Remarks by Ambassador Karan K. Bhatia
Deputy United States Trade Representative
Shanghai Institute of Foreign Trade
Shanghai, China
March 21, 2006
As Prepared for Delivery

Introduction.

Thank you very much for that warm welcome. It's a pleasure to be here in Shanghai this afternoon. I want to thank the Shanghai Institute of Foreign Trade for inviting me to talk to you today. It is fitting that an institute devoted to the study of international trade should reside in Shanghai – a city that has contributed so much to and benefited so much from global commerce.

I am glad to have this opportunity to speak to such a distinguished group of scholars and students of trade policy. You are the future leaders of government, academia, and the private sector. As you go on with your careers, I hope that your energy, expertise, and ideas will support continued market-oriented development in China, China's continued participation in the international rules-based trading system, and mutually beneficial U.S.-China economic relations.

As the stewards of the U.S.-China economic relationship, you will have a high responsibility. In my view, there is no more important bilateral trading relationship today than that which exists between the U.S. and China.

Today, I would like to talk with you about that relationship. About how growing U.S.-China trade and investment linkages have benefited both countries. About challenges that we face in that relationship – most significantly, the challenge posed by protectionism in both the United States and China. And finally, about steps our governments can take to deepen our cooperation on bilateral and global economic issues.

The Growth of U.S.-China Economic Ties.

The growing trade relationship between the United States and China marks the convergence of two great economic forces: the United States, the largest economy in the world and a leading proponent of trade liberalization, and China – the focal point of one of the great economic transformations in history. Indeed, the United States and China, together with other Asian countries, are the growth engines of the world today in large part because we have embraced more open trade and market principles.

The dramatic growth of U.S.-China economic ties is the result of a historic transformation in China. Beginning in the late 1970s, China's introduction of market-oriented economic reforms and its encouragement of export-led growth has helped to create the conditions for economic opportunity.

The impact of these reforms has been impressive. China's annual growth rate has exceeded nine percent for over 20 years – it's often been ten percent or more – and during this period China has achieved a 500 percent increase in GDP. As a result, nearly 400 million people have been lifted out of poverty. Since 1990, over $500 billion in foreign direct investment has flowed into China, creating millions of jobs as well as know-how.

In 1978, China accounted for less than one percent of the world's economy and its total trade was about $21 billion. Today, China is the second largest economy in the world in terms of purchasing power. It accounts for four percent of global economic activity with foreign trade over $1.1 trillion annually. It has become globally competitive in sectors that, less than a generation ago, it barely competed in.

These changes have been dramatically reflected in the U.S.-China economic relationship as well. In 1981, U.S. trade with China amounted to $5.5 billion. U.S. exports were in the neighborhood of $3.6 billion, more than half of which were agricultural products, while Chinese exports to the U.S. amounted to $1.9 billion, over half of which were simple manufactures. China constituted the United States' 16th largest export market, but only its 27th largest supplier of imports, ranking behind countries like Malaysia, Indonesia, Australia and South Africa. There was virtually no U.S. direct investment in China, nor any Chinese investment flows into the United States. Given those numbers, it is not surprising that trade was not exactly the defining issue in our relationship with China in 1981.

Fast forward twenty-four years. The tally for U.S. trade with China in 2005 amounts to about $285 billion – more than 50 times the amount of bilateral trade in 1981. U.S. exports to China for 2005 reached about $42 billion. Our exports today are substantially more diverse: agriculture last year accounted for about one-eighth of our goods exports, with the rest of our goods exports led by machinery, aircraft, and optical, photographic and medical equipment. Chinese exports to the United States were in the neighborhood of $245 billion. China's exports to the United States today consist of a broad range of manufactures, representing China's strengths as a final point of assembly for companies in Asia and elsewhere, as well as by traditional, simple manufactures such as apparel, footwear, and toys.

China has grown on a country basis from our 16th to our 4th largest goods export market – trailing only Canada, Mexico, and Japan – and has become our second largest supplier of imports, behind only Canada. And in the area of direct investment, the stock of U.S. investment in China in 2004 – the most recent year for which data is available – reached an impressive $15.4 billion.

Both countries have benefited from this growth in trade and investment. U.S. consumers today have access to an enormous range of Chinese-made goods at competitive prices, and U.S. companies have enhanced their global competitiveness through their access to China's manufacturing base. And China has fueled its economic development through access to the U.S. market.

But, as impressive as this growth has been, the <u>potential</u> for the relationship is even more exciting. As the United States' $12 trillion/year economy becomes increasingly integrated with

China's 1.3 billion-person economy – as established companies expand their presence in each other's markets and new companies find each other – trade and investment will continue to grow, creating jobs and increasing prosperity in both the United States and China.

This will be reinforced by a stronger U.S. economic presence in the Asian region generally. I have just come from visits to Japan, Malaysia, Singapore, and Philippines, and – two weeks ago – was with President Bush in India. We are greatly encouraged by the economic reforms and the growth that we are witnessing in Asia, and we are redoubling our efforts to strengthen our trade and investment relationships with these and other countries in the region. Doing so will only strengthen the U.S.-China relationship.

