NATIONAL ASSOCIATION OF
Manufacturers

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Testimony

of Linda Menghetti Dempsey
Vice President, International Economic Affairs

National Association of Manufacturers

Before the

International Trade, Customs and Global Competitiveness Subcommittee

of the U.S. Senate Committee on Finance

on Market Access Challenges in China

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Chairman Cornyn, Ranking Member Casey and members of the subcommittee, thank you for the opportunity to testify on manufacturers' views on market access challenges in China.

The National Association of Manufacturers (NAM) is the largest manufacturing association in the United States, representing more than 14,000 manufacturers small and large in every industrial sector and in all 50 states. Manufacturing employs nearly 12.6 million women and men across the country, contributing $2.25 trillion to the U.S. economy annually. The NAM is committed to achieving a policy agenda that helps manufacturers grow and create jobs. Manufacturers very much appreciate your interest in and support of the manufacturing economy.

U.S.–China commercial relations are a top priority for manufacturers in the United States given both the challenges and opportunities this relationship presents. I appreciate the opportunity to testify today to discuss the market access challenges that manufacturers face in China.

I. Overview

It's fair to say that our nation's trading relationship with China is complicated.

On the one hand, there are few places in the world where manufacturers sell more or have increased sales. Indeed, manufacturers in the United States export more goods to China than any other market outside of our NAFTA partners in North America—to the tune of nearly $96 billion in 2017—which, in turn, supports hundreds of thousands of U.S. manufacturing jobs here at home. Exports of "made in the USA" manufactured goods to China have grown more than $76 billion since 2002, more than to any other country, except Canada and Mexico. That's especially important considering that more than half of American manufacturing workers depend on exports for their paychecks.

On the other hand, there are few places in the world where trade has proven more challenging for American manufacturing. From unfair subsidies, to intellectual property (IP) theft and market-distorting policies that shield Chinese companies, manufacturers and workers in the United States face an unfair playing field that harms U.S. manufacturing and holds us back.

There is no doubt that we need to address these challenges. China simply must follow the same rules as everyone else. It simply must be held accountable when it cheats. On this, nearly all parties agree.

The question is how best to go about doing so.

There has been a lot of debate about this for a long time. We at the NAM believe it's time to finally change the contours of that debate. We think a comprehensive strategy will be needed if our country is to truly achieve the best outcomes for American workers and American enterprise. In our view, that means pursuing a modern, innovative and comprehensive bilateral trade agreement that wholly restructures our economic relationship with China. This is at once both a radical idea and, in our estimation, the most pragmatic and effective way forward.

Targeted actions can provide some relief in the short term to some manufacturing industries, they can harm others, and there will be a lot of arguments about their merits in-between. So, at the end of the day, we think it's best to address the underlying systemic issues that have given rise to the imbalances in the U.S.–China relationship in the first place. That's what I look forward to discussing with you further a little later in my testimony.

But first, it's important to understand the nature of our trading relationship with China.

II. The U.S.–China Commercial Relationship

The U.S.–China commercial relationship has grown substantially over the past several decades following China's accession to the World Trade Organization (WTO) in 2001. China is the United States' largest goods trading partner, the largest source of U.S.-manufactured goods imports and the third-largest export market for U.S.-manufactured goods:

- U.S.-manufactured goods exports to China grew from $19 billion to nearly $97 billion between 2002 and 2017.
- U.S. imports of manufactured goods from China have grown even more from $122 billion in 2002 to nearly $496 billion in 2017.

In joining the WTO, China agreed to abide by the WTO agreements that were largely created in the Uruguay Round talks that ended in 1994, as well as some specific requirements in its protocol of accession. In subsequent years, China has also agreed to new, targeted agreements, including the Trade Facilitation Agreement (TFA) to cut red tape at the border and regularize customs processing and the 2015 expansion of the Information Technology Agreement cutting tariffs on information and communications technology products. Unlike some of the original WTO members, most notably Brazil and India, China was brought into the WTO on much stricter tariff terms, agreeing to cut tariffs to an average rate of 10 percent without any flexibility to raise tariffs (as Brazil, India and other countries have retained) and changing thousands of regulations, laws and guidelines. China's protocol of accession also outlined many other requirements specific to China, including some requirements to address distortive activities by state-owned enterprises (SOEs) and unfair government involvement in commercial transactions. While China implemented many of these provisions fully, there are gaps in China's implementation and issues that were not fully covered by the WTO requirements.

