THE PRESIDENT'S EXPORT COUNCIL
WASHINGTON, DC 20230

October 1, 2003

The President of the United States of America
The White House
Washington, DC 20500

Dear Mr. President,

China's accession to the World Trade Organization (WTO) in December 2001 followed 15 years of negotiations and the U.S. grant of Permanent Normal Trade Relations for China in October 2000. It marked the official entry of China into the global economy and ushered in an ongoing process of reforms and liberalization. These achievements should not be underestimated or downplayed, but neither should the challenges that remain to integrate fully the world's largest population into a rules-based market economic system.

For the U.S. economy, China's WTO membership has brought a number of immediate benefits. Tariff reductions mandated under the accession agreement have allowed U.S. exporters to enjoy increased market access in certain instances. U.S. exports of goods and services (e.g., agricultural products, metals, semiconductors and basic chemicals) to China increased approximately 24 percent in the first half of 2003 compared to the first six months of 2002 (from $10.2 billion to $12.6 billion).

Yet, trade data also demonstrate the building pressures on the U.S.-China economic relationship. The U.S. trade deficit with China is on pace to exceed $100 billion for the second year in a row. The large bilateral trade imbalance is a concern because it reflects a number of distortions that continue to impair U.S. businesses. U.S. economic growth and job security for millions of Americans are dependent on an open and fair global economic system. The U.S. will not and can not realize the benefits of China's accession to the WTO until China adopts and fully implements the rules of a market-based system. It is imperative that the U.S. government ensures a level playing field in our economic relations with China. While dealing with an undervalued Chinese currency is one aspect of the recommended way forward, there are other challenges of considerable importance including non-tariff barriers to trade, subsidies to local Chinese companies, impediments to free foreign investment, and an underdeveloped capital market which, in total, create an environment of major distortions to mutually beneficial economic relations.

Currency

As you know, China has maintained a fixed exchange rate between the renminbi and the U.S. dollar since 1994. China's maintenance of this currency peg means that when the dollar appreciates or depreciates against other currencies, the renminbi moves along with the dollar. Economists estimate the renminbi is currently undervalued by as much as 40 percent against the dollar, putting U.S. producers at a considerable disadvantage when competing with Chinese producers at home and abroad.

China's monetary policy should be viewed in the context of major intervention by Asian central banks to keep their currencies undervalued against the dollar in an attempt to boost their exports. If the renminbi is market-based and appreciates against the dollar, U.S. exports will become more competitive in China and will make U.S. manufacturers more competitive at home. In addition, once the renminbi appreciates against the dollar, it may have a spillover effect on other Asian currencies like the yen and Korean won, which may also appreciate as those governments relax their foreign exchange policies. This could in turn further strengthen the competitiveness of U.S. exports. In the long run, this will provide a more sustainable basis for growth in trade.

The President's Export Council applauds Treasury Secretary John Snow's recent efforts in China and strongly supports continued efforts by the Administration to encourage China to adopt currency flexibility. The People's Bank of China should allow the renminbi to revalue against the dollar and allow market forces to prevail. In the short run, this would halt the increasingly destructive effect the weak currency is having on the U.S. manufacturing sector. In the long run, a revaluation and eventual adoption of free market mechanisms would mitigate the unsustainable U.S. trade imbalance with China and anchor the long-term trade relationship between U.S. and China on a firm footing of free trade and free market principles. For China, a stronger renminbi would lower the cost of imported goods and improve consumers' welfare as their real income increases. As the buying power of the currency increases, consumer disposable income and spending rise. A market-base currency exchange value would also provide positive incentives for Chinese industries to improve efficiency and quality toward world-class levels.

Non-Tariff Barriers

China's non-tariff barriers also contribute to the trade imbalance by preventing higher levels of U.S. exports. Access to China's markets is hindered by a variety of trade-restricting policies. Non-tariff barriers affect nearly all sectors of the U.S. economy, including agriculture, manufacturing and services, examples of which are as follows:

Lack of Transparency/AQSIQ Regulatory Practices

The lack of transparency in China's transformation to a rules-based economy has created numerous obstacles for U.S. business. Public comment periods for new regulations, if provided at all, are often too short to be effective. Licensing and regulatory requirements can vary from one locality to the next. Similarly, the process for obtaining permits to import into duty-free zones is inconsistent and complicated.

Import permits issued by China's quarantine agency, Administration of Quality Supervision, Inspection, and Quarantine (AQSIQ), are effectively being used to maintain import controls on U.S. agriculture commodities and meat exports. Chinese officials should be encouraged to ensure that import permit procedures are transparent, permit requests are dealt with in a timely and commercially reasonable manner, and procedures are not used to regulate imports through administrative interference.

Failure to Protect Intellectual Property Rights

The infringement of intellectual property rights (IPR) remains a problem in China. China's inadequate efforts to enforce intellectual property rules cost U.S. producers billions of dollars annually. The illegal use of U.S. licensed trademarks on Chinese manufactured goods crosses many industrial sectors. Copyright piracy alone has been estimated to result in losses of $1.9 billion in 2001. Counterfeiting of pharmaceutical products is both an intellectual property and an urgent public health concern. Chinese officials should be urged to continue to strengthen the country's IPR implementation and enforcement system.

