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VIEWS ON THE UNITED STATES-CHINA ECONOMIC AND COMMERCIAL RELATIONSHIP

Written Statement

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As the world's largest business federation representing more than 3 million members, the U.S. Chamber of Commerce is pleased to offer the following testimony on China economic and commercial issues to the House Ways and Means Trade Subcommittee.

The U.S. Chamber believes that the economic and commercial relationship remains at the core of broader bilateral engagement with China. This core must be nurtured—especially because it provides clear benefits to both countries. China should move to address problems of concern to the U.S. business community; the U.S. Congress and Administration should avoid yielding to the temptations of protectionist policies; and across America, we must ensure that we have policies in place—e.g., on healthcare, education, tax policy, incentives and funding for research and development, etc.—that support our continued status as the world's most dynamic and innovative economy.

The U.S. Chamber applauds the Department of Treasury and other participating branches of the U.S. government for organizing the constructive Strategic Economic Dialogue (SED) with the Chinese on a range of topics deemed vital to U.S.-China relations. We hope that the SED will improve mutual trust and understanding and lead to improved results for American business as well as serve as a substantive complement to the Joint Commission on Commerce and Trade (JCCT). The JCCT remains an essential forum for resolving bilateral disputes and securing improvements to the business environment in China for American business. The Chamber will continue to support both dialogues by providing the U.S. government with our membership's priorities and timely analysis of both the challenges and opportunities in our economic and commercial engagement.

Notwithstanding the many challenges in the bilateral commercial relationship, the Chamber underscores that the relationship continues to offer significant benefits and opportunities to U.S. exporters, investors, and the broader U.S. economy. According to recently released statistics, exports to China grew by 32 percent from 2005 to 2006, making it the fastest growing major market for U.S. goods. Since China's accession to the World Trade Organization (WTO) in 2001, U.S. exports to China have grown over 150 percent, five times faster than they have to the rest of the world.

Given the breadth of its membership, the Chamber has seen how the China market has become an integral component in the successes of large multi-nationals and small- and medium-size enterprises (SMEs) alike. Through a number of innovative programs, including our China Business Initiative—the nation's leading, sustained grassroots education program on China business opportunities—the Chamber continues its commitment to expanding export opportunities to China for American SMEs and to ensuring that our member companies have the necessary tools to compete in the China market.

Indeed, despite their challenges accessing the market, SMEs have found China to be a relatively welcoming export market. Of the 21,360 U.S. firms known to have exported merchandise to China in 2004 (the last year for which data are available), 19,201, or 90 percent, were SMEs.

The number of SMEs exporting to China has been rising much faster than the number of large companies. From 1992 to 2004 the number of SMEs exporting to China surged by 511 percent, compared to 128 percent for large-company exporters. Together, SMEs represent 35.1 percent of all known merchandise exports to China—compared with only a 28.6 percent share of U.S. exports to the world as a whole.

These data, among others, underscore the tremendous benefits U.S. companies and workers gain from our economic relationship with China. That said, we emphasize that there needs to be continued and significant progress on critical issues of concern to American business if the bilateral economic and commercial relationship is to endure and deepen.

Specifically, we hope to see timely progress from China in the following areas:

- **Industrial Policies:** Some in the Chinese government and academic circles believe China can spur growth and innovation through government directed industrial policies, including measures that tilt the playing field in favor of Chinese firms. Such policies are bad for China and will lead to significant, increased trade frictions with the United States. China should resolve concerns regarding its domestic and outbound investment and industrial policies in various "strategic" sectors, particularly as many of these sectors—from financial services to autos to telecommunications to energy—remain closed or mostly closed to foreign investment by American companies. Moreover, the Chamber believes that China should refrain from utilizing non-trade laws to impose non-tariff barriers on U.S. products and suppliers. Recently announced initiatives to promote "self-reliant innovation" by decreasing China's use of foreign technologies are worrisome to the Chamber and our members. Of immediate concern to U.S. industry is ensuring that China's evolving competition laws; proposed patent law reforms; proposed standards policies, regulations, and policies; and government procurement regime are non-discriminatory and transparent and fully respect the rights of U.S. inventors and authors.

