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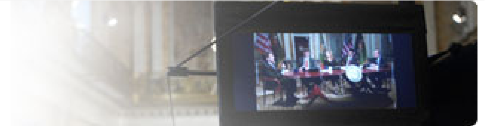

Testimony of Under Secretary for International Affairs Lael Brainard before the House Financial Services Subcommittee on International Monetary Policy and Trade, “Increasing Market Access for U.S. Financial Firms in China: Update on Progress of the Strate

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As prepared for delivery

WASHINGTON - Chairman Miller, Ranking Member McCarthy, members of the Subcommittee, thank you for the opportunity to speak with you today about our economic and financial relationship with China.

No other country presents as many opportunities and challenges as China. China is, and will likely remain, the fastest growing major economy. This Administration has worked to achieve a more balanced economic relationship with China, one in which U.S. workers and companies benefit more from the opportunities China presents.

Since early 2009, U.S. exports of goods to China have almost doubled, growing much faster than our exports to the rest of the world. In 2011 alone, the United States exported around $130 billion in goods and services to China, supporting well over 600,000 jobs here at home. China's exchange rate has appreciated by 13 percent against the dollar in real terms over the past two years. And we have seen a large reduction in China's current account surplus – from 9 percent the year before President Obama took office to under 3 percent today.

The Strategic & Economic Dialogue (S&ED) has been central to our efforts by providing a platform where the Administration engages on an ongoing basis with Chinese authorities to make progress on the economic, trade, and financial issues that matter most to Congress and American workers and businesses. We have just returned from the fourth S&ED in Beijing. While many challenges remain, we made important progress.

We secured commitments that will expand market access and help level the playing field for U.S. companies in China. And China agreed to take concrete steps to shift away from exports and relying more heavily on its own domestic consumption for growth.

On export credits China confirmed its intention to participate in negotiations for new rules on official export financing with the United States and other major exporters. The first meeting will take place this summer, with the goal of reaching agreement on a set of rules by 2014. China is one of the world's largest providers of export financing, and its export credit program has been a longstanding competitive impediment. It is critical that competitive U.S. exports are not undercut by subsidized foreign government financing.

Stronger consumption in China means more demand for U.S. goods and services, which in turn means more export opportunities for U.S. companies and more jobs here at home.

Rebalancing global demand is critical if we are to sustain strong and sustainable growth. As the United States reorients its growth strategy to focus on exports and competitiveness, and with European demand expected to be weak for some time, sustaining growth will require stronger demand from surplus emerging economies.

Chinese leaders made clear at the S&ED that they understand China will not be able to sustain its growth unless it shifts fundamentally its growth strategy. Wages are rising, labor migration from the countryside is slowing, and China's overall labor force will soon peak as its population rapidly ages. Relying on ever-higher amounts of fixed investment is depleting China's resources, damaging its environment, and producing increasingly lower returns. And weak IPR protection and enforcement constrain China's ability to move up the value-added chain through innovation.

Fortunately, China has ample capacity for growth driven more by domestic consumption and less by overinvestment in resource intensive and export industries. But achieving this shift will require important policy changes.

To strengthen consumption, at the S&ED China pledged to reduce tariffs on consumer goods imports by the end of the year, and reduce the high tax burden on services industries.

A more open and market-based financial system is also central to achieving more balanced Chinese growth and a more level playing field. For that reason, we had a focus at this S&ED on pushing for liberalization of China's financial system.

China's financial sector, which remains dominated by government-owned banks and subject to extensive government controls on the price and quantity of credit, generates massive distortions that filter through the whole economy. That is a problem for China, and for us.

Bank deposit rates are kept low. Chinese households get little return on their savings, often not even enough to keep up with inflation. There are also very few saving, investment, and insurance products available to help households manage their money efficiently, and their ability to invest overseas remains restricted. That means they have to save more – and consume less – of their income to insure against life's risks, prepare for retirement, and pay for education.

With interest rates artificially low, China relies on limiting the quantity of loans to control inflation. As a result, with demand for loans often exceeding supply, banks ration credit. This benefits large, politically connected SOEs and local governments, while starving China's private sector and entrepreneurs of funds. It also results in overinvestment and overcapacity in favored industries.

Moving to a market-determined exchange rate has to be a key part of both changing China's pattern of growth and opening its financial system. In April, Chinese authorities announced the widening of the daily RMB trading band in the context of diminished intervention. If implemented in a way that enables the exchange rate to reflect fully market forces, this would help promote rebalancing and financial reform.

We secured new financial sector commitments that will reduce market access barriers, help Chinese households save and invest more effectively, reduce the unfair competitive advantage of SOEs, and begin to loosen the chokehold that state-owned banks have on China's financial sector. China announced it intends to permit foreign investors to take up to 49 percent equity stakes in domestic securities joint ventures, moving beyond its WTO commitment of 33 percent. And China will also shorten the waiting period for securities joint ventures to expand into brokerage, fund management, and trading activities that are essential to building competitive securities businesses. China also agreed to allow U.S. and other foreign investors to establish joint venture brokerages to trade commodity and financial futures and hold up to 49 percent of the equity in those joint ventures.

Our auto financing companies will be able to issue local bonds to finance their operations – a plus for our auto producers in the world's largest market for automobiles, as well as for China's consumers. Furthermore, China amended its regulations to allow U.S. and other foreign insurance companies to sell mandatory auto liability insurance, opening access into a large and rapidly growing market, as well as an entry point to sell other insurance products to Chinese citizens. Finally, China will increase the amount that foreign investors can invest in China's stock and bond markets under its Qualified Foreign Institutional Investor Program (QFII) from $30 to $80 billion, creating opportunities for US pension funds and money managers.

We also worked to level the playing field with China's favored SOEs, which have benefited from preferential policies across a range of industries. At the S&ED, China committed to ensure credit provision, taxation incentives, and regulatory policies are applied on nondiscriminatory terms across enterprises of all types. China also announced it will encourage higher dividend payouts by all listed companies, including SOEs, and that the dividends paid by listed SOEs be in line with other publicly listed companies. During the years when China's imbalances ballooned, the high profits retained by state-owned enterprises were a major contributor to those imbalances, acting as a drag on consumption and a competitive impediment. As these savings are unlocked, it will both reduce a competitive advantage and potentially unlock a new source of funding to boost social spending.

Following its commitment from last year's S&ED, China issued measures instructing that departmental rules and administrative regulations should be posted for public comment on an official government website for a period of no less than thirty days, except under special circumstances. This will give interested parties, including U.S. firms, an opportunity to comment on rules and regulations that affect their business.

Working through USTR and USPTO, we also continued to press for robust protection and measurable enforcement of intellectual property rights in sectors such as software, and for strong enforcement against trade secret misappropriation. And we reinforced the importance of China honoring its commitments not to require technology transfer as a condition of market access. China also agreed to treat IPR owned or developed in other countries the same as IPR owned or developed in China, which will help to ensure that as China becomes a more innovative economy, its policies do not discriminate against U.S. firms. And China committed to submit a revised comprehensive offer this year to join the WTO Agreement on Government Procurement (GPA) that is responsive to the requests of the United States and other GPA parties. Specifically, on investment, China committed to open up new sectors to foreign investment.

These are tangible, significant gains that will benefit the United States. But they are not enough. Going forward, the Administration is committed to working closely with Congress to foster a more balanced economic relationship with China that maximizes the benefits of this relationship for the American people.

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