The Treasury Department's Report on International Economic and Exchange Rate Policies
Secretary of the Treasury Timothy F. Geithner
Senate Committee on Banking, Housing, and Urban Affairs
September 16, 2009

Chairman Dodd, Ranking Member Shelby, Members of the Committee, thank you for the opportunity to testify on Treasury's semiannual Report to Congress on International Economic and Exchange Rate Policies, and in particular on China.

I want to focus today on the importance of the U.S.-China economic relationship and the challenges that we must overcome in order to secure the full benefit of this relationship for the American people.

We have very significant economic interests in our relationship with China. With over 1.3 billion people and an economy continuing to grow at or near double-digit rates, China is our fastest-growing major overseas market. China's record of bringing hundreds of millions out of poverty, building a rapidly growing middle class, and now its efforts to encourage growth led by domestic demand, ultimately mean more demand for American goods and services. Increasing opportunities for U.S. firms and workers through expanded trade and investment with China will be an important part of the success of the President's National Export Initiative and our efforts to support job growth more broadly.

U.S. exports to China have grown much faster than our exports to the rest of the world, and they have recovered much more quickly following the global crisis.

So far this year, U.S. exports of goods and services to China exceed $53 billion. U.S. merchandise exports to China this year are up 36 percent compared to 2009 and are 16 percent higher than comparable 2008 (pre-crisis) levels. By comparison, merchandise exports to the rest of the world are still eight percent below 2008 levels, highlighting the importance of the Chinese market as we continue our recovery.

And China is a critical market for a broad range of American products, from agriculture, to manufacturing, to services. To name just a few examples, China was the largest market for U.S. soybeans last year, importing over $9 billion. In the manufacturing sector, the United States has already exported nearly $3.5 billion in aircraft to China this year alone, and U.S. exports of automobiles and parts to China have grown over 200 percent. In 2009 China was one of the top three merchandise export markets for nearly half of U.S. states, and nineteen states exported more than $1 billion to China. The Administration's policy is to ensure that American opportunities in the Chinese market expand as rapidly as possible.

But we also face substantial challenges in this relationship with China. I want to provide a candid assessment of where we are making progress, where progress remains inadequate, and where we are going to concentrate our efforts in the months and years ahead.

To address these challenges, we are focusing on three core objectives with China: encouraging China to change its growth model to rely more on domestic demand and less on exports; moving toward a more market-determined Chinese exchange rate; and leveling the playing field for U.S. firms, workers, ranchers, farmers, and service providers to trade and compete with China. With China's economy on a strong footing, it is past time for China to move.

We are pursuing a comprehensive, proactive strategy to push China for progress. This includes direct engagement by President Obama and this Administration with China's senior leaders. It includes coordinated and intense engagement through the Strategic & Economic Dialogue (S&ED) and the Joint Commission on Commerce and Trade (JCCT), as well as multilateral channels like the G-20 and International Monetary Fund (IMF). It includes taking dispute settlement cases when China does not comply with World Trade Organization (WTO) obligations, and enforcing U.S. trade remedy law to safeguard the rights of American firms and workers. And it includes working closely with this Committee and your Congressional colleagues to make sure we are taking the best possible approach to shape a balanced and fair relationship.

China's Growth is Critical to Our Growth

While the global financial crisis had little direct impact on China's financial system, China's leaders quickly recognized that the weak global economy would hurt demand for China's exports. China responded early and aggressively with a massive stimulus program designed to offset weaker exports with domestic demand, particularly fixed investment. Through its efforts to stimulate domestic demand, China maintained growth of about eight percent in 2009. And the resulting boom in China's imports supported the global economy and contributed substantially to recovery around the world. With this boom in imports and its exports limited by the recessions in the United States, Europe, and China's other key export markets, China's external surpluses fell significantly in 2009.

However, as growth in the rest of the world recovers and China returns to a more normal pace of growth, the factors that led to the decline in China's external surpluses are now reversing. It is critical for sustainable growth in China, the United States, and the rest of the world that China and the United States both do our part to prevent a return to pre-crisis global imbalances.

Clearly, China's exchange rate must play an important role in this effort. However, exchange rate appreciation also needs to be complemented with structural reforms to reduce the gap between saving and investment in China in order to bring about a durable rebalancing.

China responded to the financial crisis with several steps that, if sustained, would help to reduce its reliance on exports and stimulate domestic demand, including a large increase in spending on health care, education, and pensions that should reduce the need for Chinese households to save for precautionary reasons. Top priorities for further structural reform include liberalizing interest rates, lifting energy price subsidies, and removing barriers to investment in the service sector. Each of these measures would reduce the current bias in China's economy towards heavy manufacturing and exports and away from services and household consumption.

