

**U.S.-CHINA TRADE: PREPARATIONS FOR THE
JOINT COMMISSION ON COMMERCE AND TRADE**

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CONTENTS

	Page
Testimony of:	
Attaway, E. Fritz, Executive Vice President and Washington General Counsel, Motion Picture Association of America	45
Freeman Hon. Charles W., III, Deputy Assistant U.S. Trade Representative, Office of the United States Trade Representative	13
Levinson, Mark, Chief Economist and Director of Policy, UNITE	73
Lowenstein, Douglas, President, Entertainment Software Association	37
Papovich, Joseph, Senior Vice President, International Recording Industry Association of America	68
Primosch, William, Director of International Business Policy, National Association of Manufacturers	56
Tonelson, Alan, Research Fellow, The U.S. Business and Industry Council Educational Foundation	62

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WEDNESDAY, MARCH 31, 2004

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON COMMERCE, TRADE,
AND CONSUMER PROTECTION
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2123, Rayburn House Office Building, Hon. Cliff Stearns (chairman) presiding.

Members present: Representatives Stearns, Upton, Whitfield, Shimkus, Shadegg, Bass, Bono, Terry, Otter, Sullivan, Barton (ex officio), Schakowsky, Brown, Stupak, Green, McCarthy, Strickland, and Davis.

Also present: Representative Norwood.

Staff present: David Cavicke, majority counsel; Shannon Jacquot, majority counsel; Jon Tripp, deputy communications director; Brian McCullough, majority professional staff; Jill Latham, legislative clerk; and Jonathan Cordone, minority counsel.

Mr. STEARNS. Good morning. The subcommittee will come to order.

Today we'll hear from a number of distinguished witnesses on a topic that is both important and timely. The U.S.-China Joint Commission on Trade is scheduled to meet on April 21 and April 22 for its annual cabinet level meeting. It is a significant meeting because there are many pressing issues involving the U.S. trade with China. The subcommittee called this hearing to further a dialog with industry about what industry priorities are with regard to the Joint Commission meeting.

I thank the witnesses in advance for their participation today and obviously I look forward to a frank and hardy discussion on this matter.

U.S. economic ties with China have been growing in remarkable ways over the past 25 years. Since 1980, U.S.-China trade has risen from roughly \$5 billion a year to \$181 billion a year. China is now the third largest U.S. trading partner. On the whole, this has been a benefit to the United States businesses and workers because China is becoming an increasingly important market for U.S. exports. Since China has one of the world's fastest growing economies, this export trend is likely to continue.

In addition, Chinese imports have brought lower price goods to many U.S. consumers. However, obviously there are challenges as this trading relationship evolves. The U.S. trade deficit with China is \$124 billion as of 2003. This trade deficit is continuing to grow. A healthy bilateral trading relationship with deficits of this magnitude is not sustainable in the long term.

Obviously, all of us would like to see increased attention to piracy and counterfeiting issues. Counterfeiting of manufactured products and piracy for intellectual property are big business in China. Piracy of U.S. intellectual property in China may exceed \$1 billion per year. This is a real problem for U.S. exports and if remedied, would help in balancing the U.S.-China trade deficit.

In short, my colleagues, we are buying Chinese products. They are stealing many of ours. We have several distinguished witnesses here to testify about the piracy problems in intellectual property and the counterfeiting problems with manufactured goods. I want to tell those witnesses that I am committed to assisting them in their efforts to reduce counterfeiting and piracy in China. I think we've had some success in Singapore and some success in Taiwan.

China's entry into the World Trade Organization was a watershed event. WTO entry required China to reform its trade practices significantly. China's progress in meeting WTO requirements has been mixed—progress has been consistent but we still have a very long way to go to really ensure fair trade practices.

Each year the United States Trade Representative, USTR, issues a China WTO compliance report. The report issued in December of 2003 found that while China had made significant progress in meeting WTO obligations, many problems still remain.

These are just a few: agricultural and industrial quotas; tariff-rate quotas, industry subsidies; confusing and discriminatory regulation of services businesses; discriminatory taxes on imports; insufficient transparency in regulation; and lack of protection for U.S. intellectual property rights.

I look forward to the hearing and to hear from the Honorable Charles Freeman, Deputy Assistant Trade Representative, testify about his feelings here. I commend the USTR for its tireless efforts in promoting the interest of U.S. industry around the globe and in China in particular.

My colleagues, these are difficult issues, but they must be solved if the U.S. is to have some day fair trade with China. I encourage the administration to ensure that China fully complies with the WTO obligations and it seems the administration is willing to do just that.

