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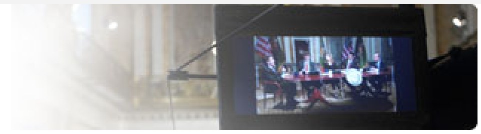

Treasury Secretary Timothy F. Geithner Testimony before the Senate Finance Committee

6/10/2010

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Chairman Baucus, Ranking Member Grassley, Members of the Committee, thank you for the opportunity to testify about China.

I want to talk today about the opportunities, and challenges, in this important relationship.

Our policy is to expand the opportunities provided to Americans from a growing China. We want future growth in China to result in more exports from the United States and more jobs in the United States. We want China to change those policies that disadvantage American companies and to provide greater protections for American intellectual property. We want China to provide a level playing field for the products of American workers and investments by American companies. And we want China to change its growth strategy to rely less on exports and more on consumption.

The President is committed to these objectives. We are seeing some progress, but we still face many challenges.

China is fast on its way to becoming the world's second largest economy and could potentially become the largest foreign market for U.S. exports of goods and services. China is consuming and importing more – including from the United States. As a result, China's overall trade surplus has fallen sharply, by roughly half as a share of its economy, over the last two years. A substantial part of this change is the result of China's strong stimulus policies and broader policy actions to strengthen domestic sources of growth.

As we emerge from the global financial crisis, U.S. exports to China have rebounded much more rapidly than overall U.S. exports, and are now running 20 percent above their pre-crisis levels. U.S. exports to China are growing much more rapidly than exports to the rest of the world. China is already the third largest destination for U.S. merchandise exports, up from 11 th place in 2000.

In fact, in the first quarter of 2010, U.S. goods exports to China rose almost 50 percent compared to the same period the year before, while U.S. exports to the rest of the world have risen by less than 20 percent. During this period, we have seen double digit growth in a variety of export sectors, ranging from high-end manufactured goods and chemical products to agricultural goods like soybeans.

China is an important market not only for large U.S. firms, but also for small- and medium-sized enterprises (SMEs). The latest data show that small businesses directly account for roughly a third of the value of U.S. exports to China and they contribute a substantial part of the value of exports by our large companies as well.

This is good for American business and good for American jobs. China is a key source of export-based jobs around the country, from Washington and Oregon on the Pacific coast, to Texas and Louisiana on the Gulf, to New York and Pennsylvania on the East coast. And the potential is there for much more growth going forward.

The broad strength in U.S. exports to China and the world is one reason why we are seeing strong growth in manufacturing. The manufacturing sector has expanded now for ten consecutive months. In April, manufacturing employment growth was faster than in any month since August 1998. Manufacturing employment has increased by 126,000 jobs this year.

Over time, U.S. imports from China have increased very rapidly, but much of this growth is the result of China replacing other foreign producers. China's exports to the United States have gradually replaced those of other countries, particularly in Asia. At the same time, a substantial share of the value added in the products we import from China comes from components manufactured in other countries in Asia.

China has to be a key part of any strategy to increase U.S. exports and jobs. Our strategy to improve the balance of benefits for Americans in this relationship focuses on change in three important areas: trade and investment policies, including China's policies to favor domestic producers and domestic technology; economic reforms to reduce China's reliance on exports and encourage more import growth; and exchange rate reform.

Promoting a Level Playing Field

One of the most important objectives of the S&ED and our broader engagement is to expand economic opportunities for American workers and firms through trade and investment with China. That is why we have urged China to take action to provide a more level playing field for American firms that export to China, that operate in China, and that compete with Chinese producers in our markets and around the world. We have asked China to make meaningful market access contributions in the WTO Doha Round negotiations that will result in new trade flows for U.S. manufacturers, farmers, ranchers, and service suppliers. We are working to improve protections for U.S. intellectual property and to reduce piracy affecting the U.S. software and entertainment industries. At every opportunity, the Administration will continue to push these important trade issues in various forums, including the Joint Commission on Commerce and Trade (JCCT).

It is especially important to the United States that the large number of policies China has put in place to promote what it calls "indigenous innovation" – including government procurement preferences, enforcement of intellectual property rights, design of product standards, and proposed new preferences and other forms of government support for specific products designated by the Chinese government – do not disadvantage American workers, firms, and technology. American firms operating in China should have the same rights enjoyed by Chinese companies, just as Chinese firms have in the United States. This is a simple principle of fairness.

