all its tariffs, but at an average rate of 30.8 percent for non-agricultural goods. Brazil's average applied rates are still significantly higher than China's at 14.1 percent. Brazil Tariff Profile, Compiled by the WTO (2009), accessed at http://stat.wto.org/TariffProfile/WSDBTariffPFView.aspx? Language=E&Country=BR. While India's and Brazil's applied rates are lower than bound rates, WTO members have no recourse if either country raises their rates up to their bound levels.

[11] China Services Profile, Compiled by the WTO, accessed at http://stat.wto.org/ServiceProfile/WSDBServicePFView.aspx? Language=E&Country=CN; Brazil Services Profile, Compiled by the WTO, accessed at http://stat.wto.org/ServiceProfile/WSDBServicePFView.aspx? Language=E&Country=BR; India Services Profile, Compiled by the WTO, accessed at http://stat.wto.org/ServiceProfile/WSDBServicePFView.aspx? Language=E&Country=IN.

As a result of these and other market openings, U.S. commercial participation in the Chinese market has grown exponentially. The export growth discussed above represents an important measure of the successes of China's entry into the WTO. U.S. investment in China has also helped reap important benefits for the United States. Such investment acts as a magnet for exports and helps spur sales within China, while also promoting U.S. research and development and higher wages for U.S. workers. And contrary to the myth that U.S. investment overseas displaces U.S. production, most U.S. investment overseas results in sales into foreign markets, with only 10.5 percent of sales returning to the United States. [12]

While China has made great strides towards opening its economy consistent with its WTO commitments, that opening has not fully occurred and in some cases has been actively thwarted by other Chinese policies, including a number of the industrial policies discussed below that favor state-owned, state-related and other domestic entities over foreign entrants. As recently stated by the Deputy United States Trade Representative, Ambassador Michael Punke, during the WTO's third Trade Policy Review of China."

> In the first years after China's accession to the WTO, China made noteworthy progress in adopting economic reforms that facilitated its transition toward a market economy and increased the openness of its economy to trade and investment. However, beginning in 2006, progress toward further market liberalization began to slow. . . . Since China's Trade Policy Review in 2008, there is increasing evidence of such a restrictive trend. Examples from the past two years include: (1) the continued and incrementally more restrictive use of export quotas and export duties on a large number of raw material inputs; (2) the selective use of other border measures such as value-added tax rebates to encourage or discourage exports of particular products; (3) the setting and enforcement of unique Chinese national standards, such as an informal requirement that all new 3G mobile handsets be enabled with a unique Chinese national standard for wireless Internet access; (4) China's government procurement practices, including an array of new central, provincial and local government "Buy China" policies; (5) a new Postal Law that excludes foreign suppliers from a major segment of the domestic express delivery market; (6) impediments to the foreign supply of value-added telecommunications services and an informal ban on new entrants in China's basic telecommunications sector; and (7) continuing significant restrictions on foreign investment in China, along with continuing consideration of "national economic security" when evaluating foreign investment through mergers and acquisitions.[13]

In a subset of these areas, the United States has initiated WTO dispute settlement cases resulting in China addressing the following issues:

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[12] *Global Investments, American Returns (GIAR)* (1998 and 1999 Update), Matthew Slaughter, Published by Emergency Committee for American Trade; *U.S. Multinational Companies: Operations in* 2006, Raymond J. Mataloni, Jr., BEA (Nov. 2008); *How U.S. Multinational Companies Strengthen the U.S. Economy: Revised Update* (2010), Matthew Slaughter, Published by Business Roundtable and United States Council Foundation.

[13] U.S. Statement on Trade Policy Review of China (May 31, 2010), accessed at http://geneva.usmission.gov/2010/05/31/tpr-china/.