As a result of the implementation of many of these provisions, U.S. manufacturers have increased exports to record levels in 2017, supporting hundreds of thousands of American manufacturing workers. China is the single largest foreign purchaser of U.S.-manufactured goods outside of North America, and U.S.-manufactured goods exports account for approximately 11 percent of all of China's imports. Among the U.S. manufacturing sectors that have seen the biggest growth are:

- Transportation equipment, including aerospace products and parts, motor vehicles, auto parts and related products, railroad rolling stock and ships and boats; overall, U.S. transportation equipment exports increased by nearly $26 billion between 2002 and 2017;
- Chemical products, which have increased by nearly $12 billion since 2002;
- Computer and electronic products, including semiconductors, measuring and medical control equipment and computer and communications equipment; overall, U.S. computer and electronic product equipment exports to China increased by nearly $12 billion between 2002 and 2017; and
- Machinery, such as industrial machines, engines and power transmission equipment; overall, U.S. machinery exports increased by more than $6 billion between 2002 and 2017.

Manufacturers of agricultural equipment, from tractors and seeds to farming implements, grain storage structures and fertilizers, have also grown as a result of increased sales to the U.S. agricultural sector, which has expanded U.S. product through strong export growth to the Chinese market in numerous areas. Indeed, U.S. agricultural exports to China have grown to nearly $18 billion in 2017, from a base of less than $1.5 billion in 2002. China is the largest single country purchaser of U.S. farm products.

The U.S.–China investment relationship is also substantial, totaling more than $68 billion in 2016. U.S. manufacturing investment in China equaled $47 billion in 2016, up from nearly $6 billion in 2002, and equal to just seven percent of worldwide U.S. foreign direct investment in manufacturing ($667 billion in 2016). Sales by U.S. manufacturing affiliates in China equaled $283 billion in 2015, compared to only $9 billion in U.S. exports by those same affiliates. Chinese foreign direct investment in U.S. manufacturing totaled nearly $21 billion that same year, up from just $215 million in 2002.

While there have been significant improvements in the U.S.–China commercial relationship, China also poses a major challenge for manufacturers small and large, imposing a range of market-distorting and trade-limiting barriers that impact manufacturers in the United States. To address some of these issues, the United States has brought more than 20 WTO challenges against China, several of which have successfully resolved issues directly covered by WTO rules, such as relating to export restraints, subsidies and automotive parts. In other areas, as discussed below, the WTO rules do not explicitly or sufficiently discipline practices, and additional work is needed to address these gaps in coverage that allow unfair barriers to continue.

III. Key Market Access Concerns in China and Related Issues

The Chinese market remains one of the most frequently cited trouble spots for manufacturers in the United States, and challenges continue to rise. Among the market-distorting and damaging industrial policies and other measures negatively impacting manufacturers in the United States include the following:

- **Localization Policies:** Manufacturers in the United States have seen in recent years a resurgence of discriminatory policies, particularly those that have a differential impact on products and technologies produced by domestic and foreign companies, even if they do not explicitly treat domestic and foreign companies differently. These

policies are often as problematic for foreign companies as explicit discrimination and should be eliminated. Particularly concerning are localization policies related to production or technology that mandate local testing and certification requirements for products in the information, communications and telecommunications (ICT) and medical sectors as well as policies requiring companies to store China-generated data on local servers and prohibiting their transfer overseas.

One policy area of significant concern is China's "Made in China 2025," an ambitious 10-year plan designed to upgrade China's manufacturing economy. The plan sets specific targets for domestic manufacturing (40 percent domestic content of core components and materials by 2020 and 70 percent by 2025), focusing on 10 priority sectors, such as information technology, new energy vehicles, agricultural equipment and robotics. While the plan's broad objective of promoting smart manufacturing policies in China is common to many countries, the specific implementation and localization targets of the plan raise significant concerns for manufacturers in the United States. In particular, the plan's focus on building globally competitive Chinese companies through specific government policies and financial support raise concerns that the plan's effect will be to benefit Chinese manufacturers over foreign ones, raising significant questions about the consistency of policies with China's WTO commitments.