One of the important issues we debated in the 106th Congress when we considered Permanent Normal Trade Relations with China was the issue of human rights. I do believe that free trade can increase freedom for people living under communist or totalitarian governments but it can only do so if democratic trading partners insist on those freedoms as part of the trade negotiations and insist on those freedoms as part of the implementation.

China's international trade commitments require it to develop institutions that respect the rule of law. The U.S. has not just an economic incentive, but also a moral obligation to ensure China does

just that. The work the U.S. Government does today must aim to nurture the fledgling freedoms of the Chinese people.

With that I look forward to the testimony today and I hope the hearing will bring focus on the important issues before the April Joint Commission Meeting.

With that, the ranking member, Ms. Schakowsky.

Ms. SCHAKOWSKY. Thank you, Mr. Chairman, and I want to welcome all of our witnesses, including Mr. Freeman and all the others as well. I appreciate your taking the time to come here to discuss our trade policy with China.

I want to offer a special welcome to Mark Levinson, the Chief Economist and Director of Policy of UNITE. I'm a proud member of UNITE myself and really appreciate that a member of my union is here to present the critically important views of working Americans of organized labor to us today.

This is a very important hearing. For most Americans, the U.S. economy is in bad shape. We've lost over 2.3 million jobs since President Bush took office. China, an important strategic trading partner and world power, enjoys a trade surplus with the United States that has swelled over the last year in particular. China's trade surplus with the United States increased 20 percent in 2003 to \$124 billion. We have a more imbalanced trade relationship with China than with any other nation.

I recognize the importance of China to the United States and the need for the United States to engage China in a constructive way, but our lack of engagement with China on issues of critical importance to our economy and to principles, issues of labor rights, human rights and the environment, in my view, is shameful and misguided.

I visited China on a CODEL that was led by Congressman Don Manzullo, the Chairman of the Small Business Committee. We met with top Chinese officials and had conversations about numerous issues, including China's lack of progress on human rights and labor rights. And I'm sad to say that since that trip the situation in China has not improved and workers in that country and the United States are paying the price.

Despite being morally reprehensible, China's disregard for workers' rights give that nation an unfair trade advantage. That, according to the AFL-CIO, has cost more than 727,000 U.S. jobs. It's bad enough that China denies its work force the right to join unions and to bargain collectively and it is unacceptable that there is no true minimum wage in China. It's unacceptable because Chinese workers deserve better and it's unacceptable for the United States in economic terms.

Chinese workers' wages are between 47 percent and 86 percent lower than they should be which, in turn, reduces the price of Chinese manufactured goods. This provides China with an unfair market advantage over U.S.-made products and undermines the U.S. job market.

The Industrial Union Council of the AFL-CIO recently filed a petition with the USTR under Section 301 of the Trade Act on behalf of the 13 million members of the AFL-CIO including nearly 6 million manufacturing workers because of the dangerous and dam-

aging effects that China's behavior is having on the U.S. economy and on the rights of its labor force.

Mr. Chairman, by unanimous consent, I'd like to place that petition into the record.

Mr. STEARNS. By unanimous consent, so ordered.

Ms. SCHAKOWSKY. I'll be spending most of my time in questioning, exploring the subject today, but before I conclude my opening statement I want to say that I'm really disappointed. I'm not just disappointed over the current state of our economy or the lack of leadership by the Bush Administration in pressing China on core human and labor rights and environmental issues, but I'm disappointed and actually surprised at the prepared testimony of our United States Trade Representative witness did not even mention labor rights or human rights or the environment. And it doesn't even acknowledge the AFL's position.

Is it any wonder that organized labor in this country feels abandoned by this administration? Judging from the USTR's testimony it would be safe to say that labor is not even on the radar of the Bush Administration. I share many of the concerns that are raised in the Deputy Assistant Trade Representative's testimony, but I think it represents a shameful trend in our Nation's overall approach to trade.

While we race to the bottom, force free trade agreements and expand U.S. market access, workers' rights, human rights and our natural environment take a back seat. It is just wrong. We need a fundamental shift in the way we approach the world, our trading partners and new trade deals. We need to put people and the environment right on a par with new profit opportunities. If we fail to do so, we fail our economic obligation to America's work force and we fail our moral obligation to the international work force. We can do better.

Again, I want to welcome our witnesses and I look forward to their testimony.

Mr. STEARNS. I thank the gentlelady and distinguished Chairman of Telecommunications.

Mr. Upton of Michigan.

Mr. UPTON. Thank you, Mr. Chairman. I appreciate the opportunity of this hearing. I do believe in free trade and I've supported it. Most of the time I think free trade is beneficial for our U.S. manufacturers and for our economy, however, with respect to China it does seem like something has gone awry. In fact, the playing field looks so uneven, I don't blame folks back home for wanting to plow it over. A trade deficit with China is beyond the point of acceptability.