- **Subsidies:** The Chamber publicly supported the U.S. government's recent action to bring a case in the WTO against China for offering prohibited subsidies for exports and import substitution. We believe that China should provide a much more detailed report to the WTO on its use of subsidies, with particular attention to subsidies of state-owned companies provided through its banking system, provincial government-level subsidization, and the amount of subsidies involved.

- **Currency:** On the currency issue, the Chamber believes that China should move as quickly as possible to a system that allows market forces to determine the exchange rate of the renminbi. Given this goal, we strongly support Treasury Secretary Henry Paulson's efforts in the context of the SED to encourage broader financial sector reforms that will enable China to accelerate its removal of capital controls and allow market forces to fully determine the value of its currency. The U.S. Chamber also believes that any legislation against China's currency regime that would be inconsistent with the rules of the WTO would be an ineffective and counterproductive tool. Such measures could amount to a steep tax on millions of lower-income American consumers and could engender legitimate Chinese retaliation against U.S. exports to China.

In late March, U.S. Chamber President and CEO Tom Donohue will travel to China for high-level discussions with China's government and business community and to host a global forum on innovation and the protection of intellectual property rights (IPR). The forum is but one example of the U.S. Chamber's continuing commitment and leadership on the global stage to foster multilateral cooperation with governments, member companies, and business associations around the world, including our counterparts in China, to address the serious challenges associated with the counterfeiting, piracy, and patent theft that harm American businesses and the U.S. economy.

During his visit, Mr. Donohue will continue to press the Chinese government to protect and enforce the IPR of American firms operating inside and outside the China marketplace. He will also travel to one or two provinces to promote cooperation in provincial and local efforts to improve protection and enforcement of domestic and foreign intellectual property (IP). The U.S. Chamber continues to work closely with the People's Republic of China (PRC) government and the Chinese business community at all levels of society to develop constructive and effective solutions to outstanding IPR protection and enforcement challenges. These efforts, along with the overarching IPR protection and enforcement challenges, are discussed below.

Intellectual Property Rights

Over the past three years the central government of China has sharply increased its efforts to improve IPR protection in China. Progress has been made in certain areas, although the overall the level of IPR violations in China during 2006 did not improve from previous years and remains at critical levels. Advances within China have been offset to some degree by apparent increases in Chinese exports of counterfeit and pirated goods, facilitated to a great extent by the Internet.

The central government and a number of provincial governments appear committed to dealing more proactively with counterfeiting and copyright piracy going forward, and cooperation with industry and with IPR enforcement authorities in the United States has increased. Significant reductions in the levels of piracy and counterfeiting in the market are, however, the only true measures for determining the fulfillment of these commitments.

Progress and Ongoing Challenges

The Chinese government took important steps between 2004 and early 2006 to improve legislation on IPR protection and at the same time increased the number of criminal cases against trademark counterfeiters. For example, the government reported a 52 percent increase in the number of criminal convictions for IPR offences during 2006. However, the total number of such cases was only 796, and most of these cases appeared to involve local IPR owners, rather than foreign parties. Further, a majority of foreign companies polled in one recent industry survey indicated that counterfeiting in China during 2006 had either remained the same or worsened.

The Chinese government recently reported the results of robust administrative enforcement campaigns undertaken in 2006 to address optical disk and online copyright piracy. Still, American film, music, software, and book publishers report that these campaigns only appeared to reduce the superficial visibility of piracy, and overall losses remained at critical levels during 2006—anywhere between 85 percent and 95 percent for optical disks. Meanwhile, our members report that China is increasingly the preferred location for copyright pirates to establish Internet servers providing access to pirated films and music distributed worldwide.

China's General Administration of Customs meanwhile reported a 100 percent increase in seizure of infringing goods (mainly counterfeits) during 2006, to 2,473, involving goods valued over US$25 million. This laudable increase in enforcement does not appear, however, to have slowed the overall growth of counterfeit exports from China. The Department of Homeland Security (DHS) disclosed that China (including the Hong Kong SAR) was the source of 87 percent of all infringing items seized at America's borders last year, and the value of seizures from China and Hong Kong almost doubled, to over US$135 million.

