THE US-CHINA BUSINESS COUNCIL
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US-China Trade Policy: Issues and Solutions

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The US-China Business Council (USCBC) is the leading organization that represents American companies doing business in China. Our membership consists of more than 220 companies in manufacturing, services, agriculture, and resource industries. USCBC has a long history of working with the US government to eliminate market access barriers in China so that American businesses and workers can prosper from that country's tremendous economic growth. To this end, we look forward to working with the 112th Congress and continuing to coordinate with the Obama administration to address trade and investment barriers in the world's second-largest economy.

China is a cornerstone for US exporters. It is the only major US export market over the past decade to have provided the 15 percent annual growth rate needed to meet the Obama administration's goal of doubling US exports by 2014. At roughly $70 billion, China was our third-largest export market for goods in 2009. As of November 2010, US exports have already surpassed this number and are on pace to reach $90 billion when full-year data is released. If this occurs, then US exports to China will have increased more than 450 percent since 2000, the last full year before China joined the World Trade Organization (WTO). If US exports to Hong Kong—a major through-point for US goods destined for China—are added, the 2010 export figure already surpassed $100 billion for the first time, without December data.

That's not the end of the story, however. US companies also profit from China's growing domestic market through their investments. Sales in China of products made there by US majority-owned affiliates totaled $87 billion in 2008, the latest year for which these statistics are available. Local product sales between 2000 and 2008 increased 431 percent. These sales are vital to US companies' operations here at home. The reality of the global marketplace is that we cannot make everything in the United States and be competitive in far away markets such as China because of lead times, transportation costs, and the need for many businesses to be closer to their customers. More than 90 percent of sales by US majority-owned companies operating in China over the last decade were to China or other foreign markets, with a mere 8 percent being exported back to the United States.

The services story is also one of strength, albeit one that needs to get stronger. Services exports to China hit $15.3 billion in 2009. China was our seventh-largest export market for services that year. Local services sales reached $11.6 billion in 2008.

Add it all up, eliminate overlaps, and China is probably well over a $150 billion market for US companies. It is a meaningful market for US companies and for American jobs. The commercial relationship with China has many problems, but the reality of these numbers tells us why getting this relationship right is critical to US interests.

Top Challenges for US Companies in China

Though it has resulted in economic benefits, the US-China trading relationship is not without challenges. Underlying these challenges is a debate within PRC policy circles over foreign involvement in the Chinese economy. While many policymakers there embrace the benefits of market liberalization, others feel that foreign businesses play too large a role and unfairly stunt the development of domestic industry. The result is a cautiously liberalizing economy that is too often defined by protectionist tendencies.

One manifestation of those protectionist trends can be seen in China's policies to support "pillar" industries and build national champions. In USCBC's most recent annual membership survey, respondents described various areas in which China favors domestic competitors, such as in standards setting, government procurement, administrative and business licensing, and enforcement of laws and regulations. Chinese economic policies and practices that run counter to US interests have also appeared in China's innovation policies, intellectual property rights (IPR) protection, investment restrictions, and market access barriers.

On all these fronts, the Obama administration complements the efforts of US industry. The administration's general policy of addressing issues through bilateral and multilateral dialogue and defending US rights when good-faith negotiation fails has proven to be the right strategy when dealing with issues American companies face in China.

Indigenous innovation

A good example of how real progress can be made on critical issues for US industry is last year's advocacy effort on China's indigenous innovation policies. China, like all countries, is interested in fostering innovation to drive economic growth. To achieve that goal, China launched in 2006 its "indigenous innovation" program, which has subsequently appeared in a range of PRC policies and regulations, including those related to IPR, standards, taxation, and government procurement.

In late 2009 and early 2010, China released several key rules to create lists of favored innovative products that would receive preferences in government procurement. This approach runs counter to international best practices, creates market access barriers for US companies, and would ironically undermine true innovation, rather than enhance it. Once on a product list with market protections, a company may have less motivation to continue to innovate since it is guaranteed sales with no further improvements to its products. Managing numerous product lists at the central and local levels is cumbersome, and such periodic lists are quickly outdated as new, innovative products are developed. The only certain outcome from a product list is discriminatory treatment in the marketplace and substandard technologies. The answer is to do away with product lists and procurement preferences, a firm advocacy point of the US government and the private sector during the past year. In place of product lists, we have encouraged China to follow international best practices for innovation incentives and use non-discriminatory tax, research and development support, and other programs to reach its innovation goals.