I'm concerned about a number of aspects of our relationship with China on trade. First of all, I think the on-going currency manipulation is a real problem. The drastic under valuation of the currency makes it seem like it is cheaper to do business than it really is.

Mr. Chair, the Telecommunications Subcommittee, I'm very worried about piracy issues, particularly in the realm of computer software, movies and music. I'm worried about safety issue which it comes to counterfeit medical devices and I've not been satisfied with the level of response by the Chinese government with regard

to piracy and counterfeit goods and I hope that our witnesses today will talk about that issue.

I also believe when China joined the WTO that there was an expectation that they would adhere to principles of fair trade through that organization. It doesn't seem like that is happening when we watch jobs continuing to move there on a routine basis. I've got great concerns when it comes to steel and China's impact on the steel industry. It seems like China is the only country that's immune to the current shortages and inflated prices. Why is it a problem here and it doesn't seem to be a problem there?

Thank you, Mr. Chairman, I look forward to today's testimony and the ability to engage the witnesses on these important issues. I yield back.

Mr. STEARNS. I thank the gentleman. Mr. Strickland?

Mr. STRICKLAND. Thank you, Mr. Chairman. Mr. Chairman, members of this committee, I feel a deep sense of anger today because yesterday our Treasury Secretary John Snow was in Ohio and our President was in Wisconsin. According to newspaper accounts, Mr. Snow in Ohio, in economically hard hit Ohio, said that outsourcing was an integral part of our global trading system. And the President, in Wisconsin, was defending outsourcing apparently in a State that has lost 80,000 manufacturing jobs. And I just am frustrated. The American people are frustrated. How anyone can come to Ohio and with a straight face support such a statement is almost beyond belief.

I quote, this is from the Cincinnati Enquirer. The Treasury Secretary said that the practice of moving American jobs to low cost countries is "a part of trade" and "there can't be any doubt about the fact that trade makes the economy stronger." And then there's the comment that his remarks were reminiscent of the remarks made by Mr. Mankiw in the report that the President signed, the Economic Report to the Nation where he said among other things that "if a good or a service can be produced at lower cost in another country, it makes sense to import that product rather than to produce it domestically."

And I asked our Secretary of Commerce last week to please give me a list of the products that cannot be manufactured for lower cost in another country. I think given the fact that the people that I talked with in Mexico were getting \$38 a week and that situation exists around the world, that nearly every product can be produced at lower cost in another country.

Now those remarks required Mr. Mankiw to apologize to our House Speaker, Mr. Hastert. I wonder if the President and Mr. Snow will apologize.

According to a report in the National Political News, the President told his audience in Wisconsin that he understood there was concern about jobs going overseas, for some people looking for work, I understand that. The some people looking for work are hundreds of thousands of people who have seen their jobs outsourced.

I look forward to the testimony because I also have questions about the steel industry, about the restrictions on the exporting of coke, about the importation of scrap metal from this country that

is providing a serious, serious problem to our steel fabricators and our machine shops and our steel producing companies.

We are facing a crisis and I simply ask myself and I think the American people are asking when is this administration going to understand what is truly happening and take actions which will save the American economy.

Thank you, Mr. Chairman, I yield back.

Mr. STEARNS. I thank the gentleman. Mr. Otter.

Mr. OTTER. Thank you, Mr. Chairman. I want to thank you, Mr. Chairman, and ranking member for holding this hearing and allowing us the opportunity to highlight some of the important commerce issues facing the United States and China.

As an Idahoan and as a rancher I know the importance of private property. There we talk in terms mostly of dirt. Here, I think we have to talk in a much broader concept and as you know, the Founding Fathers defended private property rights as a fundamental tenet of our United States Constitution. In the fifth amendment, in fact, to the Constitution it says "nor shall private property be taken for public use without just compensation. Compensation must be required to pay for all properties taken physical, dirt, or intellectual, creative."

Through this founding concept, our copyright system preserves the rights of authors of intellectual properties and their estates to profit from their creativity. And I fully support protecting the rights on the international scene. Copyright laws encourage people to creatively express themselves and to make a livelihood in doing so. As we enter into another round of talks in U.S.-China Commission on Commerce and Trade next month, I think it's important to recognize the importance of protecting our citizens' intellectual property not from under costs, not from low cost producers as has been suggested by the other side, but from theft, out and out theft.

The effects of China and other nations to protect intellectual properties can only be described at best as very, very lax and probably insincere. An estimated 9 out of every 10 CDs sold in China are pirated. That means no one in America is compensated for his or her investment on 90 percent of the transaction in music trade. In 2003, the Motion Picture Industry estimated they lost at a minimum \$175 million in China. Interestingly enough, that's more money than the film industry made in China in 2003.