- In July 2004, China lifted its discriminatory tax rebate for certain semiconductors.
- In November 2008, China agreed to a Memorandum of Understanding (MOU) with the United States to settle the U.S.-led WTO action against China's restrictions on financial-information providers. As part of the MOU, China established the State Council as the independent regulator of these financial-information services (which had formerly been run by Xinhua, a competing source of financial information in competition with U.S. and other foreign headquartered firms). In 2009, China issued regulations permitting foreign financial-information providers to establish local operations in China.
- On January 1, 2009, China eliminated tax subsidies that had been raised by the United States.
- Effective September 1, 2009, China repealed provisions that had been found to violate WTO rules and negatively affect imports of auto parts.
- China eliminated export-contingent subsidies from its Famous Brands policies in 2009.

As a result of other WTO rulings, China is also required to:

- Provide foreign entities rights for the importation of copyright-intensive products, such as theatrical films, DVDs, music, books, newspapers and journals.
- Make changes to its copyright and customs laws with respect to intellectual-property protection.

The United States continues to monitor China's full implementation of these decisions as well as the full and effective implementation of China's WTO commitments through annual reviews and reports, as well as other mechanisms. The WTO monitors China's implementation of WTO commitments through its Trade Policy Review mechanism every three years.

Key Issues in the U.S.-China Economic Relationship

Despite the substantial progress and reform as China joined the world trading system and the substantial opportunities that the Chinese market provides to U.S. farmers, manufacturers, service providers and their workers, great challenges remain and much more work needs to be done by the Chinese government to open its markets to U.S. goods and services. In some cases, China's actions and policies continue to fall short of its WTO commitments; in others, China is taking actions and adopting policies that are contrary to the core principles of non-discrimination and rule of law that transcend the international trade system, although they may not be fully covered by WTO rules. Among the key issues on which ECAT and ECAT companies are focused are the following:

1. Indigenous-Innovation Policies that Restrict Market Access

China, like the United States and other major countries, has a strong interest in fostering domestic innovation to spur technology development, job creation and economic growth. Unlike the United States or other major countries, however, China is moving forward with indigenous-innovation policies that are highly discriminatory and restrictive and counterproductive to the goal of fostering an innovative, 21st-century economy. These policies represent one of the most important challenges for the United States in its economic relationship with China and need to be addressed quickly and comprehensively.

China's indigenous-innovation policies were first formally included in its national industrial policy in 2006 with the release of its *Medium and Long-Term National Plan for Science and Technology Development (2006-2020)*. Other documents from 2006 onward continue to build on this concept, through which China aims to boost the development and use of Chinese-made innovative products. Most recently, in late 2009 and early 2010, China began more fully implementing its indigenous-innovation policies in ways that will make it nearly impossible for American companies to participate in significant segments of China's market through its November 2009 *Circular 618*, its December 2009 *Catalogue of Industrial Equipment Products* and its January 2010 Draft *Implementing Regulations on the Government Procurement Law.*

The November Circular, December catalogue and January draft implementing regulations represent a major challenge to U.S. participation in China's government procurement market and beyond. The November Circular, in particular, represents an unprecedented use of domestic intellectual property as a market-access condition. Under these criteria, it will be virtually impossible for the products of American companies to be eligible for these preferences, unless the companies establish Chinese brands and transfer their research and development of new products to China. As a result, American companies will be shut out of major portions of China's government procurement market. While these rules apply to government procurements, there is also widespread concern that they will be used more broadly by other purchasers in China, representing an even more substantial barrier to U.S. access to China's market. These rules run directly counter to the repeated pledges by the Chinese government to avoid protectionism, including the joint commitment of President Hu and President Obama at their summit in November 2009 to pursue open trade and investment. Implementation of these policies is also counterproductive to China's own interest in developing a technology-based, 21st-century economy. ECAT, working with others in the business community, has raised these issues with the U.S. government and the Chinese government. On April 10, 2010, China issued *Draft Notice Regarding the Launch of the National Indigenous Innovation Product Accreditation Work for 2010*, on which it has requested public comments. ECAT welcomes the modification of several provisions, including the following:

- Relaxed somewhat intellectual-property requirements to permit indigenous-innovation accreditation for products based on IP that has been licensed for use in China from overseas.
- Eliminated requirement that trademarks and brands be first registered in China, but requires applicants to have exclusive rights to the product's trademark, or have the right to use the trademark, in China.