The PRC pledged at the April 2006 JCCT that "IPR trial chambers will be open in courts across China" and that "50 IPR Infringement Reporting Centers will be set up in 50 key cities in China." The Chinese government completed the establishment of these centers in late August 2006, and they may prove useful for IP owners that have in the past been confused as to the correct authority with which to file enforcement complaints. But it remains unclear whether these centers will have other functions, such as the job of intervening when difficulties arise in the course of administrative transfers to judicial authorities or with protectionism. We hope the Chinese government will move to address this issue.

The PRC also announced at the April 2006 JCCT that it had issued a notice requiring the pre-loading of legal operating system software on all computers manufactured in or imported into China as well as a notice requiring government agencies to provide adequate budget for, and the purchase of computers with pre-loaded legal software. In line with these requirements, several Chinese computer manufacturers signed agreements last year to purchase U.S. operating system software. These announcements built upon commitments undertaken by China at the July 2005 JCCT to complete its legalization program designed to ensure that all central, provincial, and local government offices use only licensed software, and to extend this program to enterprises (including state-owned enterprises) in 2006. This is a very positive step.

Moreover, China issued new Internet regulations last year to protect IPR in the digital environment. While helpful, the Chamber has concerns regarding the scope of the rights protected by the new law and vague terminology in the law that could result in significant loopholes. An effective Internet law is critically important given the rapid uptake in broadband in China, the increase in Internet piracy, and the fact that all peer-to-peer web sites streaming broadcast content without authority are headquartered in China.

These commitments underscore the central government's efforts to improve IPR protection and enforcement, and create a basis for optimism that the Chinese government will continue to achieve progress in IPR protection. However, because there has not been a substantial reduction in the scope and depth of the overall IPR problem over the last two years, and to ensure sustainable forward movement in areas where strong commitments have been made, more aggressive actions, especially in the areas of enforcement and transparency, are urgently needed.

The Need for Deeper Reforms and Additional Policy Resources

There are many factors which contribute to ongoing IPR problems in China. Foremost among them is China's lack of sufficient criminal enforcement, and a corresponding lack of resources, training, and awareness at the local level. These are problems which are symptomatic of IPR enforcement in most countries, regardless of their level of development. But the U.S. Chamber and its partner organizations believe that the problems in China are particularly acute given their size and scope. Both the central and local governments can—and must—do better, not only to comply with WTO obligations, but also to promote long-term growth and innovation in China.

Central authorities have also been unable to implement more timely and effective improvements in certain local hot-spot regions across the country, including the Chaoyang District of Beijing (home of the Silk Market), and elsewhere. Local protectionism remains a key barrier to progress, and one which will require greater political commitment in the coming months and years if it is to be overcome.

There are, however, steps proposed by foreign governments, industry and China's own IPR experts that the central government can take in the short- to medium-term which can lead to more progress in the fight against IPR infringements. These include structural changes, including the updating of the PRC Criminal Code, clarification of existing laws and regulations to eliminate loopholes and simplify enforcement procedures, the introduction of greater transparency and information sharing, and other measures.

While the WTO technically renders IPR protection as a "trade issue", we hope the Chinese government recognizes that foreign concerns over China's difficulties in IPR protection are motivated by a good faith desire to promote the rule of law, to stop the growth of organized crime, and to facilitate the growth of a vibrant healthy economy for both Chinese and foreign enterprises equally. We are particularly cognizant and appreciate that China's desire to ascend the value chain and develop an economy based on innovation rather than low-cost manufacturing are driving its new focus on IP.

In this regard, the U.S. Chamber is monitoring closely China's post-WTO accession use of industrial policies—including antitrust law, standard setting, and patent reform—to foster the development of strategic sectors and that could reduce the value of foreign-held IPR. We are closely tracking several different draft laws and regulations that could substantially weaken legal protection for U.S. rights' holders, and we would be pleased to provide the committee with additional information on this topic.

U.S. Chamber China Intellectual Property Action Plan

The U.S. Chamber is hopeful that more intensified dialogue and research on these structural problems and ongoing legislative changes in China's IPR regime will take place during 2007, in tandem with continued exchanges and training activities undertaken in cooperation with the Chamber's provincial government initiatives.

Beginning in 2004, the U.S. Chamber has attempted to promote change, raise capacity and awareness and strengthen industry and government cooperation on IPR protection in China through a number of its own initiatives. These are summarized below:

(1) Enhancing coordination of policy messages delivered to the U.S. and Chinese governments on China IP concerns.