As we move forward in outlining an appropriate exchange of markets with China, we must recognize the importance of protecting our resources and our interests. We must also recognize that we in the U.S. have to continue in the effort to be more responsible in how we value those intellectual properties.

In minutes, a child in the United States can purchase a CD or a DVD, upload it on a file sharing internet service. Shortly after, someone in China can download a perfect copy of that CD or that DVD, package it and illegally sell it in an open street market with little or no concern about any repercussions.

Protecting intellectual property must be a collaborative effort. I am pleased to see this listed as a high priority in the upcoming discussions with China and diverting from my prepared testimony, Mr. Chairman, I would only suggest as I have with many, in many cases, with much of our trade negotiations and efforts, that I would

invite the USTR and all those who are really concerned about getting the best deal that we can, as I have in farm products, as I have in some of our manufactured products, to put a person on that negotiating team that knows what they're doing in real life rather than just out of theory and because they went to college somewhere.

I'd like to see a person that actually drove the wheat combine negotiating on a wheat trade. I'd like to see somebody who worked in a processing plant, perhaps a union member sitting at that table. I've had the opportunity to negotiate contracts with both union members and farmers and they're pretty tough negotiators and I think we need that kind of advantage at our negotiating table.

And finally I would say in this context, I would hope that you would invite somebody from the motion picture or the entertainment industry to the negotiating table to help you find that safe road for fairness in our negotiations.

Thank you, Mr. Chairman.

Mr. STEARNS. I thank the gentleman.

Gentleman from Texas, Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman, and I thank you and the ranking member for holding this hearing on U.S.-China trade and I'm pleased that both the chairmen of the full committee are interested in trade issues and I think it's very appropriate that our subcommittee exert its jurisdiction over trade issues.

Article 1, Section 8 of the Constitution clearly states that the U.S. Congress has the sole authority to regulate trade with foreign countries. With the approval of fast-track authority, I think Congress abdicated a lot of our authority except for one vote on the floor of the House. However, I wholeheartedly support the efforts, our committee's efforts to renew so our voices can be heard.

This subcommittee's trade jurisdiction extends to non-tariff related trade issues and in my opinion most of this country's problems with China falls squarely within that jurisdiction. China's currency manipulation, lack of regulation and State subsidies gives them an unfair competitive advantage when it comes to trade with the United States. But their largest advantage and our largest disadvantage remains in the issue of the standard of living. The United States cannot engage in a race to the bottom to be able to compete in a global marketplace that rewards low wages and substandard living conditions. The American people simply can't afford that kind of battle.

Faced with this reality, we have few options that can help us truly level the playing field and considering \$124 billion trade deficit with China, we must take every avenue available.

I have joined several efforts in this chamber to encourage China to stop undervaluing its currency. The Chinese currency has been fixed at 8.3 yuan to the dollar which results in a seriously undervalued yuan. This makes Chinese exports even less expensive and results in an unfair competitive advantage that American products simply can't compete against. In fact, many economists have concluded that the undervalued currently amounts to a 40 percent subsidy for all Chinese exports to the U.S. and a 40 percent tariff on all U.S. exports to China.

Mr. Chairman, I represent the Port of Houston which is the largest U.S. port in foreign tonnage. The ships that come from all over the world, but particularly China, have kept our port busy and provided good paying jobs for my longshoremen, yet to put it simply as much as I like to see those ships coming in full containers into the Port of Houston, I'd like to see them leave our ports full of American goods going to a foreign market. The cost of containers is so cheap in China that sadly in most of our foreign ports we have an excess of containers because it's cheaper to build a container in China than it is to ship one back empty. It would be much better if we could ship it back with some of our products.

There's no question we must take quick action against the unfair trading practices in China and I'm interested in suggestions of our witnesses that have to offer and I thank them for appearing today. And again, Mr. Chairman, I thank you and yield back my time.

Mr. STEARNS. The gentleman from Oklahoma, Mr. Sullivan.

Mr. SULLIVAN. Thank you, Chairman Stearns. As a new member of the committee, I'm very interested to hear the testimony presented today. The U.S.-China Joint Commission on Commerce and Trade has played a very important role in issues of trade between our two nations. Issues of intellectual property protection and piracy, non-tariff barriers to the U.S., manufacturing products in China are extremely important to me and the people of the First District of Oklahoma.

My District has lost over 16,000 jobs in the last year. While not all of this is in the manufacturing sector, much of it is. And part of that concern involves trade with China. For the second time, the U.S. Trade Representative found that China continues to have problems meeting its WTO obligations, especially in regards to agriculture, services, IPR protection, tax policies, trade rights and distribution and transparency of trade laws and regulations.