The Obama administration efforts, combined with industry's work on the issue, bore fruit during PRC President Hu Jintao's recent visit with China's commitment to delink its innovation policies from its government procurement preferences. Though the value of this commitment will lie in its implementation, the administration's efforts in coordination with industry have provided a platform from which to press China to evolve its innovation policies in a nondiscriminatory way.

Intellectual property rights

China's IPR situation remains a key concern for US companies. China's poor record of IPR protection influences what products foreign companies are able to research, manufacture, and sell in China's market, and counterfeit products made in China often confront US companies in other markets as well. Two-thirds of respondents in USCBC's 2010 survey of China's business environment said that China's inadequate IPR protection impacts their business in some way. In addition, IPR is a component of many other high-profile issues, from the threat of compulsory licensing under the PRC Antimonopoly Law to incorporation of patents into standards.

We should keep in mind, however, that some areas of China's IPR regime—both the legal framework and some areas of enforcement—have improved over the years. The severity and nature of the problems vary considerably depending on the industry and the type of IPR involved. The solutions and approaches that the US government takes must be crafted to tackle these multiple challenges. For companies in certain sectors, such as movies and software, piracy of copyrighted material is without doubt their top problem in China and needs to be addressed. For other companies, China's courts are becoming a more reliable channel for resolving IPR cases.

The Obama administration has given great attention to IPR in its dealings with China. Yet one priority policy action to pursue is the adoption of tougher deterrents in China, such as allowing criminal sanctions to be applied in cases of commercial scale. Counterfeit goods hurt consumers, in China and the United States, by exposing them to substandard and potentially harmful goods. Counterfeits also harm businesses through loss of sales and undermine consumer confidence. An effective deterrent can help to address those problems.

Standards and conformity assessment

Another top area of concern for USCBC companies is China's developing standards system. Though China has made progress in some areas, foreign companies remain concerned about several trends, including barriers to participate in standards-setting activities and the development of China-specific standards and technical policies that effectively block market access for US companies.

China also requires that most products sold in China be tested for compliance by a Chinese certification body, rather than by an internationally accredited third-party certifier or through self-certification, as is common in other countries. This denies market access for US testing and certification service companies and increases the time and cost burden for businesses producing a variety of goods covered under China's conformity assessment regimes.

The Office of the US Trade Representative (USTR) has rightfully focused attention on this issue by creating an annual report for technical barriers to trade. The administration should continue to coordinate with industry to address issues involving standards-setting and conformity assessement in China.

Investment restrictions

As explained in the introduction to this testimony, investments in China are important for many American companies and complement operations here in the United States. But the opportunities for foreign investment in China are uneven across industries. In many sectors, China allows foreign companies to establish wholly foreign-owned enterprises (WFOEs); in fact, 75–80 percent of US investment going into China is in 100-percent American-owned facilities, not joint ventures. In other key sectors, however, foreign companies are limited to minority ownership or face other restrictions. Agriculture, automobile, chemical, express delivery, insurance, securities, and telecom companies all face these limits, for example. China's Catalogue Guiding Foreign Investment in Industry, last revised in 2007, lays out categories where foreign investment is encouraged, restricted, or prohibited in sectors across the economy. China is in the process of revising the catalogue, and USCBC submitted recommendations to key agencies of the PRC government that most restricted or prohibited sectors be further opened to foreign investment. A top US government priority in 2011 should be to ensure that China releases a draft of the proposed revisions to the catalogue for public comment prior to finalization and implementation.

In addition to selectively restricting areas for foreign investment, China factors in "national economic security" during reviews of mergers and acquisitions that involve foreign companies. China's Antimonopoly Law also has provisions that could be used to promote domestic companies at the expense of foreign enterprises.

We should keep in mind that China is also encouraging its domestic companies to invest in the United States and other overseas destinations. Any US governor or mayor will affirm the value of foreign direct investment in creating jobs and economic growth: US states and cities continually organize delegations to China to attract investment to their local economies. We should ensure that China's central and local government officials and company executives understand the mutual interest in maintaining open and fair investment and trading regimes; treatment of foreign companies in China will influence treatment of Chinese companies here.

To solidify this mutual interest, the Obama administration should coordinate with Congress to move forward with negotiations on a meaningful bilateral investment treaty (BIT) with China--one that includes strong national treatment provisions, applies to new and existing investments ("pre-establishment"), and applies to all investments except those specifically excluded in the agreement ("negative list" approach). The Chinese have expressed interest in negotiating a BIT, and doing so provides one of the best opportunities to further open markets for US companies and improve protection for American investments in China.