ECAT remains concerned, however, by several aspects of the *Draft Notice*, including its relationship to government and commercial procurements in China, the continued use of IP as part of government-procurement preferences and innovation promotion, and the vagueness and ambiguity of key provisions. ECAT urges the United States to work with the Chinese government to stop the implementation of these indigenous-innovation policies and work to develop its government procurement and other policies on innovation in a way that promotes a reciprocal, open and mutually beneficial relationship.

2. Intellectual-Property Protection and Enforcement

While China's laws on the protection of intellectual property have been improving over time, there remain major areas where the standards for protection need to be improved and substantial problems in China's enforcement of existing protections. Key issues include:

- Theft of IP by state-owned enterprises, inconsistent with JCCT commitments.
- Internet-based piracy and counterfeiting.
- Retail and wholesale trademark counterfeiting.
- Counterfeit products.
- Preferences for Chinese-created IPR.
- Inadequate standards with respect to copyrighted material.
- Inadequate protection for pharmaceutical products, including insufficient protection for clinical test data and marketing approval of infringing products.

Despite China's commitments to the U.S. government over the last four years, the level of piracy and counterfeiting remains extremely high, particularly with regard to film, music and software. Continuing and more rigorous high-level attention is required for China to make needed progress with respect to IP protection and enforcement. IPR reforms alone, however, will do little to increase market access if other barriers are not eliminated. For example, China's latest efforts to implement its indigenous-innovation policies discussed above will effectively nullify the benefits that could result from the significant reform of the IPR regime that the United States has long sought. Similarly, China's continued refusal to allow publishers to print and distribute their materials freely in China increases the likelihood of infringements and piracy by artificially raising the prices foreign-owned publishing houses must charge to recoup transportation and customs costs. And, while consistent with China's WTO obligations, the 20-cap limit on foreign films fosters piracy by preventing access by Chinese consumers to legitimate films. To be effective at changing the balance in the U.S.-China economic relationship, China's commitment to improve its IPR regime must also be accompanied by Chinese actions to increase market access and refraining from the imposition of discriminatory industrial policies that exclude or significantly restrict U.S. products from the Chinese market.

3. Government Procurement

China's 2002 Government Procurement Law establishes the basis for all government procurements and requires the use of domestic goods and services unless those products cannot be obtained in China under "reasonable commercial considerations." A number of regulations and guidance have been issued related to this basic law. As discussed above, China issued *Draft Implementing Regulations on the Government Procurement Law* on January 11, 2010. These long-awaited regulations provide additional clarity to China's existing government-procurement structure and in many respects treat foreign-invested enterprises as equal to Chinese enterprises as China committed during last year's JCCT. However, Article 9 of the draft regulations gives a preference for indigenous-innovation products, which, as discussed in depth above, represents a major restriction for government procurement. On May 21, 2010, China issued draft measures for the government procurement of domestic products to define eligible domestic products. This definition, while superficially similar to U.S. Buy American restraints, is much more restrictive and fails to include the very important interpretations of exceptions and flexibilities captured in the U.S. system. ECAT also remains concerned by China's Administrative Measures on the

Government Procurement of Imported Products. Issued by the Ministry of Finance in December 2007, these measures heavily restrict government procurement of imported foreign products and technologies. As a result of the basic law and related regulations, circulars and guidance, U.S. companies, even those that have invested in facilities in China, have limited access to China's government-procurement market.