(2) Providing an overarching, inclusive platform for substantive dialogue on IP-related legal and policy matters between U.S. corporate, legal, and academic IP experts and Chinese government officials at the national, provincial, and local levels.

(3) Establishing new benchmarking initiatives at the national and provincial levels to more accurately monitor the government's performance, including effectiveness in IPR enforcement, and responsiveness to domestic and foreign industry concerns. Just last month, the Chamber signed a memorandum of understanding with the Jiangsu Provincial IP authorities, which includes collaboration on education, training, and benchmarking. The Jiangsu provincial leadership and its IP authorities have demonstrated substantial good will in our engagement, and we are hopeful that we can achieve measurable progress in IP protection and enforcement for both American and Jiangsu companies.

(4) Creating new joint working groups in the provinces to collaboratively identify obstacles in enforcement at the provincial and local level and to generate possible solutions.

(5) Conducting joint enforcement seminars in Guangdong, Jiangsu, and Zhejiang provinces to educate local stakeholders and further research important IP issues. The Chamber has conducted many seminars in China and in the United States since July 2005, and will conduct additional seminars on IPR protection and enforcement in Jiangsu and Guangdong later this year.

In the year ahead, the Chamber will continue to work with all levels of the PRC government with the goal of reducing the level of counterfeiting and piracy of IPR in China. To strengthen IPR protection and enforcement, the Chamber will stimulate expert discussions on a wider range of necessary legal reforms, introduce more international "best practices," and continue efforts to raise awareness. Furthermore, the Chamber plans to expand its program of targeted seminars with provincial authorities and initiate a broader range of cooperative projects both with individual ministries and other U.S., Chinese, and foreign industry associations.

Conclusion

The U.S. Chamber and our members appreciate the opportunity to participate in China's continuing development. We applaud the many cases in which Chinese authorities have worked closely with the U.S. business community to implement WTO commitments as well as to resolve disputes that have arisen during the implementation process. As stated at the outset of this testimony, China is now the fastest-growing trading partner of the United States. Rapidly expanding bilateral economic and commercial ties underscore the market opportunities that China offers to U.S. exporters and investors, which support the creation of high value-added jobs at home.

But China can and must do more. The U.S. business community and others that vigorously advocated China's WTO membership premised their support on expectations that China is evolving into a more open and transparent market based on the rule of law. China's unsuccessful efforts to consistently enforce its IPR laws and to vigorously deter IP theft represent the most visible examples of these expectations remaining unfulfilled.

Similarly, China has continued its reliance on state guidance and industrial policies—capitalization requirements, mandated national technology standards, subsidies, investment restrictions—in key sectors. Not only are such policies a breach of the spirit of China's market access commitments and openness that China embraced when joining the WTO, but they also give credibility to China's critics who doubt China's commitment to create a business environment that values equally the economic contributions of domestic and foreign companies. Thus, the need for both proactive and substantive government efforts remains pressing.

Given the manner in which issues across all aspects of the relationship impact each other, the U.S. Chamber applauded the Department of Treasury and other participating branches of the U.S. government, along with their Chinese counterparts, for organizing the SED. The Chamber has provided input to the U.S. government on priority issues for our membership—including capital markets, industrial policy, IPR, health, energy, and transparency—since the inception of the SED, and we will continue to work with the relevant agencies through the various SED working groups. The Chamber also continues to strongly support the JCCT as an important forum for discussion and resolution of issues of concern, many of which have been touched on in this testimony. The importance of progress on IPR, and the need to address concerns with regard to market access in a number of industries, can not be underestimated.

The Chamber underscores, however, that for all the fits and starts, for the examples of China's sluggish WTO compliance, none of these trumps the value of engaging the world's most populous nation in the rules-based trading system. For all those who care about the future of our economy, jobs for Americans, stability and peace in the world, the protection of global health, and the advancement of environmental quality and human rights, we must continue to encourage China to become an active and committed member of the world trading system. Working within the WTO framework remains the most promising path to progress and is vastly superior to approaches that seek to punish and isolate this emerging global power. Moreover, in demanding that China adhere to the standards of a rules-based trading system, we too must honor those rules and take no action that is illegal under WTO agreements.