In response to some of our concerns, China has acted to modify its policies to promote innovation and technological advancement. China published a draft measure proposing revisions to some of the troubling elements of its product accreditation system, and we will continue to work with China to address our concerns. At our strong urging, China has also pledged that its innovation policies would be consistent with the principles of non-discrimination, market competition, open trade and investment, strong enforcement of intellectual property rights, and leaving the terms of technology transfer, production processes, and other proprietary information to agreement between individual enterprises. Sharing the concerns of U.S. companies about China's innovation policies, we secured agreement from the Chinese to establish a high level process over the coming weeks and months, led by my colleagues Ambassador Kirk, Secretary Locke, and Science and Technology Director Holdren, to find ways to address the unresolved issues, and to take into account the results of these discussions in formulating and implementing their innovation measures. While we still have more work ahead, we now have agreed to a broad set of common principles and a framework on which to move forward and resolve our differences.

The best way to limit China's use of government procurement preferences to promote its industrial policies is having China join the rules-based WTO Agreement on Government Procurement. China has now committed to submit a revised offer by July 2010, and just before the S&ED, it issued for public comment draft regulations on the determination of "domestic products" under its government procurement law containing a 50 percent local content provision.

China has also committed to revising its investment catalog and to encourage and expand areas that are open to foreign investment, including certain services, high-technology goods, high-end manufacturing, and energy saving products. Finally, China also agreed to facilitate foreign investment by narrowing the scope of its investment review and approval processes.

The Administration will apply forcefully the full remedies available under U.S. law to address unfair trade practices, such as injurious dumping and subsidies. The Department of Commerce has been investigating antidumping and countervailing duty complaints against Chinese goods, consistent with U.S. law.

We will continue to apply the full arsenal of tools available to ensure that China meet its international trading obligations, including in the WTO. Last year, we reached a favorable settlement in a WTO dispute in which we challenged what appeared to be prohibited export subsidies. We also won two WTO cases against China relating to intellectual property rights – one on copyright and trademark protection and another on the importation and distribution of certain publications and audiovisual products. China also repealed measures that discriminated against U.S. auto parts in order to come into compliance with a favorable WTO ruling obtained by the United States in another case. The United States is also now pursuing another dispute on raw material export restraints.

Economic Reforms to Reduce Export Reliance and Promote More Balanced Growth

The United States and China recognized two years ago that the pattern of growth in both countries and globally was unsustainable. While we both acted aggressively to stimulate our economies and stave off the worst of the financial crisis, we also both took actions to create a more balanced, sustainable base for strong growth in the future.

In the United States, we are saving and investing more, and it is important that future growth is less reliant on consumption financed by excess borrowing.

As we make this shift here, China and other large economies that have traditionally run large trade surpluses need to shift their growth model to rely more on domestic demand, rather than exports, to drive growth. Without this shift, China and the world economy will grow below the potential rate of growth.

Recognizing this imperative, at the first Strategic and Economic Dialogue in July 2009, China and the United States agreed to promote fundamental rebalancing of the drivers of global economic growth. And that agreement paved the way for the G-20 to embrace this goal, and launch a new global initiative.

For its part, China has begun to make progress. It used its sizable stimulus package to reinforce the start of this transition to consumption-led growth. Rather than focusing on expanding manufacturing capacity, which would create further pressure on firms to increase their exports, China has instead concentrated its stimulus funds in measures to increase household income and in infrastructure projects, particularly in its less prosperous interior regions.

Other features of China's stimulus and reform that will support consumption-based growth are:

- *Increased public spending on health and education and strengthening of the safety net.*
- *Higher wages and real income for ordinary people.* This includes recent increases in provincial minimum wages of 20 percent or more.
- *Greater transfer of the substantial corporate sector savings to households* , through higher wages and interest rates, along with corporate governance and dividend reform.
- *Gradual liberalization and opening of important service sectors,* such as health, education, telecommunications, and logistics.
- *Financial sector reforms* to promote a greater share of lending to consumers and small businesses, and a greater variety of financial products for households to save for education and retirement and insure against risks.