China formally began negotiations to join the WTO GPA in December 2007, although it had agreed to start negotiations "as expeditiously as possible" when it joined the WTO in 2001. China has made an initial offer and has committed to make a revised offer by July 2010. While these negotiations are ongoing, however, China has been systematically making its government procurement rules more restrictive through indigenous innovation and other policies, contrary to the basic principles of WTO negotiations that countries not worsen their laws to improve negotiating leverage. These increases in restrictions are also contrary to the basic standstill that all G-20 countries have agreed to on several occasions since the beginning of the current economic crisis.[14]

4. <u>Industrial Policy</u>

China's continued governmental intervention in the marketplace to the advantage of domestic companies is exemplified not only by the indigenous-innovation guidance and catalogues released in late 2009 and early 2010, but also apparent in other sectors of the economy. For example, while China's May 2004 automobile-industrial policy corrected some of the major areas of discrimination found in the earlier draft policy, the final policy continues to create discriminatory preferences for domestic parts and technology. ECAT has also been concerned that China's 2006 automobile-parts regulations perpetuate prohibited local-content requirements. Those regulations were the subject of a successful WTO challenge brought by the United States. Other issues that have arisen include very problematic policies and regulatory activity over foreign mergers and acquisitions and state control of "critical" equipment manufacturers. ECAT remains concerned by the Chinese government's continued development of unique standards, particularly regarding the use of encryption technology in the IT and telecommunications sector.

More broadly, ECAT is also concerned by a growing series of localization measures that require local content, local ownership and make other restrictions limiting the participation of U.S. and other foreign enterprises in the Chinese market. In addition to the indigenous innovation policies discussed above that seek to require local research and development and local innovation, such

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[14] At the November 15, 2008, G-20 Summit, all G-20 members pledged:

> In this regard, within the next 12 months, we will refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing World Trade Organization (WTO) inconsistent measures to stimulate exports.

G-20 Declaration: Summit on Financial Markets and the World Economy (November 15, 2008), accessed at http://www.g20.org/Documents/g20_summit_declaration.pdf . This pledge has been reiterated at each of the subsequent G-20 Leaders' Summits. **See** G-20 London Summit – The Global Plan for Recovery and Reform (2 April 2009), accessed at http://www.g20.org/Documents/ final-communique.pdf; Leaders' Statement: The Pittsburgh Summit (25 September 2009), accessed at http://www.g20.org/Documents/pittsburgh_summit_leaders_statement_250909.pdf.

restrictions have been promulgated by China regarding standards and certifications of manufactured goods in the information and communications technology sector and other sectors, through government procurement restrictions and through investment restrictions and other measures such as the localization of wind energy production.

There also remain persistent and growing concerns about Chinese government favoritism towards its state-owned enterprises (SOEs) and state-related enterprises. While comprehensive and accurate data is not easily obtainable, data from China's own Statistical Yearbook shows state-owned enterprises totaling less than five percent of the total number of enterprises in China, but producing nearly 14 percent of China's gross industrial output.[15] One 2008 report found that there are some 150 large SOEs that report directly to the Chinese government, along with thousands of others that are subsidiaries of these SOEs or otherwise state-related.[16] While on overall terms, Chinese government support for SOEs has declined as the number and size of SOEs has declined, Chinese government support for some SOEs – viewed as strategically and economically important by the Chinese government – continues and is increasingly posing a challenge to market access by U.S. and foreign companies. Whether the policies are in standards, procurement (such as indigenous innovation) or other areas, certain state-led sectors of the Chinese economy are raising concerns.

