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"Across the Pond: U.S. Opportunities and
Challenges in the Asia Pacific"
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Chairman Salmon, Ranking Member Sherman, and Members of the Subcommittee, thank you for providing me with this opportunity to speak to you today on "U.S. Opportunities and Challenges in the Asia Pacific."

I commend the Subcommittee for holding this important hearing and am honored by the invitation to testify. I take great pride in, and it is a source of enormous personal satisfaction, to have served in a bipartisan manner on the staff of the Senate Banking Committee from 1983 to 1998. I very much enjoyed working for the elected representatives of the people. I also enjoyed my ten years of service as a Commissioner on the bipartisan and bicameral U.S.-China Economic and Security Review Commission. Seven of the Commission Reports to Congress during my tenure were adopted unanimously by all 12 Commissioners. Two others were adopted by votes of 11 to 1. On those two, I was with the 11. The Commission, some of whose views I will refer to in my testimony, is charged by the Congress "to monitor, investigate and report to the Congress on the national security implications of the bilateral trade and economic relationship between the United States and the People's Republic of China." That trade and economic relationship, which is completely out of balance and damaging to our nation, will be the focus of my testimony here today. I think the Commission, which Congress created, is a valuable asset to the Congress and the American people. It is the only think tank I know of which is integrating our economic and trade relationship with China with the military and geopolitical aspects as well.

China's Rise and the Pivot to Asia and the TPP as Responses

I think America's so-called "pivot" to Asia and the Trans Pacific Partnership Trade Agreement (TPP), as part of that pivot, are both grounded on concerns about the rapid rise of China's economic, political and military power. The pivot includes, among other things, beefing up our military capabilities in Asia and building a closer military working relationship with

Japan and India. I understand that by 2020 the navy and air force plan to base 60 percent of their forces in the Asia Pacific region. It also involves a more vigorous presence in Asian centered groups such as APEC, increased attention to the ASEAN nations, and a more integrated economic relationship with Asian economies such as those with whom we are negotiating the TPP.

I should note that we presently have a combined total trade deficit with the TPP countries, with whom we are negotiating, of over $100 billion. I am now hearing a lot about the geopolitical reasons we must do the TPP, but I am not aware of any analysis that claims the TPP deal, if approved, would reduce our very large trade deficit with the TPP countries. I also hear a lot of talk about how the TPP, whose provisions I have not seen, will bring about increased exports from the U.S. but nothing about what we might expect in terms of increased imports into the United States. At a minimum, we must ensure that we get provisions to address exchange rate manipulation into the TPP if we are to minimize what I expect will be a further detrimental impact on our job base and economy.

I believe, however, that the pivot to Asia will not succeed in its purpose as it does not adequately address the issues relative to China's growing economic strength upon which its increased military and political power is based. The Chinese use a term called "Comprehensive National Power" to describe the concept that if you build your economic power, it will be the basis upon which you will grow your political and military strength. Our trade and economic policies toward China, which are totally out of balance, are helping them to achieve their goal of being a Great Power much sooner than most had thought imaginable ten years ago. Instead of addressing that imbalance problem head on, we are in our pivot and TPP initiatives talking around it. We even talk about bringing China into the TPP later. Let me explain why I think we must correct our totally imbalanced economic relationship with China if we want to strengthen America's geopolitical position in Asia and elsewhere. .

What Drives China

China was for thousands of years the dominant power and civilization in Asia as well as the world's wealthiest society. The Chinese considered their Emperor, the supreme political authority, and themselves the geopolitical center of the world. Henry Kissinger has told us that “as late as1820 China produced over 30% of the world’s GDP, an amount exceeding the GDP of Western Europe, Eastern Europe, and the United States combined.”

Beginning with the First Opium War, in 1843, in which the British defeated Chinese efforts to stop the importation of opium by British companies, China fell rapidly from its high perch and suffered economic collapse and partial dismemberment in what its leaders refer to as a “Century of Humiliation.” This ended in 1949 when Mao Tse Tung united China under one government controlled by the Communist Party. During the over 100 years of China’s decline, the noted China scholar David Lampton has told us that the universal goal of China’s people was to “make China rich and powerful and to regain the nation’s former status as a great power that controls its own fate.”