Examples of other policies with localization elements include:

- Cybersecurity policies that pressure companies to localize technology;
- Data flow restrictions/internet controls; and
- Expedited product approvals for innovative medical device products.

- **IP Rights:** While China has increasingly recognized the value of innovation and IP rights and enforcement, with some steps being taken to upgrade IP laws and regulations, promote IP awareness and tackle IP enforcement, much more work is needed in this core area important to manufacturers of all sizes and types. Among the areas of most concern that impede U.S. market access and fair competition in the Chinese market are:

    - High levels of counterfeiting, piracy and trade secret theft, both physically and online;
    - Structural barriers to strong IP enforcement, such as value thresholds that effectively preclude criminal enforcement;
    - Policies designed to push companies to localize R&D and technology and promote the development of Chinese IP-intensive industries;
    - Policy developments in areas such as competition, standards and product price controls that undercut U.S.-generated IP;
    - Cybertheft that has targeted several U.S. companies; and
    - Weak enforcement.

- **Standards, Technical Regulations and Conformity Assessment Procedures:** Manufacturers in the United States continue to experience a variety of challenges related to standards and technical regulations in China, ranging from inadequate channels for participation in standard-setting processes, treatment of IP in standards setting and Chinese efforts to promote standards, both at home and abroad, that do not harmonize with international standards. All of these regulations and requirements

can add significantly to the cost of manufacturing products for export to China and limit the ability of U.S.-manufactured products to compete fairly in China. Among the areas where manufacturers in the United States are facing challenges include electric vehicles, medical equipment and hazardous substances in electric and electronic products.

- **Subsidies and Other Measures:** Manufacturers in the United States continue to be concerned about a range of other Chinese government actions that have led to market distortions, such as subsidies and state-owned enterprise (SOE) interventions in the market that have built up massive overcapacity. Steel and aluminum are front and center, but overcapacity is also a problem in industries such as chemicals, fertilizer, concrete, agricultural processing and semiconductors. More broadly, Chinese government agencies continue to use a variety of export policies, particularly export restraints and subsidies, to promote or restrict the growth and export of priority products and sectors to provide an advantage to Chinese producers reliant on various metals and raw materials. While the United States has brought and won WTO cases on some of these policies, others continue to pop up. These actions both undermine U.S. market access in China and distort competition in the U.S. and third-country markets, all to the disadvantage of manufacturers and their workers in the United States.

- **Investment Restrictions:** Manufacturers also face investment caps in key manufacturing sectors, such as agricultural processing, automotive and telecommunications, forcing them to form joint ventures with domestic companies under the Catalogue Guiding Foreign Investment. Problematically, this allows government and company stakeholders leverage to seek concessions from foreign companies, including investment commitments, local sourcing and access to capital and technology, in exchange for investment approval. In a series of changes in late 2016, China approved some revisions to its main foreign investment laws, which, while generally welcome, did not fully address remaining concerns from manufacturers in the United States about continued investment caps in critical sectors, efforts to build a national security review system for foreign investment and broader regulatory concerns that impact foreign-invested enterprises. Given the role of investment overseas in helping manufacturers reach foreign customers and participate in foreign resource and infrastructure projections, these rules negatively impact market access for manufacturers in the United States.

- **SOEs:** During China's WTO accession, China made a number of commitments related to the activities of SOEs and state-invested enterprises (SIEs), including agreeing that those firms would make purchases and sales based solely on commercial considerations and not be influenced by the government. Despite that commitment, the Chinese government has continued to play a strong hand in SOE and SIE management and decision-making and pressure these firms to act in ways to support government priorities. Efforts to strengthen SOEs have only accelerated under President Xi Jinping, with plans that have generally focused on strengthening, not reforming, SOEs with only small changes, such as promoting mixed-ownership structures, addressing corruption and reforming executive board operations.