5. <u>Financial-Services Liberalization</u>

Liberalizing China's financial-services sector is an important area that will help improve U.S.-China trade relations. In particular, expanding China's consumption of U.S. financial services would not only increase the surplus that U.S. financial services currently enjoy, but also help China meet many of its reform goals and foster conditions that would encourage China to re-value its currency. There has been positive reform of China's banking sector, including steps toward the elimination of the single-bank system, implementation of a viable system for commercial lending and the establishment of interbank, equity and forex markets. The issuance in November 2006 of *Regulations for the Administration of Foreign-Funded Banks* raised, however, additional issues, including inappropriate restrictions on incorporation and on the activities in which foreign banks can engage. As well, new restrictions were imposed in 2006 on foreign providers of financial news that led to U.S.-China WTO consultations that successfully addressed a number of U.S. complaints. At the first meeting of the Strategic and Economic Dialogue (S&ED) with President Obama and Chinese President Hu, China reiterated its commitment to deepen financial services reform and agreed to continue to allow foreign-invested banks incorporated in China that meet relevant prudential requirements to enjoy the same rights as domestic banks with regard to underwriting bonds in the interbank market. China still needs to do more to address delays in bank approvals, inconsistent capitalization requirements, and restrictions on Chinese-foreign joint venture banks, as well as eliminate limits on foreign banks operating electronic payment systems for single-brand RMB-denominated credit and debit cards and eliminate restrictions on foreign banks trading RMB and RMB-linked products. Securities and asset management firms also face significant restrictions, including equity limitations and trading restrictions. The Chinese government also should put in place a transparent roadmap, on an agreed-upon timetable, to

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[15] **China Statistical Yearbook (2009)**, Table 13-1 Main Indicators of Industrial Enterprises above Designated Size (2007) (using data for state-owned enterprises, state joint ownership enterprises, join state collective enterprises, state sole funded corporations), accessed at http://www.stats.gov.cn/tjsj/ndsj/2008/html/N1301e.htm .

[16] Jonathan Woetzel, "Reassessing China's State-Owned Enteprises," **McKinsey Quarterly** (July 2008).

provide foreign securities firms the ability to engage in a full range of securities activities, including the ability to participate in the derivatives market.

6. Standards and Certifications

China's rules and regulations and formation of standards also represent a significant barrier for U.S. industry. For example, China Compulsory Certification (CCC), which took effect in 2003, represents a costly, non-transparent and increasingly significant and discriminatory barrier to products being sold in the Chinese market. This barrier is made worse by China's restrictions on the accreditation of foreign testing and certification groups to perform testing and its failure to accept foreign test data. In April 2009, China released regulations requiring that 13 categories of information technology (IT) security products conform to the CCC regulations by the implementation date of May 1, 2010. As clarified at the JCCT in 2009, China indicated that the testing and certification requirements only apply for products being procured by the government. Nonetheless, there is strong concern that this system runs counter to international standards and practices. Of most concern is the requirement that highly sensitive source-code information be disclosed during the process, which could result in the improper release of trade secrets and intellectual property. ECAT supports efforts to remove the source-code requirement and conform the CCC process to internationally accepted standards on independent third-party test labs and the protection of IPR (including source code and low-level design information).

7. Investment Restrictions

China's 2007 revision to its *Catalogue Guiding Foreign Investment in Industry* further limited certain investment opportunities in several sectors. As a result, U.S. investors face major restrictions to investment in agriculture, manufacturing, and services, including soybean and other food processing, mining, textiles and apparel, wood pulp, chemicals, electronics, transportation equipment and other manufacturing, financial services, wholesale and retail distribution, telecommunications services, cinemas and video distribution, and printing. As discussed below, the negotiation of a strong U.S.-China bilateral investment treaty would help address many of these issues.

8. Other Non-Tariff Barriers on Agriculture, Manufactured Goods and Services

China continues to maintain and create burdensome, opaque and sometimes inconsistent entry, regulatory, licensing, customs, customs valuation, and other requirements that place major barriers on agricultural, goods and services trade. Barriers to entry and investment continue to be significant and impede full participation in many sectors, including publishing, financial services and others. As well, China maintains barriers to activities that undermine existing operations of companies that already have entered the Chinese market, including, for example, limiting U.S. credit agencies from providing credit ratings for domestic bond issues. While making some progress, China continues to impose non-scientific and non-commercial barriers in agricultural trade in particular, with unnecessary and unfounded phytosanitary barriers to agricultural trade, including China's ban on the importation of beef and certain poultry products, and its barriers to processed food products. ECAT welcomes China's March 2010 announcement that it will open its market to U.S. pork and pork products. China's maintenance of a quota allowing only 20 foreign films per year also represents a substantial limit on the access of U.S. entertainment products to China, despite the high demand for foreign content that cannot be satisfied under existing distribution limits. As noted above, this problem has exacerbated the widespread audio-visual piracy prevalent throughout China.