Market access barriers
Despite the unquestionable growth in US exports to and local sales in China, numerous restrictions remain that limit the products and services foreign companies can provide to the Chinese market. USCBC details our members' top concerns each year in our submissions to the US government in advance of the meetings of the Joint Commission on Commerce and Trade (JCCT) and in our testimony for the administration's annual review of China's WTO compliance record. Some barriers are technical and include China-specific product standards that limit the types of goods that can be sold in China. In other instances, foreign companies cannot receive the necessary licenses to provide their goods or services. Many of these barriers are individual trade issues that the administration continues to pursue under JCCT working groups and other forums.

Foreign companies are particularly restricted in China's services sector. Notably, however, increasing the participation of foreign companies in this sector would benefit China's economy and help it meet its goals of creating employment, promoting domestic consumption, and improving the efficiency of its markets. For example, allowing greater foreign access to China's logistics and legal services industries would have a multiplier effect for businesses across the board by creating a more efficient commercial environment in China. Closer alignment with international standards—and increased market access for foreign conformity assessment bodies—would increase the quantity and quality of product testing and certification and better integrate China into the world economy. Insurance industry reforms and openings would help promote domestic consumption by improving the safety net for Chinese households. Though US officials have raised restrictions in this sector within certain JCCT working groups, both meetings of the JCCT under the Obama administration have resulted in minimal progress for services companies. With services accounting for more than three-quarters of the US economy and about one-third of total US exports, this an area where meaningful progress will greatly benefit American businesses and workers.

One services industry that does not receive sufficient attention is the financial sector. Capital markets play a central role in economic development and further openings will help China achieve its goals of building a more services-based, consumer-driven economy. Though the recent financial market problems in the United States and resulting economic downturn have impacted China's views of financial reforms, we need to resume our advocacy efforts with China on continuing financial reforms, which will ultimately assist in addressing issues such as global imbalances, exchange rate policy, and increasing China's domestic demand.

Government procurement
As noted previously, access to China's government procurement market is a top issue for US companies. USCBC members are particularly concerned about procurement policies and trends that seem designed to promote China's own "national champions" with protected market positions and preferential treatment. Adding another layer to government procurement discrimination in China are "buy local" policies issued by several provincial- and municipal-level governments. There are two developments worth noting that deserve priority advocacy attention.

First, China agreed during President Hu's January visit to submit a revised offer this year to join the WTO Government Procurement Agreement (GPA). In that commitment, China agreed to include purchases by sub-central entities. GPA entry would help US companies gain better access to China's government procurement market, if China's offer is a meaningful one. To be meaningful, the offer should include a more comprehensive list of government entities covered, procurement thresholds closer to international norms, and a timelier implementation schedule than in China's previous offers. It is important to note that although the GPA's principle of national treatment may help address some issues related to procurement, China's indigenous innovation policies are larger than the limited scope of the GPA. Nevertheless, we encourage the administration to continue working with China and other signatories to pursue robust GPA accession commitments from China.

Second, the PRC government is revising its procurement rules in ways that will affect market access for US companies operating in China. The government is considering new draft rules on domestic content requirements and draft regulations that affect the treatment of foreign-invested companies as domestic enterprises. The Obama administration must continue to press China to move toward a nondiscriminatory government procurement regime.

Administrative licensing

Foreign companies in China must often jump a wide variety of bureaucratic hurdles to establish and operate their businesses. Companies report that managing the licensing process in China requires an inordinate amount of their time and resources. These challenges include, but are not limited to, approvals for new or modified products, office licenses and renewals, approvals for different aspects of projects or investments, and licensing for various business administrative functions. Inconsistencies across different agencies, levels of government, and regions create uncertainties that undermine business planning. Often the licensing requirements for foreign entities differ from those for Chinese companies, raising questions about China's commitment to its national treatment obligations.

USCBC's analysis has found that China's campaign for more transparent and efficient government in recent years has yielded some improvements, but there remain many agencies, levels, and regions of government where opacity, inefficiency, and inequity continue. Licensing issues are diverse and vary across industries. The Obama administration pursues these issues on an individual basis through various JCCT working groups. But the process may benefit from more macro-level discussions that analyze the matter in a cross-cutting manner to look for ways to address the overarching issue of how PRC ministries and agencies at all levels manage the issuance and review of administrative licenses.