China's Exchange Rate Policy

We share the concern of the Committee and many of your colleagues about China's exchange rate policy. After allowing the renminbi to appreciate over time against the dollar from mid-2005 through mid-2008, in July 2008, as the financial crisis intensified, China effectively "re-pegged" to the dollar, and there has been essentially no movement of the renminbi against the dollar over the past two-plus years.

On June 19, 2010 China took a very important step when it announced that it would renew the reform of its exchange rate and allow the exchange rate to move higher in response to market forces.

In the roughly three months since that announcement, however, the Chinese have allowed their currency to appreciate against the dollar by only one percent, and the currency has actually depreciated against the weighted average of the currencies of its trading partners.

During this same period, China has had to continue to intervene in the exchange markets on a very substantial scale to limit the upward pressure of market forces on the Chinese currency.

Even with the appreciation of the renminbi against the dollar that has taken place since this process began in 2005, China's real trade-weighted exchange rate is now only 4.9 percent stronger than it was on average from 1998-2002, an unjustifiably small change given that China's productivity doubled during that time.

It is the judgment of the IMF that, in view of the very limited movement in the Chinese currency, the rapid pace of productivity and income growth in China relative to its trading partners, the size of its current account surplus, and the substantial level of ongoing intervention in exchange markets to limit the appreciation of the Chinese currency, the renminbi is significantly undervalued.

We share that assessment. We are concerned, as are many of China's trading partners, that the pace of appreciation has been too slow and the extent of appreciation too limited.

We will take China's actions into account as we prepare the next Foreign Exchange Report, and we are examining the important question of what mix of tools, those available to the United States as well as multilateral approaches, might help encourage the Chinese authorities to move more quickly.

The undervalued renminbi helps China's export sector and means imports are more expensive in China than they otherwise would be. It undercuts the purchasing power of Chinese households. It encourages outsourcing of production and jobs from the United States. And it makes it more difficult for goods and services produced by American workers to compete with Chinese-made goods and services in China, the United States, and third countries.

China needs to allow significant, sustained appreciation over time to correct this undervaluation and allow the exchange rate to fully reflect market forces.

Specifically, in evaluating progress two key factors should be the pace and extent of appreciation and the level of ongoing intervention required to slow the rate of appreciation.

During the last period in which the Chinese authorities allowed the currency to move higher it appreciated about 20 percent against the dollar and 13 percent on a real, trade-weighted basis.

We recognize that this movement will not be a steady, uninterrupted path—there will be days when the exchange rate goes down, as one would expect as the exchange rate becomes more determined by market forces. And China is going to be careful to try to avoid creating a market expectation of a "one-way bet" that could cause a large speculative inflow. But the exchange rate must demonstrate a sustained, trend appreciation.

As the exchange rate gets closer to a level that reflects underlying economic fundamentals, the level of intervention should decline. Continued heavy intervention, in contrast, would support the judgment that the currency remains undervalued.

As China's leadership has acknowledged, a more market-determined exchange rate is in China's interest. A more flexible exchange rate will allow China to pursue a more independent monetary policy better suited to responding to China's economic conditions. It will provide greater ability to pursue needed structural reforms to encourage consumption with less fear of feeding inflation. And it helps China prepare for further opening and internationalization of its capital markets.

Going forward, sources of global demand growth have to adjust to the new economic realities. China and other surplus countries like Germany and Japan will have to increase domestic demand as the United States and other deficit countries save more and consume less. By continuing to maintain a rigid exchange rate, China is impeding the adjustments needed to secure the strong, sustainable global growth we all need.

Creating a Level Playing Field for American Firms and Workers

Beyond the exchange rate, China has for a long time combined the pursuit of an export-driven growth strategy with a substantial set of protections and preferences for its domestic industries. We are committed to leveling that playing field.

It is a simple principle of fairness that American firms competing in China's markets should have the same rights enjoyed by Chinese companies, just as Chinese firms compete on a level playing field with U.S. companies here.

For example, the government still plays a very large direct role in the economy, through state-owned enterprises, and in the allocation of credit and other inputs to domestic production. China pursues industrial policies to promote what it calls "indigenous innovation," aimed at promoting innovation and technological advancement in China that potentially discriminate against U.S. firms and their products, services, and technology. China also has yet to meet its 2001 commitment to sign on to the disciplines provided by the WTO Agreement on Government

Procurement (GPA). And China continues to maintain investment barriers that prevent U.S. firms from having the same opportunities that Chinese firms enjoy in the United States.