Discriminatory Tax Policies

China's tax policies appear designed to benefit domestically produced or manufactured products at the expense of imports. China's value added tax (VAT) and consumption tax are applied unevenly, giving domestic producers a competitive advantage (the VAT disparity between domestically produced and imported semiconductors is a good example). China's border trade policy gives an unfair tax advantage to neighboring countries at the expense of U.S. manufacturers. The U.S. government should work closely with U.S. industry and the Chinese government to ensure that China's tax policies are WTO compliant.

Technical Barriers to Trade

China also employs regulatory policies that violate national treatment commitments under the WTO, blocking U.S. exports. For example, China does not recognize U.S. standards or testing methods. Acquiring China's quality mark requires U.S. manufacturers to pay for expensive factory inspections by Chinese personnel.

Burdensome regulatory policies that add costs or consume significant resources, such as redundant testing or navigating complex import licensing requirements, are particularly difficult for small U.S. manufacturers.

Tariff rate quotas (TRQs) for a number of bulk agricultural commodities are not being allocated according to the WTO accession agreement. Chinese officials should be encouraged to honor TRQ obligations and not delay announcements, grant uneconomic quotas or apply other unnecessary restrictions. Biotechnology regulations and sanitary and phytosanitary restrictions also harm U.S. agricultural exports to the region.

The elimination of these non-tariff barriers is essential for equitable market access. The U.S. government should reinforce the necessity of transparency and equal treatment.

Subsidies

Some U.S. industries believe that many of China's exports continue to benefit from subsidies, including tax benefits, in contravention of WTO obligations.
Large state-owned enterprises (SOEs) in some strategic industries continue to enjoy significant government subsidization. Examples include the steel industry, where Chinese producers benefit from low-interest loans from the government, a subsidy to the extent that

the loans are below commercial market rates. China' s banking system substantially facilitates government subsidization for a number of state-owned industries.

China must not be permitted to provide subsidies that distort the allocation of resources, including capacity subsidies. The U.S. government should seriously consider WTO consultations and dispute settlement proceedings where compliance is not forthcoming within a reasonable period of time (e.g., six months).

Investment and Services

Investment and service barriers and controls on foreign exchange also distort the U.S.-China economic relationship to the detriment of U.S. foreign investors. Despite WTO commitments to allow increased foreign investment and participation in many service sectors, the Chinese market remains practically closed for U.S. companies in a number of instances. Such impediments to foreign investment are damaging in any economic environment. However, given China's continued reluctance to address adequately the undervalued exchange rate, it is all the more important that U.S. foreign investors have a level playing field to participate as local producers in an economy that may remain somewhat protected.

For example, the ability to invest in China's energy sector – dominated by the state-owned firms Sinopec, PetroChina, and CNOOC – is severely restricted for foreign investors. China's fulfillment of its obligation to provide trading rights to "non-state" traders has been less than ideal. Trading and import rights should be granted to qualified firms in the spirit of open markets promised in WTO commitments and not concentrated in the hands of subsidiaries of China's SOEs. Although China has committed to allow foreign investment in the petroleum retail and wholesale sectors, there are concerns that China may impose investment restrictions such as limiting the size of a retail chain, and the selective granting of import/trading licenses to domestic players.

The U.S. government should continue to encourage China to fully open its oil and natural gas sectors - both upstream and downstream. Foreign investors should have the ability to establish wholesale operations, establish majority-owned onshore refining facilities, operate large-scale retail chains (owned and franchised), and enjoy unrestricted access to supplies and markets. Oil and natural gas pricing should be transparent and market based, without interference from the Guidance Pricing system of the National Development and Reform Commission (NDRC), which can discourage competition.

Another example is in the auto sector where China committed, upon accession, to allow non-bank financial institutions to provide auto financing. Final implementing regulations have still not been issued and the most recent draft versions contain excessive capitalization requirements that are higher than those found in any other markets around the world.

In addition, the U.S government needs to continue to urge the Chinese government to make its legal system transparent, clear and consistently applied. Enforceability of contracts, the basis for doing business in a rules-based market economic system, is critical to the long-term success of the transition of the Chinese economy.

Summary of Recommendations

Strong economic ties with China benefit the U.S. economy, but those advantages are significantly eroded when monetary policies, non-tariff barriers and other policies that restrict U.S. trade and investment are allowed to proliferate. Continued U.S. government efforts to address these impediments will help alleviate concerns about the bilateral trade deficit by boosting the competitiveness of U.S. exports and keeping the positive developments in the Chinese economy on track.

China's implementation of its WTO commitments is critical for U.S. firms to realize the potential of the Chinese market. The Administration should urge China to redouble its efforts to implement WTO obligations. The U.S. government should, in a collaborative manner, urge China to reform its currency policy, eliminate non-tariff barriers and trade-distorting subsidies, bring tariffs to agreed levels, and open further to foreign service providers and investors. At the same time, the United States should remain committed to diligent enforcement of our trade remedy laws, such as those dealing with antidumping and countervailing duties, to achieve our objectives. Achieving these outcomes will not only benefit the U.S. economy, but will provide a solid basis for the continued development of the U.S.-China economic relationship, which is a cornerstone for security in the Asia-Pacific region.

Sincerely,

JW Marriott Jr

J.W. Marriott, Jr.
Chairman