If the U.S. is to continue in the multi-billion trade relationship with China, these issues must be addressed. I'll look forward to hearing today's testimony and yield back the balance of my time.

Mr. STEARNS. I thank the gentleman. The gentleman from Florida, Mr. Davis.

Mr. DAVIS. Thank you, Mr. Chairman. Obviously, there's a lot of anxiety in the country as manifest in this committee today over the aggressive business activity in China and increasingly sophisticated manner in which the country is taking advantage of trade. This is understandable.

It is the same approach we take here in the United States in our trade with China and other countries. But at the core of the issue here is the rule of law. The Chinese government has bound itself, its businesses and its citizens to the rule of law and to the terms and conditions of the WTO and are bilateral. And it is essential that we focus on living up to that agreement and that they live up to it as well.

I have, as I'm sure you know, been a consistent supporter of many of the trade agreements that were presented by the Clinton Administration and this administration. I think it's time for us to take a second look at how we define success. I think it's fair to say success has largely been defined at the USTR's office under any administration in the number of agreements that were signed as op-

posed to how effectively we enforce the ones that were signed. If that presents resource issues on your part, I hope that you'll mention that today or your office will follow up with this committee and others, but it is important that we do a better job and put more priority on making sure these agreements are adhered to.

I also hope that you will comment upon what efforts we are taking to help the country of China start to develop a more reliable and sophisticated judiciary. I've heard anecdotally there are some judges in China that don't even have a law degree. There's a lot of democracy building that needs to be done there both on the human rights, political and civil rights, and on commercial. This should be an era we can bring all the competing interests together.

Finally, I don't see any reference in your testimony to the issue that you're going to hear from everybody here about the monetary policy of China. If you don't think it's an issue or you don't think there are any easy solutions, you should say so and I'm sure there are other committees that will be talking about that as well, but it's clearly something we should at least be discussing.

I think the ranking member's comment about labor and environment has some merit from that standpoint. I also would encourage you today and in the future to simply try to address those issues. One of the ways that President Clinton was trying to develop a Center on Trade Agreements and I'm referring specifically to Jordan, Singapore and to some extent Chile, was to begin to put more emphasize on labor and environment. We will not always agree as to how we get there and how quickly we get there, but it is a mistake not to at least address those issues and try to develop some common ground, both in the enforcement on the China trade agreement in the WTO and in other trade agreements we'll be talking about.

So I hope you'll take those comments to heart as a constructive way that we can try to figure out how to solve some of these problems instead of just spending most of our time identifying them.

Thank you, Mr. Chairman.

Mr. STEARNS. I thank the gentleman.

Mr. Shimkus?

Mr. SHIMKUS. Thank you, Mr. Chairman. Briefly, I want to welcome Mr. Freeman here and basically a lot of us are talking about job losses and a lot of job gains. I've been really talking about the difference between the household survey and the payroll surveys because I have a lot of self-employed individuals. They're never counted in a payroll survey because they're household employed and I think we lose that argument in this whole job. And I just throw that out as—for the public to understand that when self-employed individuals are not counted in job gains or job losses, we lose a lot of people who are really entrepreneurs.

On the subject particularly, China's currency is significantly undervalued. I agree with Congressman Davis. I think it's a WTO violation and we ought to be aggressive in addressing that issue.

Piracy would be another, I think, breaking of the WTO agreement and we ought to be very aggressive, especially on intellectual property. I'm also concerned about the safety of products. Again, big conflict when we're concerned about safety of maybe manufac-

tured goods and we're not concerned about safety of reimported drugs, but that's a political debate that we'll continue to have.

We have an additional cost to manufacturing in this country with high health insurance, high worker comps, high litigation, high regulation that also has to be part of the debate on the competitive nature of our manufacturing sector and that's also part of the struggle that we have as we try to define how we're—where we're doing well and how we're having challenges. So I look forward to the hearing. We all have a great concern in this issue and I yield back the balance of my time.

Mr. STEARNS. I thank the gentleman.

The gentleman from Ohio, Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman. I appreciate your leadership and Ms. Schakowsky's leadership on trade issues and your support for fair trade that you have both advocated for as Members of this body.

I share Mr. Strickland's concern about the President's trip to Wisconsin and his comments and Secretary Snow's trip to Ohio. When I hear the President calling us economic isolationists that is not helpful in this debate and calling people who believe in fair trade as Mr. Chairman Stearns and Ms. Schakowsky and most of here who believe that trade should include environmental labor standards, doing name calling like that doesn't really help us engage in the debate.