As a result of these ongoing efforts, over time Chinese households will be able to earn more and buy more, including American goods and services.

In part because of these policies, domestic demand has been growing much faster than overall GDP growth, consumption growth is contributing a much larger share of overall growth than in the past, and imports, including from the United States, have been growing faster than overall growth in global trade.

This shift has been exaggerated by the effects of the crisis on exports, and it is important that this shift be sustained through continued reforms as the global economy recovers and as China moves to withdraw its various stimulus programs.

Exchange Rate Reform

Reform of China's exchange rate is critically important to the United States and to the global economy. And it is in China's own interest to allow the exchange rate to reflect market forces.

President Hu stated in public this month that China is committed to the reform of the exchange rate, and stated that reform is a key part of China's strategy to produce more balanced growth, growth that relies more on domestic demand.

A stronger renminbi (RMB) would benefit China because it would boost the purchasing power of households and encourage firms to shift to production for domestic demand, rather than for export. A more market-determined exchange rate also means that China will be able to pursue a more effective, independent monetary policy, which is particularly important now, with China's economy facing a risk of inflation in goods and in asset prices.

In July 2005, China shifted its exchange rate regime from a fixed rate pegged to the U.S. dollar to a gradual appreciation. Over the three years from 2005-2008, the RMB appreciated by about 20 percent against the U.S. dollar, and by about nine percent on an average trade weighted basis.

However, as the global financial crisis deepened in the summer of 2008, the Chinese authorities decided to re-peg the RMB to the U.S. dollar, and the RMB-dollar exchange rate has remained essentially unchanged over the past two years. During the early months of the crisis, most emerging market currencies depreciated against the dollar, and many remain lower than their pre-crisis values. And the dollar overall rose in value against most currencies as investors sought the safety of U.S. financial assets.

As a consequence, even though the RMB was held essentially fixed to the dollar over the past two years, China's currency appreciated by about nine percent against the weighted average of the currencies of its trading partners. Europe is China's largest export market, and 45 percent of China's appreciation on a trade-weighted basis, since July 2008, has occurred in the last seven weeks, due primarily to the sharp appreciation of the U.S. dollar against the euro in May.

China's exchange rate policy affects all of China's trading partners. Because of concern about the impact on their competitiveness, many emerging markets have been intervening in foreign exchange markets in order to resist upward pressure on their exchange rate. Intervention in the rest of emerging Asia outside China has been at record levels over the last nine months. The distortions caused by China's exchange rate spread far beyond China's borders and are an impediment to the global rebalancing we need. A more flexible RMB will allow market forces to play a more active role over time in facilitating strong, balanced and sustainable growth globally.

Conclusion

Chairman Baucus and Ranking Member Grassley, we will continue to engage forcefully with China to expand the economic benefits of the relationship for American workers and companies.

The Administration is committed to use any and all effective means of expanding opportunities for U.S. workers and firms and promote U.S. interests in our bilateral economic relations.

The United States and the American people have benefitted, and must continue to benefit, from strengthening our economic relationship. We cannot afford to miss the opportunity that China's growth presents, not to shrink from the challenges it poses.

Our ability to gain these benefits will depend significantly on the policies we pursue to strengthen our economic fundamentals at home. We are making very substantial investments in innovation, in education, in research and development, in basic science, in new energy technologies and in investment incentives. These investments, along with actions to restore fiscal sustainability as the economy recovers from crisis, are critical to the future to growth in the United States. They are essential to strengthen the manufacturing base of the American economy and to provide greater opportunities for American workers.

The economic strengths of America and China are complementary. Just as America benefits from China's growth, China benefits from ours. American companies are leaders in innovation. We are exceptionally good at making the goods and providing the services that the rapidly growing parts of the world – including China – need.

Right now our job is to help the private sector do what it does best. Our job is to help American businesses expand. Our job is to make sure that as China continues to develop, it does so in a way that does not disadvantage our firms.

We will work closely with this committee and your colleagues in Congress to support these goals. We may sometimes have different ideas on how to achieve that aim. But where there is no difference is in the belief that our workers, our companies and our innovators must have the chance to compete fairly on the global market, especially in China, and that, given a level playing field, we will compete and thrive.

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