9. Transparency

While remarkable progress has been made from the opaque situation that most companies experienced 10 years ago, there remains uneven and inadequate transparency in the promulgation of governmental measures, standards, judicial proceedings and other governmental actions. Lack of full transparency undermines significantly the ability of U.S. companies seeking new or continued market opportunities in China.

Recommendations for Future U.S.-China Economic Relations

To promote U.S. economic growth and broader national interests, it is vital that the United States work to maximize the economic opportunities that U.S.-China relations present and address effectively the economic challenges that China poses. To do so, it is most important for the United States to adopt and implement a comprehensive, coordinated and multifaceted approach to improving the U.S.-China economic relationship, including through:

- Employing all of the WTO mechanisms available, including the Doha Development Agenda negotiations, the WTO Trade Policy Review Mechanism, WTO committee meetings, and the dispute-settlement system to promote China's compliance with WTO rules and its full participation in the global trading system. As one of the leading trading nations, China too must be a responsible and leading participant of the WTO.
- Working in a sustained and coordinated fashion through the Strategic and Economic Dialogue, the Joint Commission on Commerce and Trade, and other dialogues to focus on addressing priority and systemic issues in the U.S.-China economic relationship from intellectual property to market access.
- Building a stronger U.S.-China economic relationship through clearer, deeper and more far-reaching commitments where possible, including through a U.S.-China Bilateral Investment Treaty (BIT).
- Expanding the U.S. presence and participation in Asia through stronger economic ties, such as the Korea-U.S. Free Trade Agreement and the negotiation of a Trans-Pacific Partnership agreement.

This approach must be comprehensive and sustained, rather than the one-off type of effort that has too often characterized U.S.-China economic relations and has led to the United States negotiating and renegotiating virtually the same commitments over and over again. The U.S. approach must use all effective avenues within and outside the WTO to build off of each other. At the same time, it is important to recognize that there are also proposals that will be counterproductive to growing U.S. economic opportunities in its relations with China and those proposals should be rejected.

1. Recommendations for U.S.-China Relations within the WTO

Promoting more beneficial relations between the United States and China can take several forms within the context of the WTO, including promoting stronger market-opening commitments by China and enforcing existing commitments.

- Promoting Greater Responsibility by China within the WTO. Given China's role in the international economy as one of the largest trading nations and one of the major beneficiaries of strong WTO rules promoting non-discriminatory market access, China should be playing a leading role within the WTO to advance its goals, including in moving the Doha negotiations towards an ambitious, market-opening outcome. Unfortunately, China is simply not playing that role. In the Doha talks, China has often played the role of a "developing" economy, and shied away from agreeing to, let alone championing, more ambitious market opening for itself or others. With China's growth, comes responsibility and U.S. policymakers should work with China to help it grow into that role in a manner that fosters a strong international system of rules.

- Promoting Stronger WTO Commitments. While China made relatively strong commitments in its accession to the WTO in 2001, more and deeper commitments by China are important to secure increased market access and U.S. participation in China's market. At the present time, there are two major ways that China can expand and strengthen its WTO commitments: (1) the Doha Development Agenda (Doha) negotiations; and (2) accession to the WTO Government Procurement Agreement (GPA). As noted above, China is simply not playing the type of leadership role in the Doha negotiations that it should given its size in the international economy and the benefits it has received from such participation. Similarly, China should be moving forward expeditiously to accede to the GPA to promote transparent, non-discriminatory and cost-effective government procurement. At the most recent Strategic and Economic Dialogue (S&ED), China agreed to submit a new GPA offer by July 2010. New, expanded and deeper commitments on market access and government procurement will go a long way to address many of the barriers that impede more fulsome U.S. participation in the Chinese market. While these negotiations are ongoing, China should observe a standstill and not increase barriers to government procurements as a way to increase its leverage in these negotiations.