I want to welcome Mr. Tonelson and Mr. Levinson, friends of mine, thank you for being here and lending your thoughts to this debate.

Free trade ideologues are quick to point out that America has significant exports to China. That's true, but stopping the analysis there is like trying to balance your checkbook by counting only the deposits and ignoring the withdrawals. It makes for an assessment that makes us feel better, but it really isn't terribly accurate. The U.S. trade deficit with China topped \$124 billion last year, the largest deficit, as we all know, with one country in U.S. history. The monthly trade deficit with China the last month we know, this past January, stood at a record \$43 billion. That's four times the trade deficit in January is four times the annual trade deficit we had with China my first year in Congress in 1993.

The main reason for China's comparative advantage when we harken back to ideology of sixteen decades ago is obvious. An exiled Chinese labor activist, Wei Jinsheng, told The Washington Post, the reason Chinese products are so cheap is the workers have no rights. China's government employs forced labor, slave labor, and child labor to minimize costs. They prevent workers from joining unions. They prevent workers from bargaining collectively. They deny citizens safe working conditions. They provide no minimum wage.

The AFL-CIO estimates that by using abusive labor policy to stack the deck in its favor, China unfairly costs U.S. companies and businesses and workers 727,000 jobs. The AFL-CIO sought relief from the U.S. Trade Rep. under Section 301 of the Trade Act of 1974. That petition, a first of its kind in trade history filed on the basis of labor policy is an important first step toward a level playing field with China.

I urge Mr. Freeman, Mr. Zoellick, the USTR, and President Bush to act quickly and forcefully in support of the AFL-CIO petition. I think this would substantially dramatically change the trade relationship we have with China. If this hearing could lead to one thing it would be, Mr. Freeman, your support of that AFL-CIO petition, to give workers, put workers on the same field as we put intellectual property.

Well, I totally agree with my friends on the other side of the aisle and Mr. Davis, both who mentioned, many of whom mentioned the whole issue of intellectual property, why we need to stand strong on that issue. We should stand strong, as the Jordan agreement did on labor, environmental standards. It's the right thing for human beings. It's the right thing for trade policy. It's the right thing for jobs here and it's the right thing ultimately for economic development in the developing world.

I yield back the balance of my time, Mr. Chairman.

Mr. STEARNS. I thank the gentleman.

The gentleman from Nebraska, Mr. Terry.

Mr. TERRY. Waive.

Mr. STEARNS. Waives. The gentleman from Arizona, Mr. Shadegg.

Mr. SHADEGG. Mr. Chairman, other than to thank you for holding this hearing and welcome our witnesses, I too, will waive.

Mr. STEARNS. The gentleman from Georgia, Mr. Norwood.

Mr. NORWOOD. You're very kind, Mr. Chairman, but I'm just here to listen today, thank you.

[Additional statements submitted for the record follow:]

PREPARED STATEMENT OF HON. JOE BARTON, CHAIRMAN, COMMITTEE ON ENERGY AND COMMERCE

I want to commend Chairman Cliff Stearns for holding this hearing on U.S.-China trade today. Trade is a vital engine for economic growth. Our committee has jurisdiction over non-tariff impediments to international trade and I intend to pursue this jurisdiction vigorously during my Chairmanship.

No bilateral trading partner of the United States has received more attention than China. Trade with China has expanded from \$5 billion in 1980 to \$181 billion in 2003. China is our third largest trading partner, and the rate of growth of U.S.-China trade is staggering. China is our second largest source of imports and our sixth largest export market. This trade has allowed for substantial economic growth for both countries.

There are important issues in this relationship that merit our attention today, however. The U.S. trade deficit with China was \$124 billion in 2003 and it is growing. Trade deficits of this magnitude are not sustainable in the long term. China exports quality products to the United States for which we pay free market prices.

The United States is the world's leading producer of intellectual property—movies, music, books and software are some of our high value added products. We have three witnesses today from industries that produce intellectual property—movies, music and video games. I am particularly interested to hear their views of what can be done to get China to enforce intellectual property rights.

China joined the World Trade Organization at the end of 2001 after fifteen years of negotiations. China's accession required it to eliminate many tariff and non-tariff impediments to the Chinese market. These restrictions included those on manufactured imports, and those on foreign ownership and investment.

In December 2003 the USTR issued a report on Chinese compliance with its WTO obligations. I commend the USTR for its fine work on the report and its tireless work to open markets to U.S. trade. The conclusions in the report were troubling. It indicated that China has failed to live up to its WTO obligations in areas as diverse as agriculture, services, protection of intellectual property, tax policies and transparency of laws generally.

The USTR has filed a case against China for discriminatory tax treatment of imported semiconductors. This case is important, and we in the Congress support the USTR in its effort to see that our trading partners live up to their obligations.