China's indigenous innovation policies include proposed government benefits for specific products designated by the Chinese government such as preferential access to China's government procurement market. These and other measures, if implemented, would threaten normal, commercial intellectual property-related transactions and undermine market competition.

China, like all countries, has a legitimate interest in promoting domestic innovation and technological progress. At the same time, its policies should not disadvantage U.S. firms and workers.

We have made some progress on this front but much more must be done. We are pursuing this through all available bilateral and multilateral channels. At the S&ED, China committed that its innovation policies would be consistent with the principles of nondiscrimination, strong intellectual property rights enforcement, market competition, and open trade and investment, as well as to leaving the terms and conditions of technology transfer to individual enterprises. China also agreed to a high- and expert-level process led by Office of Science and Technology Policy Director Holdren that includes all relevant U.S. and Chinese agencies, to address our unresolved issues so that American firms and their workers are not disadvantaged by these policies. This process was launched in meetings in Washington in July and we will hold the next meeting in China this fall.

Under the leadership of Secretary Locke and Ambassador Kirk, we will address specific trade and investment issues relating to innovation in detail with China at the next meeting of the JCCT later this year.

On intellectual property rights (IPR), rampant IPR violations and the overall level of IPR theft in China remain unacceptable. Even with recent improvements in Chinese law designed to protect intellectual property, piracy and theft of intellectual property are widespread. For example, the share of IPR-infringing product seizures just at the U.S. border that were of Chinese origin was nearly 80 percent in 2009. Despite recent positive steps by China, including the largest software piracy prosecutions in Chinese history and an increased number of civil intellectual property cases in the courts, widespread IPR infringement in China continues to impact U.S. products, brands, and technologies in a wide range of industries. IPR enforcement is an important economic issue, and robust enforcement provides incentives for innovation and creativity, crucial to our economy.

We will continue to press China to strengthen its IPR enforcement and its prosecution of violations so that U.S. firms are not being undercut by pirated technology and counterfeit goods.

When China fulfills its WTO commitment and completes the negotiations to join the WTO's rules-based GPA, as we have been pressing China to do, China's ability to use government procurement to pursue discriminatory policies, including China's proposed product accreditation system, will be limited. In line with its commitment to us in the S&ED, China submitted a revised offer in July to join the GPA. While improved, it is still insufficient, and we will continue to make clear to China that it must provide broad coverage consistent with that of other GPA members.

Investment barriers continue to prevent or constrain U.S. firms' ability to invest in specific sectors of the Chinese economy. Reducing these barriers, as well as maintaining the longstanding open investment policy of the United States, is vital to creating more jobs for American workers.

In many cases, foreign investment by U.S. firms, including in China, provides a major channel through which U.S. exports flow, and as a result contributes to creating jobs here at home at our exporting firms.

Again, it is a simple matter of fairness that U.S. firms enjoy the same access in China that Chinese firms have here. We intend to hold China to its S&ED commitment to expand areas that are open to foreign investment, including certain services, high-technology goods, high-end manufacturing, and energy saving products, and will push for further opening to expand opportunities for U.S. firms.

For our part, we are fully committed to welcoming foreign investment, including from China, consistent with safeguarding our national security. Foreign investment benefits the United States. It creates high-paying jobs, and brings new skills and technologies. According to the latest data available, 5.5 million Americans – approximately 4.6 percent of U.S. private industry employment – are employed by U.S. affiliates of foreign firms.

U.S. Policy Options

We are very concerned about the negative impact of these policies on our economic interests, and are pursuing a carefully designed, targeted approach to address these problems.

The Administration is using all tools available to ensure that American firms and workers can trade and compete fairly with China. We are committed to promoting policies in both the United States and China to create new opportunities for Americans and grow jobs in the United States. And we are not leaving these outcomes to chance.

We will continue to encourage China to rely to a much greater extent on domestic demand for growth – particularly by giving households the income and the confidence to spend more and enjoy higher living standards. We are urging China through all channels to allow significant, sustained appreciation of the renminbi over time to accurately reflect market forces and correct the distorting undervaluation. We are urging China to end discriminatory trade and investment measures, protect intellectual property, and adhere to international best practices in promoting innovation.