Transparency

Transparency covers the full extent of a country's rulemaking system, including the solicitation of public feedback during the creation of new laws and regulations, government decision making, and the availability of information on costs and markets. The matter impacts a host of issues that affect companies' daily operations, such as administrative licensing, IPR protection, standards setting, and investment policy. A lack of transparency also exacerbates perceptions of discrimination against foreign companies.

USCBC welcomes efforts by the PRC State Council to improve transparency in PRC government rulemaking, but much work remains. Though the National People's Congress has fully complied with commitments to post new laws for a 30-day public comment period, PRC ministries and agencies under the State Council have a much poorer record. The administration brings focused attention to this issue each year through the US-China Transparency Dialogue, led by the Department of Commerce's Office of the General Counsel. As this issue affects multiple areas important to US companies, US officials must continue to press China to improve government transparency.

Currency—Not a Top Issue for Most US Companies

USCBC supports an exchange rate that better responds to China's global trade flows, and reforming PRC monetary policy is in China's own economic interest. But China's exchange rate has never ranked as a top issue for USCBC members in our annual membership survey and is probably not the significant factor in the US trade deficit that some make it out to be. For example, the renminbi (RMB) appreciated nearly 20 percent between 2005 and 2008 as a result of steady engagement and negotiation. During this period, the US trade deficit with China continued to grow. Clearly other factors drive our bilateral trade deficit with China, as USCBC's analysis has shown. Our report on this topic can be found at http://www.uschina.org/public/documents/2010/currency_trade_deficit.pdf. Focusing on the exchange rate to solve the US trade deficit is the wrong approach.

Some US policy makers think that the United States should enact legislation that imposes tariffs on imports from China to offset currency undervaluation. The application of duties on this basis is of questionable WTO legality and would focus the world's attention on US trade remedy policies and away from China's exchange rate policies. It would also require the Department of Commerce to estimate the "true" exchange rate—a process that will be highly subjective and potentially politicized.

The Obama administration had it exactly right last year when it said it would pursue a multilateral approach to exchange rate issues. China is not the only country with monetary policies that concern other trading partners. Global exchange rate imbalances require a multilateral discussion and solution. US officials should continue to complement G-20 dialogue on this matter with bilateral discussions under the Strategic and Economic Dialogue and in meetings with other concerned trading partners. But tariff legislation will do more harm than good for the American economy.

Recommendations for Action

Listing the problems is one thing; effectively addressing them is another. Often achieving policy results in China is difficult, frustrating, and time consuming. As we consider ways to improve on that record, however, we should be mindful that unilateral actions that might help one group of Americans frequently threaten to adversely affect another group of Americans. Picking winners and losers among ourselves to address problems with China seems counterproductive and usually results in divisive policy options.

USCBC, with its 38 years of experience, believes that the best course of action for our country's overall approach to China consists of a stepped-up advocacy effort involving the US government, the private sector, and a multilateral approach, and the continued use of effective, WTO-consistent trade remedies when good faith negotiations fail.

More effective advocacy

If there were a single agency or official that controlled China's economic policies, it would be easy to structure and target our advocacy efforts. Unfortunately, the bureaucratic owners of these policies are many and diffuse throughout the PRC government. We therefore need to pursue consistent, sustained bilateral dialogue and expand it to include the range of senior officials and agencies that devise and impact trade and industrial policies. The Obama administration increasingly uses this approach and should be encouraged in this process.

The simple fact is that the breadth and depth of the relationship has outgrown the bilateral negotiating and dialogue structure of the past two decades, and the Obama administration is correctly pursuing a path of revamping and expanding the structure to better fit today's reality.

As this structure develops, however, several other features are needed to improve the prospects for success:

- Consistent and supportive engagement at the two highest levels of the PRC government—president and premier—on the need for a level playing field and China moving ahead with further economic reforms and openings. It is important that messaging on these broad concepts is done at the levels above the bureaucratic silos. USCBC was pleased with the attention that President Obama devoted to the economic and commercial issues in advance of and during President Hu's recent visit.
- Close US interagency coordination of each of the dialogues to ensure consistent, sustained engagement and negotiation throughout the year. This may require a more active White House role.
- Private sector advocacy directly to the PRC government. USCBC will continue to press for policy changes that will level the playing field for US companies.
- Multilateral consistency on the issues. US companies are not alone in facing market access barriers in China, and the US government should not be alone in seeking to have those barriers eliminated. Coordinating messaging with other governments can work, as we have seen with some of the modifications that China has made to its indigenous innovation rules. We should build upon that model.
- Finally, US leadership on investment and trade openness. We must not pursue protectionist policies or actions that will undermine our credibility and give China an excuse to continue on their own protectionist path.