I expect that the Committee will be active in the trade area for the remainder of this Congress. We will look at the Free Trade Agreements with Australia, Morocco and Central American countries. We will also look at specific impediments as they affect sectors of U.S. industry.

I thank the witnesses for their participation and yield back the balance of my time.

PREPARED STATEMENT OF HON. BART STUPAK, A REPRESENTATIVE IN CONGRESS
FROM THE STATE OF MICHIGAN

Mr. Chairman, thank you for calling this hearing. I would like to take this opportunity to thank all of the witnesses for joining us today to discuss the issue of U.S.-China trade and the upcoming Joint Commission on Commerce and Trade (JCCT) meeting between our two countries.

Everyday our trade deficit grows. U.S.-China commercial relations have been strained particularly by the surging \$124 billion U.S. trade deficit with China which is by far the widest trade gap the U.S. has with any other country.

Everyday we are losing jobs to China. We need to go further in combating the illegal and unfair Chinese trade practices that are creating an un-level playing field for U.S. manufacturers and costing our country valuable manufacturing jobs. They don't seem to understand the meaning of "playing by the rules."

Since joining the World Trade Organization (WTO) two years ago, China agreed to certain concessions. China has a mixed record, at best, when it comes to implementing its WTO obligations. The Bush Administration says it is closely monitoring China's compliance with its WTO commitments, but monitoring isn't enough. We need to do more.

Despite China's ascension to the WTO and its adoption of the Agreement on Trade-Related Aspects of Intellectual Property Rights, the Chinese government has failed to effectively enforce its Intellectual Property Rights (IPRs) protection. The IPR enforcement mechanism is failing to curb widespread piracy and counterfeiting of U.S. products. The U.S. loses more than \$18 billion every year as a result of Chinese piracy of everything from film and recorded music to a steady increase in auto parts and research results. Counterfeited products account for 15 to 20 percent of China's total production—that is about 8 percent of its GDP.

Another problem we face is that China's currency is significantly undervalued compared to the U.S. dollar by between 15 and 40 percent. This policy has been devastating to U.S. manufacturers, who are struggling to compete against cheap Chinese imports. It's time for the Administration to take concrete steps to get the Chinese to establish a specific timetable for floating the yuan.

These practices give Chinese manufacturers an unfair competitive edge over U.S. companies. I know that given a fair chance to compete with foreign workers, American workers can compete because they are proven to be more efficient and better educated than many workers in developing countries. It is simply not fair to our workers when foreign governments, and China is one of the worst, throw up road blocks to U.S. imports. That's when our workers cannot compete and jobs are lost.

During the upcoming JCCT meeting on April 21st, I strongly urge the Administration to insist that China fully comply with its WTO obligations on market-opening commitments, press China to take immediate steps to put a stop to the production and exporting of counterfeit U.S. products, and to make it absolutely clear that the U.S. will no longer sit by while they undervalue their currency at the expense of Americas workers.

While I recognize this might not fall under the scope of the JCCT, I will end by saying that over the next few years, auto imports from China are expected to explode, as is the number of workers employed in China by Detroit's automakers and suppliers. We need to find ways to discourage U.S. companies, such as Detroit's three automakers from making a product in say, China, and shipping it to the U.S. and encourage them to keep jobs in the U.S.

Mr. Chairman, I look forward to hearing from the Deputy Assistant U.S. Trade Representative Freeman on exactly what actions the Administration plans to take to combat the illegal and unfair Chinese trade practices as well as from members of the second panel on their suggestions on how to deal with this issue.

Mr. STEARNS. With that, it appears that the opening statements are complete and so we welcome our first panelist, the Honorable

Charles W. Freeman III, the Deputy Assistant U.S. Trade Representative, Office of the United States Trade Representative.

I understand, Mr. Freeman, you just arrived here from China, I think my staff said, so we appreciate very much your attendance and your willingness to participate and with that, we look forward to your opening statement.

STATEMENT OF HON. CHARLES W. FREEMAN III, DEPUTY ASSISTANT U.S. TRADE REPRESENTATIVE, OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE

Mr. FREEMAN. Thank you, Mr. Chairman and Congresswoman Schakowsky, it's an honor and a privilege to be here, members of the committee and to testify here today. I have to tell you that I've just had two trips to China in the last 3 weeks, so I'm not exactly sure whether I'm coming or going right now, so to the extent that I'm at all incoherent today, I hope you'll blame me and not the administration's trade policy.