We are working in multilateral channels, including the G-20, APEC, and the IMF to press China to achieve balanced, sustainable growth, particularly by allowing prompt, meaningful, and continuing appreciation of the renminbi. A more flexible renminbi is in the best interests of the entire global community. At the IMF, China allowed publication of the annual Article IV report for the first time since 2006, a step we strongly encouraged. In the G-20, we expect China's commitment to rebalancing to be a key part of the agenda at the Leaders Summit in Seoul later this year.

We are aggressively using the full set of trade remedies available to us under U.S. law to address unfair trade practices and safeguard the interests of U.S. workers. The Commerce Department has moved actively, consistent with WTO rules, to defend U.S. companies and workers from unfairly traded goods from China. And last year, the President imposed temporary import relief under Section 421 when imports from China disrupted the U.S. market.

We also will continue to use all tools we have to hold China to its international trading obligations, including in the WTO. Yesterday, Ambassador Kirk announced the filing of two new WTO cases against China, one involving discrimination by China against U.S. suppliers of electronic payment services (EPS), and the second challenging China's imposition of countervailing duties on U.S. exports of a high-tech steel product known as "Grain-Oriented Electrical Steel" (GOES).

Last year, the United States won two WTO cases against China relating to intellectual property rights – one on copyright and trademark protection and another on the importation and distribution of certain publications and audiovisual products – and successfully settled a third case in which we challenged what appeared to be prohibited export subsidies. China also repealed measures that discriminated against U.S. auto parts in order to come into compliance with a favorable WTO ruling obtained by the United States in another case.

We are in the process of reviewing carefully the evidence presented in the Section 301 petition filed by the United Steelworkers Union challenging a wide range of Chinese policies in the renewable energy sector.

And we are exploring ways to encourage a substantial improvement in intellectual property protection in China.

We are pursuing these important economic objectives at the highest levels of the U.S. government, with a carefully coordinated assessment of priorities, led by the White House, and using all available tools, consistent with our WTO obligations.

Our commitment starts at the very top. President Obama has made clear to the highest levels of the Chinese government our economic priorities, including real progress on currency and indigenous innovation. He designated Secretary Clinton and me to lead the S&ED, through which we are pursuing an integrated and coordinated strategy to level the playing field; we do so together with our interagency colleagues as part of an Administration-wide effort.

We are making some progress. We welcome the recent assurances by the Chinese government, including Premier Wen's statements this week, to afford national treatment to U.S. companies operating in China. But we want to see that level playing field extended to U.S. exporters selling to China. This is the basic premise of the multilateral trading system from which China and the United States have benefitted greatly.

Mr. Chairman, we welcome your attention to these issues. And we will work closely with this Committee and your colleagues in both houses of Congress to find ways to best advance and best protect our economic interests in this important strategic relationship.

China has a very substantial economic stake in access to the U.S. market, and China has benefitted greatly from the rules and protections that underpin the multilateral trading system. And we have a very strong interest in a more level playing field in the Chinese market, so that U.S. businesses and U.S. workers do not face unfair trading practices.

I want to be clear: a strong and growing China benefits the United States, just as a strong and growing United States is good for China. The more level the playing field, the truer this is.

Fundamentally, our ability to benefit from the U.S.-China relationship depends more than anything else on our own actions to strengthen the American economy. To take advantage of the opportunities presented by a growing China, we have to educate our children, teach and advance basic science, invest in R&D, and foster innovation.

We are making very substantial investments to do just that – to develop our abilities in growing fields like new energy technologies and prepare our industry and workforce to remain global leaders.

And we are committed to restoring fiscal sustainability as the economy continues to recover so that our own economic conditions support strong and sustained growth, at home and globally. To achieve this, the Administration's Budget puts a three-year freeze on non-security discretionary funding. Congress established its own pay-as-you-go budgeting rules in 2007 and the President proposed and signed legislation making PAYGO a legal requirement last February. PAYGO played an important role in restoring fiscal discipline in the 1990s. And the President has appointed a bipartisan Fiscal Commission which will make further recommendations by the end of the year.

Renminbi appreciation will not erase our global trade deficit, nor our deficit with China. Our bilateral trade deficit is likely to persist. But Chinese exchange rate adjustment is critical to removing a major distortion in the global economy, to rebalancing China's economy, and to ensuring strong, sustainable, and balanced global growth.

We need a more balanced economic relationship. This is imperative for us, but it is important to China as well.

I look forward to working closely with this Committee and your colleagues in Congress so that the American people get the full benefits of an open and fair economic relationship with China.

Thank you.