Legally sound remedies

When good-faith dialogue fails to resolve issues, USCBC supports using legally sound trade remedies and dispute settlement mechanisms to address concerns. US companies have the right to seek assistance by petitioning the Department of Commerce to apply antidumping (AD) and countervailing duties (CVD) to products they suspect are unfairly supported by PRC government policies. These WTO-legal remedies are intended to provide a fair opportunity for both sides to argue over objectively established criteria. China complains about AD and CVD duties, but

USCBC believes these actions are consistent with a rules-based trading system, if duplicative penalties are avoided.

To that end, we should keep in mind that US antidumping rules for nonmarket economies, which are employed in cases involving goods from China, calculate the normal value of a product. They are not based on any undervalued Chinese costs or prices, but on the value of the costs and prices of that product as if it were produced in a comparable market economy. That comparison between the normal value and the actual delivered US price from the nonmarket economy (which includes any benefit from an undervalued currency) produces the AD margin. As a consequence, US law does not need to change to address concerns about China's exchange rate—the law already provides such a remedy.

The WTO's dispute-settlement process is another tool for the US government and US companies to use when good-faith bilateral negotiations fail. USTR has taken eleven cases to the WTO against China and has won three; four others were resolved by China before WTO action was required; and four are still pending. USCBC has consistently supported WTO cases when well-defined, winnable, and supported by industry and will continue to do so in the future.

Congressional support

The administration is not the sole driver of US-China trade policy. Congress has an important role to play and can help achieve meaningful results in several ways.

First, Congress should increase resources for US trade agencies. To better enforce our trade rights, Congress should increase funding to USTR and other trade agencies so that they can effectively pursue American rights through bilateral engagement and under the WTO. The tremendous growth in China's economy and in the size of our commercial relationship has not been matched by the capacity and expertise needed.

To help US companies better access the opportunities of China's market—particularly for small and medium-sized companies—Congress should also increase funding to the US Foreign Commercial Service so that it can expand its support presence in China. Such a proposal was put forth in the US-China Market Engagement and Export Promotion Act (HR2310), introduced in the last Congress by Representative Rick Larsen and now Senator Mark Kirk. Though our nation is looking for ways to tighten its belt, improving the capacity of our government to promote and protect American businesses and workers in China will yield great returns.

Second, Congress, the administration, and the private sector should better coordinate to reinforce our shared goals on improved market access and leveling the playing field. It is vital that China hear from all three constituencies—the administration, Congress, and the private sector—on the importance of these issues. American companies are on the front lines of dealing with the policies I have mentioned today. Better coordination between the US public and private sectors on these issues will help create a more comprehensive yet focused approach to the US-China commercial relationship.

Finally, members of Congress should also directly engage with PRC government officials and their counterparts in the National People's Congress to raise these concerns. Congressional delegations that travel to China often meet with high-ranking members of the PRC government. These meetings are an important addition to engagement from the administration and private sector. Holding them will help ensure China has a more comprehensive understanding of our nation's views and concerns.

Conclusion

USCBC companies are committed to the Chinese market but have serious concerns about the policy trends there that favor domestic companies. Our members want solutions to these specific problems, however, not sanctions that would disrupt the relationship.

Addressing the issues directly is the best way to support American businesses and workers. Unfortunately, there is no silver bullet or magic wand that will solve many of these problems easily. Resolution of these issues requires a strong overall message to China's top leadership from the administration, Congress, and business leaders and sustained and expanded engagement across the board on the various specific issues we face.

Our bilateral commercial relationship with China plays an important role in the recovery and future growth of the US economy, and it will be difficult to meet President Obama's goal of doubling US exports by 2014 without it. The administration's approach toward China has begun to show signs of progress, though it will be ultimately measured by how China adheres to its commitments. We must build upon that foundation with China by expanding trade dialogues, promoting US products and services, negotiating a meaningful BIT and GPA accession, and resisting calls for protectionism within our own country that undermine the credibility of our efforts. As challenging as it may be, this relationship is worth the effort.