Challenges in the Relationship

With all this good news – and with all the exciting potential for the relationship – one could be tempted to assume that the future is assured. That, regardless of governmental policies, the market will somehow find a way to keep the relationship growing. Taking that for granted would be a mistake.

The fact is that – notwithstanding the positive developments – we face profound challenges in our economic relationship. Perhaps most significantly, we face the threat of protectionism on both sides of the Pacific.

In the United States, there are those on both sides of the political spectrum who would seek to close down the U.S. market to China. When my boss, US Trade Representative Ambassador Portman, was in China four months ago, he observed that if the U.S. Congress had to vote again on China PNTR, it is unclear how the vote would turn out. In recent months, there has been legislation proposed in the United States that could have a seriously adverse effect on U.S.-China trade and investment. While President Bush has taken a strong stand in favor of free trade and economic openness, he has faced criticism for doing so. For example, late last year, the President declined to impose additional tariffs on standard steel pipe imported from China, which he could have imposed in accordance with safeguard provisions negotiated as part of China's WTO accession. Although he resisted political pressures and kept the U.S. market open, he was strongly criticized by U.S. steel companies and workers, and by members of Congress.

There are worrisome trends in China as well. There are numerous voices calling for new policies and regulations to restrict market access by foreign firms, particularly in high technology and service sectors. There are growing calls to provide protection, and other forms of government support to domestic companies. And there signs that the government is listening to these requests and is increasingly experimenting with mercantilist policies that seek to direct markets rather than opening them. This is a mistake. Not only will these efforts generate trade frictions, but they will also prevent the market from selecting optimal technologies, reducing the efficiency and raising the cost structure of the entire Chinese economy.

Protectionism – like that we are witnessing in both the United States and China – finds support when we are not vigilant in addressing the legitimate concerns that the other side has.

Accordingly – as trade policymakers – it is critical to try to see the relationship from each other's perspective.

From China's perspective, I think that many Chinese policymakers believe that the United States does not appreciate the breadth and depth of changes that China has made to open its economy to the world. When the world urges them to do more … faster … they point out that the Chinese economy has undergone dramatic change in the span of just 25 years – reforming not only the domestic economy, but passing hundreds of laws and regulations that have increasingly opened the Chinese economy to foreign companies. I believe that Chinese interlocutors also are concerned that the United States does not appreciate the challenges that China continues to face – in meeting aggressive economic growth targets, and in pushing forward change through a complex bureaucracy.

I do not discount these perspectives. China <u>has</u> made substantial reforms, and deserves credit for those reforms. As part of its WTO accession, China has lowered its tariffs on a wide range of goods from an average of 25 percent to an average of seven percent; most import license requirements have been eliminated; companies have been granted trading rights and allowed to engage in distribution; and new opportunities have been created for many companies in the service sector. And we do need to appreciate that change is difficult – it takes hard work and political courage. One of the things that you – as Chinese students – can to help share here is to share your perspectives on this with your American counterparts.

From the U.S. perspective, there are several concerns. There is concern that, while the United States has fulfilled its commitment to open its market to Chinese companies, China is not fulfilling its part of the bargain. There is growing frustration that China is not "playing by the rules." The huge and growing bilateral trade imbalance has served to fuel these concerns. I am sure you can imagine that there would be similar concerns here if our positions were reversed and China was running a $202 billion trade deficit with the United States.

American companies and workers are concerned that they cannot compete when China is offering generous subsidies and other forms of support to favored industries, maintaining and creating barriers to American goods and services while enjoying full access to U.S. markets.

Americans do not believe that China is competing fairly when rampant piracy, counterfeiting, and copyright infringement cost businesses billions of dollars each year. The movie, music, publishing, software and electronic entertainment industries are areas where the U.S. is especially competitive, and China's weak enforcement of copyright laws has a disproportionately heavy impact on our sales to China. IPR enforcement problems in China also affect us in markets outside of China. Last year, for example, 69 percent of IPR infringing goods seized by U.S. customs at the U.S. border had originated in China. A 2005 White Paper issued jointly by the American Chamber of Commerce in China and the American Chamber of Commerce in Shanghai reported that 80 percent of 331 American companies surveyed described China's IP protection as "ineffective" or "totally ineffective." Of course, the failure to protect intellectual property also hurts innovative Chinese companies, and could undermine China's efforts to continue to foster an even more dynamic, knowledge-based economy.

Perhaps most fundamentally, many Americans are concerned about China's commitment. They question whether China is truly committed to free and fair trade when China fails to clamp down vigorously on blatantly illegal activity, when it continues to pursue state interventionist policies that distort markets, when it retains regulations that serve to block foreign access to domestic markets. And they question China's commitment to reform when China fails to take action to address these concerns.

The upshot of these difficulties, not surprisingly, is that support in America for the bilateral trading relationship is being challenged as never before.

Advancing the U.S.-China Relationship.

What then must we do to ensure that the economic benefits of the relationship are protected – and the potential gains are achieved?