From 1949 to his death in 1976, Mao and his Communist-controlled government attempted, without success, to restore China’s great power status by rebuilding its economy through a domestic-based and centrally-planned autarkic economy. They failed. At the time of Mao’s death in September 1976 the country was still mired in poverty. Its total population of 900 million people produced a GDP of only $200 billion.

In 1978 Deng Xiaoping, emerged as China’s new ruler. Deng knew Mao’s economic policies had failed, and wanted to find a different way for China to rebuild its economic strength in order to provide a base for building its military and political power. Deng decided China needed foreign investment, foreign technology, foreign know-how and foreign markets to grow its economy and power. As a first step in that strategy he focused on obtaining formal recognition from the United States that his Communist Party was the legitimate government of China and to obtain “Most Favored Nation (MFN)” trade status from the United States. He got both in 1979. This enabled China to begin its export led growth strategy.

Prior to 1979, and the granting of MFN tariff treatment by the United States, Chinese goods coming to the U.S. would have faced an average tariff of over 40%. Once China got MFN trade treatment, that average tariff was reduced to around 4%. China, under Deng’s leadership, then used various subsidies and strategies, including tax forgiveness, free land, cheap labor, and lax environmental laws to encourage American and other foreign companies to make greater profits by moving production to China and exporting to the U.S. and other markets outside of China. Foreign companies were also persuaded to transfer know-how and technology to China through joint venture investment agreements. China also sent its students abroad to get good educations in math, engineering and the sciences,

China also began a practice of underpricing its currency to give Chinese produced goods a further export subsidy, and to make it more difficult for American companies to export to China. When our dollar is overpriced, American companies are incentivized to invest in China to service Chinese customers not export from here to there. China also adopted a “value added tax” policy that rebates the tax on Chinese-produced goods made for export. In 1980 the U.S. trade deficit with China was $500 million. In 2000 it was over $83 billion. In 1980 China’s GDP was $400 billion. In 2014, according to the IMF’s *World Economic Outlook*, China’s GDP was $17.63 billion, larger than America’s $17.42 trillion. So China’s export-led growth strategy has been an enormous success in building China’s economic strength but has had a very detrimental impact of our job base and economy.

Another key step to encouraging Western investment into China was that nation’s entry into the WTO in 2001. Prior to China’s entering into the WTO, the U.S. gave China MFN trade treatment only one year at a time, and we had the ability to revoke it. China’s government believed that if the U.S. market was locked open by a grant of permanent MFN, which WTO participants had to grant each other, it would increase foreign investment into China. It would bring about more exports by foreign companies to their home markets. It worked. In joining the WTO China also wanted to nullify the ability of the U.S. to unilaterally use Section 301 of its trade law to sanction China for unfair trade practices, such as currency manipulation and the theft of intellectual property. Under WTO procedures such sanctions could only be done by first winning a case in WTO dispute settlement, which is a lengthy and altogether unsatisfactory process. This took away leverage from the U.S. to ensure that China would not engage in these unfair trade practices.

After China joined the WTO in December 2001 new foreign investment poured into China as American and other foreign companies moved more of their manufacturing capabilities there. Our annual trade deficit with China grew from $83 billion in 2000 to over $340 billion in 2014. Of that $340 billion, our trade deficit with China in advanced technology products was over $123 billion.

Transfers of Technology and R & D

Although China pledged in its WTO entry commitment not to force U.S. companies to transfer technology for market access, as it was doing prior to 2001, China is now using its market to leverage technology out of foreign firms on the basis that they are doing so voluntarily and not by force. The companies are making decisions to transfer sophisticated technology and R& D activities to China in order to be considered "friends of China" with a hope to receive better treatment for their operations in China. If one U.S. company does this, it may not have a great impact, but when it becomes a general practice it can harm America's ability to innovate and compete. These technology transfers and R&D operations are also helping China to move up the technology chain and to improve its defense industrial base and its military capabilities.

Intellectual Property (IP) Theft

The Chinese also move up the technology chain by the theft of intellectual property. Jon Huntsman, a former Governor and former Ambassador to China last year co-authored a report on China's theft of intellectual property in violation of its WTO commitments. That Report stated:

> National industrial policy goals in China encourage IP theft and an extraordinary number of Chinese business and government officials are engaged in this practice.

Again the theft of intellectual property by China is costing the United States billions of dollars in profits to our companies and hundreds of thousands of good paying jobs for our citizens. It also aids China's efforts to move up the technology chain.