- **Import Regulation:** From tariffs and customs barriers to differential import procedures, manufacturers in the United States face a number of border barriers in China that impede U.S. exports and limit market access:

    - While China reduced tariffs as part of its WTO implementation on a broad range of manufacturing products, the process did not eliminate all of China's burdensome tariffs, including some high tariff rates in key manufacturing sectors.
    - While China ratified the WTO's TFA in September 2015, it will not implement its Schedule B commitments, including implementation of a "single window" system for customs clearance, publication of average customs release times or customs cooperation, until 2020. As a result, U.S.-manufactured goods face higher costs and red tape as well as delays in exporting to China.
    - Inconsistencies in customs-related regulations and enforcement create unnecessary challenges for U.S. exporters. Particularly concerning are different customs clearance proceedings and regulations between different ports, different agencies and even different customs agents as they seek to get products cleared, including customs classification, customs valuation procedures and clearance requirements.
    - In addition, China's current import clearance regime unnecessarily complicates trade and restricts low-value shipments (including shipments of manufactured goods sent through e-commerce channels) from benefitting from expedited shipments treatment, as envisioned in the TFA. Although China's complex import clearance procedures can clear products through one of three channels (including an e-commerce category), burdensome requirements to utilize the e-commerce channel prevent many products from benefitting from this option.
    - Manufacturers in the United States are seeing the misuse of Chinese trade laws to retaliate against U.S. industries and limit U.S. imports unfairly.
    - Import bans and other regulatory limits have also undermined U.S. access to China's market, including bans on remanufactured products and units and a July 2018 ban on 24 types of materials, including scrap paper and plastic.

- **Transparency and the Rule of Law:** Despite Chinese commitments during its accession to a range of reforms related to the rule of law, including regulatory transparency and consistent implementation of laws and regulations, China continues to struggle with many of these areas in ways that have a significant negative impact on the ability of manufacturers in the United States to navigate China's regulatory framework and participate on a level playing field in the Chinese market. Among the most concerning areas are:

    - A lack of full regulatory transparency regarding laws and regulations, where new rules are implemented with limited notice and input from the private sector; and
    - A lack of fair and open processes regarding regulatory approvals.

IV. Improving the U.S.–China Commercial Relationship

The U.S.–China commercial relationship holds potential to spur the growth and expansion of manufacturing here at home, but the trading relationship must be fair and open and must tackle persistent barriers.

On this point, there is a lot of work left undone. Of particular importance for manufacturers is work to ensure full enforcement of existing international and domestic trade rules, including bringing additional WTO cases; engagement and coordinated activities with our trading partners and through regional and global channels, such as the Asia-Pacific Economic Cooperation Forum and G20; and the creation of new rules to ensure a free and fair competitive landscape for manufacturers in the United States.

While targeted actions can provide some relief in the short term to some manufacturing industries, they can harm others, and there will be a lot of arguments about their merits in-between. This is especially true of tariffs, which, as NAM President and CEO Jay Timmons recently put it, can also create new challenges in the form of significant added costs or provoke China to take further destructive actions. So, at the end of the day, we think it's best to address the underlying systemic issues that have given rise to the imbalances in the U.S.–China relationship in the first place.

As Timmons explained in a letter to the president on January 8, to address these issues comprehensively and truly level the playing field for the long term, the United States should "be pursuing a truly modern, innovative and comprehensive bilateral trade agreement with China that wholly restructures our economic relationship." The letter explained that "[t]o be successful, this free and fair agreement must:

- Eliminate barriers that unfairly block American companies and America's manufacturing exports from full and fair access to the Chinese market;
- Raise standards in China and create new rules to prevent the wide range of market-distorting practices that violate free markets and fair competition and hurt American businesses and workers; and
- Create clear mechanisms to mandate strong and binding enforcement of the agreement, providing specific channels for government and industry alike to address cheating and violations."

A bilateral U.S.–China trade agreement would need to build on, but go far past, previous agreements by adding priority issues relevant to China, from industrial policy, state-favored industries and new transparency and IP disciplines to rules that reflect other changes in the global economy since the WTO agreements were negotiated, starting with digital trade and cross-border data flows. In particular, such an agreement would need to address those areas where unfair, discriminatory and harmful Chinese policies and practices are not actionable at the WTO.

We believe this approach, while in some sense a radical idea, presents the best way to restructure the U.S.–China economic relationship so that it works for manufacturers and all Americans.

V. Conclusion

Chairman Cornyn, Ranking Member Casey and members of the subcommittee, thank you for your work on global trade and competitiveness issues and for holding this hearing.