We must demonstrate that we can work together effectively to resolve bilateral issues. Last month, the U.S. Trade Representative's Office released a "Top to Bottom Review" of U.S.-China Trade Policy. The review concludes that the U.S. trade relationship with China is entering into a new phase. After a twenty-year period in which US policy was focused on getting China into the WTO and then on China's implementation of its accession commitments, U.S. policy must now be readjusted to deal with China as a mature trading partner. As mature trading partners, U.S. and China here is a long list of important issues on which we believe the U.S. and Chinese governments need to make more progress. These include: protection for intellectual property rights, market access issues related to telecommunications, financial services, healthcare and direct sales; subsidies and structural issues, in sectors such as the steel industry; standards; labor; environmental protection; and transparency and the rule of law. We believe that progress in these areas will benefit China as well.

That is why it is so important we take advantage of opportunities through institutions such as the bilateral US-China Joint Commission on Commerce and Trade. Through positive outcomes on these issues we will be able to demonstrate that we are making progress towards a U.S.-China relationship that has greater equity, durability, and balance of opportunities that it provides.

Looking beyond the bilateral issues, China can also take actions that demonstrate it is prepared to play a role as a responsible stakeholder in the international economic system commensurate with its commercial heft and with the benefit it has obtained from that system. China needs to work closely with its partners in regional fora, such as APEC. Multilaterally, China can strengthen the WTO by opening its markets beyond the specific requirements of its accession agreements, and by playing a more active and positive role in the Doha Round negotiations. The negotiations are at a critical juncture and the United States would welcome a closer partnership with China in advancing the round.

As the International Monetary Fund has said, China can also contribute to the global economy by helping to facilitate the adjustment of global macroeconomic imbalances by increasing the flexibility of its currency and allowing it to demonstrate greater responsiveness to market forces. Accelerating financial sector and currency reform would not only demonstrate that China is doing its part to contribute to the stability of the global economy, but would benefit China's economy as well.

The Bush Administration is committed to using cooperative bilateral mechanisms such as the JCCT to the fullest extent possible to resolve bilateral trade and economic issues. However, given China's relatively recent accession to the WTO and our rapidly growing economic ties, it is natural that we will have a large number of issues on which we have differences. Those that we fail to resolve through bilateral consultations may need to be addressed through other means, including WTO dispute settlement proceedings. In our Top-to-Bottom review, we indicate that we need to strengthen our efforts to ensure that China complies with its international obligations – which will benefit not only U.S. companies and workers, but China itself.

There are those who have asked me whether a more vigorous enforcement effort will upset the bilateral relationship, or even lead to a trade war? My answer is no. Trade wars arise when you don't have dispute settlement mechanisms. An active dispute agenda should not strain our relationship with China, any more than disputes with other major trading partners strains those relationships.

I would look at it this way -- active participation in dispute settlement is reflective of active and mature engagement in the world economy and in building and maintaining the multilateral trading system.

The EU has been sued 63 times and the US 86 times since the WTO was created. Brazil has brought 16 suits since 2000 alone – Korea 10. In many ways, China has been an anomaly in terms of its isolation from the WTO dispute settlement process. China, the growing economic colossus of Asia, has been the defendant in exactly one WTO case. That case – brought by the United States -- challenged China's imposition of a discriminatory semiconductor VAT. It settled before going to a panel.

I suspect that this will change. In the future, China, as an important player in the international trading system will more frequently be a party in WTO cases – either as a defendant or complainant.

We should remember that dispute settlement was actually intended to de-politicize disputes. Resorting to a quasi-judicial forum to resolve legal disputes, as we do in WTO dispute settlement – is just another tool to address difficult trade issues not a weapon in a trade war. Making use of this mechanisms that all WTO members have agreed to ought not get in the way of other areas of cooperation – economic-, diplomatic-, security- related or otherwise.

Trade frictions arise even among the closest of partners. In a mature international relationship, those frictions are dealt with on their own terms, while the broader relationship continues to flourish. What is important is that we use all of the bilateral and multilateral means available to solve problems on our bilateral trade agenda.

Conclusion.

I am optimistic about the U.S.-China relationship. Our economies are growing increasingly interdependent every day. We meet more frequently with our Chinese counterparts and I believe that both sides understand the importance of making this relationship work. But I am realistic about the challenges we face. China's growing impact on the United States and the rest of the global economy means that it is now being held to a higher standard – that of a mature trading nation. Entering this new phase of our relationship requires that we approach our bilateral dialogue with even greater ambition about the progress we must make on bilateral issues. China should also embrace the new responsibilities it has as a leading player in the international economy.

The United States has played a constructive role in the supporting China's integration into the global economy and in its accession to the WTO. We will continue to do so. We look forward to overcoming new challenges and creating even stronger commercial and political ties in the years to come.

If this is to be the Pacific century, both China and the United States, as Pacific economic powers, will play important roles. We are firm in the belief that, if China continues on its course of economic reform and liberalization, all the world's trading nations will benefit from China's transformation. Thank you.

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