- Enforcing Current WTO Commitments. Also important is the enforcement of China's current WTO commitments, which the U.S. government has taken seriously since China first entered the WTO in 2001. The United States has worked through annual reviews and reports, WTO committees, consultations and formal dispute settlement to address a myriad of issues, as China implemented its WTO commitments across all sectors of the economy. As a result of this work, China has made enormous strides towards opening its economy, which has resulted in greatly increased U.S. exports to China since its entry into the WTO. Among the most public actions are the eight cases that the United States has initiated with respect to China (more cases than brought by any other country with respect to China's actions). In particular, WTO dispute settlement or the announced intention to pursue WTO dispute settlement has resulted in:

  - China's elimination of discriminatory tax policies on semiconductors.

- China's rescinding of its improper imposition of antidumping dumping duties on U.S. kraft-liner board imports.
- China's authorization for foreign financial-information suppliers to establish local operations in China.
- China's repeal of discriminatory rules regarding imported automobile parts.
- China's eliminating export-contingent subsidies for famous brands and other items.
- China being required to provide foreign entities rights for the importation and distribution of copyright-intensive products, such as theatrical films, DVDs, music, books, newspapers and journals.
- China being required to make improvements in its copyright and customs laws.

As discussed above, however, China continues and in some cases has increased the use of industrial policy measures and favoritism to its SOEs and other domestic strategic industries in ways that restrict U.S. and other foreign access to China's markets. These measures, some of which may not be directly contrary to the precise commitments that China has made, do however impair U.S. participation in China's market in ways never envisioned when China joined the WTO. Moving forward, therefore, the United States should continue to make enforcement of China's WTO commitments a top priority, but also examine more holistically the extent to which market access is actually being achieved in those areas where China has committed to open its market. Where appropriate, ECAT supports the use of the WTO's dispute-settlement mechanism to ensure China's full compliance with its commitments.

- Avoiding Counterproductive Responses. When China joined the WTO, the United States also undertook its own commitment to treat China in accordance with U.S. WTO commitments. Over the past nine years, numerous pieces of legislation relating to trade with China have been proposed that are widely viewed as being contrary to U.S. WTO commitments. The enactment of such legislation is counterproductive to promoting greater respect within China for its full implementation of its own WTO commitments. The more the United States moves away from respecting the rules it helped established, the harder it will be to convince China to play by those rules. Enactment of such legislation will increasingly bring WTO challenges – already China has brought five cases against the United States – and sanctions where the WTO dispute settlement system finds the United States out of compliance, thereby, reducing U.S. market access in China, rather than increasing it. Among the types of legislation on which ECAT has expressed strong concerns on this point include legislation to:

  - Block entry of certain products, such as poultry, from China.
  - Impose countervailing duties on imports from China without accounting for double counting or by creating a presumption to use out-of-country subsidy benchmarks.
  - Impose additional antidumping or other tariffs on imports from China to account for misalignments in its currency.

  ECAT recommends that the United States forgo the use of WTO-inconsistent measures as a way to pressure China to refrain taking WTO-inconsistent action.

2. Recommendations for U.S.-China Relations beyond the WTO

While seeking the expansion of China's WTO commitments and China's enforcement of its commitments is vital to promoting U.S. economic interests in China, the WTO framework cannot address at this juncture all of the barriers and challenges within the China market. Other mechanisms, frameworks and commitments are also important to pursue in coordination with WTO-related policies to promote U.S. economic interests in China. Among the key mechanisms that ECAT supports are:

- U.S.-China bilateral investment treaty (BIT) negotiations that have the ability to address key barriers in China's market. U.S. investment overseas is a magnet for U.S. exports and helps generate and support American jobs and investment in U.S. research and development.
- Continued U.S. engagement in the Joint Commission on Commerce and Trade to promote the resolution of ongoing trade issues and in the S&ED to promote resolution of longer-term and broader issues.
- Continued U.S. engagement in multilateral mechanisms where countries are seeking common objectives, such as the work of the G-20 to promote global economic recovery.
- High-level and focused efforts to address key issues, such as China's indigenous-innovation policies and continued failure to enforce effectively intellectual property rights. Where possible, the United States should work with others in the international community to help promote the strong rules that reflect the principles of openness, non-discrimination and IP protection that permeate the international trading system.