Currency Manipulation by China

The China Commission, on which I served, in its very first report to the Congress in July of 2002 noted that China was making large official purchases of U.S. dollars to maintain an underpriced currency. The Commission noted that by holding down the price of its currency, China was gaining an unfair trade advantage that was increasing our trade deficit with China. China has continued this practice for over a dozen years in complete violation of both its WTO and IMF treaty obligations.

Article XV of the WTO entitled “Exchange Arrangements” states in part that “Contracting parties shall not by exchange actions frustrate the intent of the provisions of this Agreement, nor by trade actions the provisions of the Articles of Agreement of the International Monetary Fund.” The intent of the GATT/WTO Agreement as spelled out in its preamble was “reciprocal and mutually advantageous arrangements related to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce.”

Article I of the IMF Charter, to which China belongs, states that one of its purposes is to “promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciations.” Article IV of the IMF Charter entitled “Obligations Regarding Exchange Arrangements” obligates each member nation from manipulating its currency “to gain an unfair competitive advantage over other members.”

The IMF has adopted surveillance provisions to guide its members on how this Article IV should be interpreted. It indicated currency manipulation under the Article could be defined as “protracted large scale intervention in the exchange market” and the “excessive accumulation of foreign currency reserves.” Moreover there is a direct linkage between WTO/GATT Article XV and IMF Article IV since Article XV states that the WTO when dealing with problems regarding exchange practices shall consult fully with the IMF.

China has for years been blatantly violating both its IMF and WTO exchange rate obligations by intervening in currency markets to purchase trillions of dollars in order to prop up the dollar’s value against the yuan. China has run over $3 trillion in trade surpluses with the United States just since 2001 and has invested these dollars in U.S. Treasuries and other U. S. debt obligations as part of the manner by which it underprices its currency. China now has almost $4 trillion dollars in foreign currency reserves. This amount is larger than the GDP’s of India, South Korea and Thailand combined and gives China the ability to advance its interests in Asia, Africa and South America. Groups of Americans injured by China’s currency practices petitioned USTR to bring a WTO case against China under Article XV but that agency refused to do so.

<u>Pressure on U.S. Companies to Lobby Congress</u>

One of America’s most influential China experts is Dr. Kenneth Lieberthal, who as the former senior director for China on the National Security Council, strongly favored bringing

China into the WTO in 2001. Nevertheless he noted on page 89 of his 2011 book entitled *Managing the China Challenge* that:

> When Congress debates trade distorting legislation that targets China, it is not unusual for the Chinese Government through its Embassy in Washington or other channels, to pressure multinational corporations to weigh in to prevent the legislation from passing.

This could help explain why the multinational corporations have not supported legislation passed by both Houses of Congress, in different years. That legislation would have enabled domestic companies, injured by imports from China that are subsidized by an underpriced currency, to bring countervailing duty cases against the importers.

China's Growing Economy Feeds Its Military Spending

The U.S. China Economic and Security Review Commission in its 2014 Report to the Congress stated:

> China's rapid economic growth has enabled it to provide consistent and sizeable increases to the PLA budget to support its military modernization…China's defense budget has increased by double digits every year since 1989.

It indicated that China's growing confidence in its military capabilities underpins its aggressive behavior in the East and South China Seas since 2009. The Commission also stated unanimously in its 2014 Report:

> As a result of China's comprehensive and rapid military modernization, the regional balance of power between China, on the one hand, and the U.S. and its allies and associates on the other, is shifting in China's direction.

So it is clear that our imbalanced trade with China, that helps feed China's extraordinary economic growth, is contributing to a shift in the balance of power in Asia against our interests.

Impact of Our China Trade Imbalance on the U.S.

The many ways that China has used to grow its economy and enrich a portion of its populace has also caused major problems in the U.S. economy. These problems include the theft of intellectual property that harms innovation here and the outsourcing of production by U.S. manufacturers to China that also hurts America's ability to innovate and even make items essential to our defense capabilities. Business experts have pointed out that when we outsource so much of our industrial production, we are weakening out industrial commons and our ability to innovate new products. The outsourcing of production also results in a loss of tax revenues for our nation, states, and communities, increases unemployment, and contributes to our massive trade deficits which feed our exploding international debt problem. The latter will lead to increasing ownership of the U.S. economy by Chinese state owned enterprises. Let me explain that point.