3. Recommendations for U.S.-Asian Relations

Any comprehensive and effective policy to improve the U.S. economic opportunities vis-à-vis China must also include coordinated policies and actions to expand the U.S. commercial and economic presence in Asia and the Asia Pacific. U.S. trade and investment with Asia and Asia Pacific have expanded significantly over the last decade. Nevertheless, U.S. exports represent a declining portion of the Asia-Pacific's imports, as other countries, particularly China, have pursued a much more aggressive policy of participating in those markets and entering into new arrangements with our Asian and Asia-Pacific trading partners.[17] The Asia and Asia-Pacific region is one of the most dynamic in the world in terms of economic and population growth. It is also marked by the recent proliferation of preferential trade agreements that do not include the United States, such as the China-ASEAN Free Trade Area and the China-New Zealand free trade agreement. These and other agreements reflect a deepening of commercial ties amongst these partners, which leaves the United States at a competitive disadvantage in these vital growth markets. If the United States is to remain competitive in one of the fastest growing regions of the world, the United States must pursue much more active economic engagement. This must include at a minimum:

- Congressional implementation and entry into force of the Korea-U.S. Free Trade Agreement. With the EU-Korea agreement expected to enter into force later this year, the

[17]Total U.S. goods trade with APEC members equaled $1.6 trillion in 2009, reflecting a decrease of over $430 billion as a result of the global economic downturn. As a share of total U.S. trade, U.S. goods trade with APEC accounted for 52.2 percent in 2009, declining from 61.5 percent in 2008. In 2009, U.S. goods exports to APEC countries totaled $618 billion and U.S. goods imports from APEC countries equaled $994 billion. U.S. services exports with APEC members totaled over $180 billion in 2008. **Sources:** U.S. Department of Commerce, Trade Stats Express (tse.export.gov); Bureau of Economic Analysis, Trade in Services, accessed at http://www.bea.gov/international/international_services.htm.

United States will lose major opportunities if it does not move quickly to approve and implement this agreement.

- The negotiation of a high-standard and comprehensive Trans-Pacific Partnership (TPP) agreement by the time that the United States hosts the APEC Leaders Meeting in November 2011. Currently, the United States is joined in the TPP negotiations by Australia, Brunei, Chile, New Zealand, Peru, Singapore and Vietnam, but other countries are looking at joining the negotiations or the eventual agreement. A strong and commercially meaningful TPP that expands U.S. economic opportunities throughout the Asia Pacific is an important mechanism to expand U.S. participation in this important region for the benefits of U.S. farmers, manufacturers, service providers and their workers.
- Continued work in the Asia Pacific Economic Cooperation Forum (APEC) to promote greater trade and investment liberalization among all APEC countries, ultimately through a Free Trade Area of the Asia Pacific.

Conclusion

As stated in the recent Treasury Department Factsheet on the conclusion of the second meeting of the S&ED:

> As the world's third largest and fastest growing major economy, China presents enormous opportunities for U.S. workers and firms, but also considerable challenges.[18]

In formulating U.S. economic policy towards China in a manner that will promote economic opportunity for American enterprises and promote and sustain American jobs and innovation, the United States must continue to work to expand new economic opportunities in China and address the major challenges that China poses – most importantly those that limit market access for U.S. goods and services in the Chinese market or undermine U.S. innovation or intellectual property.

Thank you.

[18] U.S. Department of the Treasury Factsheet from the Second Meeting of the Strategic and Economic Dialogue (May 25, 2010)