Warren Buffett, in a famous article that appeared in *Fortune Magazine* on October 23, 2003, told us that the trade deficit was selling the country out from under us. He noted when we run a trade deficit it means we are living better than we are earning. He likened our nation to a rich family that possesses a large farm, but that is no longer earning its way, and thus has to sell off a part of the farm each year. He said it was imperative that we take "action to halt he outflow of our national wealth."

The Chinese now have enormous amounts of money to buy assets in this county. According to the China Commission unlike their investments in developing countries, where they are buying natural resources, the Chinese are focusing on buying famous brands and manufacturing technologies in this country. Some years ago Dr. Alan Bromley, the first President Bush's science advisor warned policymakers that "our technology base can be nibbled from under us through a coherent plan of purchasing entrepreneurial companies." We need to make sure we have an adequate CFIUS policy in place to review the increasing purchases of U.S. companies by Chinese investors. It is important to know that outbound investment from China needs government approval and Chinese companies, even non-state owned ones, can receive government funding to finance their purchases here. Increased Chinese foreign investment here, which is the other side of our trade deficit with China, will also give China more political influence in our open democracy.

<u>What is to be Done: Immediate Trade And Investment Steps?</u>

America's political leaders must realize that the United States has thrown its citizens into an increasingly competitive global economy in which many of our Asian trading partners such as China, Korea, Japan and Taiwan have national goals and strategies to move their economies forward. Underpricing their currencies to achieve trade surpluses and attract investment is just one part of such strategies. We must develop our own strategy to compete in such a world. Among the points in such a strategy must be measures to aggressively address mercantilist trade practices, being used by China and some our other key Asian trading partners to achieve trade surpluses with us. These practices include currency manipulation, barriers to imports, illegal export subsidies, forced technology transfers, and the massive theft of intellectual property. Included in our strategy or "business plan" if you will, should be:

1. Treating goods imported here from countries that are underpricing their currencies as subsidized imports to which increased duties can be applied under our unfair trade laws.
2. Bringing a WTO case against China for manipulating its currency contrary to its obligations under Article XV.
3. Working within the IMF, to whom the WTO will turn for advice, to make sure its members join with us to have the IMF be more aggressive in policing violations of its Article IV prohibition against currency manipulation.
4. Strengthening our CFIUS review of foreign investment coming into the U.S. to make sure we are not permitting the acquisition of technologies important to our national security.
5. Granting companies an antitrust exception ,for coordinating trade strategies with other companies, against a country that is trying to extort concessions from them.
6. Including penalties or snap back clauses in trade agreements that can be invoked against violators of such agreements.

<u>What Is To Be Done: Setting Goals And Adopting Measures To Achieve Them</u>

1) Set a National Goal to balance our trade account by a date certain, say 2025. Our massive trade deficits with Asian countries and others over the last ten years have cost us millions of manufacturing jobs and the loss of more than 60,000 factories. Our citizens are rightfully dubious about the merits of new free trade initiatives that are advanced by the same interests and groups who told us China's entry into the WTO would help balance our trade with China. If we have a balanced trade goal we can evaluate whether new trade initiatives will advance us toward such a goal.

2) Convene an Emergency National Summit on the trade deficit that would be attended by the President, relevant Cabinet Officers, bipartisan leadership of both Houses of Congress, and a small number of top corporate and labor leaders. Establish a BRAC type commission to develop some initial ideas on measures needed to balance trade and then have Congress, through multi-Committee hearings, develop a new trade bill as was done in 1988 when Congress developed and passed the Omnibus Trade and Competiveness Act.
3) Align corporate and national interests: Other countries have instituted practices that give incentives to U.S. and multinational corporations to help them grow their own economies at our expense. Our corporations are operating in a system that compels them to focus on making profits for their shareholders. Top corporate officials get significant financial rewards for achieving these objectives. Our nation must develop policies to counter foreign practices designed to entice our corporations to serve their interests. We must find the means to align the interests of American based corporations with the national interest ,which includes keeping and creating well paying high tech jobs in this country and not transferring huge chunks of our productive capabilities out of the country. One such incentive might be to reduce corporate taxes on corporations that add to U.S. jobs and GDP by producing in this country, and to put higher taxes on corporations that earn their profits by producing abroad and shipping back here.

Thank you again for inviting me to present my views on these important matters. I will pleased to answer any questions that you may have for me.