But that said, obviously China's trade issues are a high profile issue these days. China is our third largest trading partner now. It's our six largest export market. In the last 3 years, while the global economy has stagnated, and exports to the rest of the world have declined 9 percent to China, they've actually increased about 76 percent. The pace of export growth to China is actually faster than the pace of import growth on a percentage basis for what it's worth. That's of course the good news. As you all know, it's not what any of us really focus on.

The trade deficit with China, as you've pointed out, is over \$124 billion in 2003 and you can rationalize and credibly explain some of the reasons for that number, but by any counts it's striking.

When President Bush met with Chinese Premier Wen Jiabao this past December, they talked about the rising deficit and the powerful impact it's had not only on the American psyche, but also on the consensus in this country that favors open markets.

To his credit, Premier Wen agreed with President Bush that the right way to deal with the deficit is actually increase U.S. exports to China rather than to reduce the ability of U.S. consumers to purchase Chinese products. One of the decisions that was taken during those discussions this last December was to take the Joint Committee on Commerce and Trade, the JCCT, and elevate it. It's not only been a U.S. Department of Commerce-Chinese Ministry of Commerce exercise, the President and Premier Wen agreed to elevate that so it's actually an exercise between Vice Premier Wu Yi chairing her side and a group of ministries on the Chinese side.

Ambassador Zoellick of USTR, Secretary Evans of Department of Commerce, with support from Secretary Veneman of Agriculture and others, to actually not only try to resolve some of the bilateral problems that we face in our trade relationship, but actually to promote U.S. exports to China.

USTR's fundamental role in U.S.-China trade policy is to ensure that U.S. manufacturers, farmers, workers, service providers and consumers actually get the benefits of a deal that we struck that brought China into the WTO in 2001.

While therefore some of the discussions within the JCCT deal with some of the fundamental concerns that some of you have

raised with respect to the structural underpinnings of the U.S.-China trade relationship, many of our priority concerns have to do with China's lack of implementation or lack of complete implementation of their commitments on entering the WTO.

I know that many of the excellent witnesses later today will address these concerns in greater detail, but along with other matters, but I wanted to briefly point out some of the broad areas on which we are focused as part of our attempts to utilize the JCCT to achieve the goals set by President Bush and Premier Wen.

The first broad area, as some of you have alluded to is intellectual property rights. There's no getting around it. Intellectual property rights in China are not well protected. Enforcement of IPR is very, very lax and piracy is absolutely rampant. Even though in 2001, China implemented a legal regime which is consistent with the agreement on trade related aspects of intellectual property rights, the actual level of enforcement and the actual level—well, the actual level of enforcement seems to have gone down and the actual level of piracy seems to have increased.

Other areas with which we're concerned are industrial policies that seem to discriminate against U.S. exports, including tax policies, in new industrial standards in other areas. These are things which fundamentally alter the playing field for some of our companies that are not only trying to do business there, but trying to export U.S. manufactured goods.

In services, we have a range of issues, whether it's through the incomplete implementation of China's commitments on trading rights and distribution services which fundamentally is where the rubber meets the road in terms of China's WTO commitments. Trading rights is the ability to import and export products into China. Distribution services is the right to actually distribute those products to the Chinese people and to the Chinese marketplace. Incomplete implementation of those rights and services would, in essence, undercut the entire value of the deal.

With respect to agriculture, we continue to be troubled by what are perceived to be an effort by some Chinese bureaucrats to lean on the tap in terms of imports from the United States into China, some of our key grains and other commodities. This is something that is critical to us and on which we've been extraordinarily concerned and focused for the last few years, couple of years anyway.

I should note cutting across all of these areas is the critical issue of transparency. Really, what we need to see from China and what China committed to in the WTO agreement was a broad agreement to make sure that the processes for putting in place new regulations and for enforcing those regulations would be transparent. We'd have the opportunity to comment on them. We'd have the opportunity to help correct that. China's transparency commitment has been very unevenly enforced.

I should say that while our primary goal through all of this is to resolve these concerns through dialog, we have not been shy about utilizing the measures we have available in the trade policy toolbox to assert U.S. interests when it's not possible to resolve them through dialog. As many of you know we did utilize special safeguards provided through us through the WTO agreement to impose remedies on three categories of textile products last year. We

recently on March 18th brought the first WTO dispute settlement case against China, first of any other WTO member for its discriminatory treatment of foreign semiconductor products. And the administration has demonstrated its willingness and its right to employ other WTO legal means to ensure that our producers get a fair shake in the face of unfair competition with China.

But the bottom line is that this country was built on open markets and we'd like to keep our markets that way. It appears, at least from my discussions today with the Chinese in preparing for the JCCT, China would like us to keep our markets open too. I hope we've been effective in reminding our Chinese friends that that will in no small part be dependent on what they do over the next few months.

Thank you very much. I look forward to your questions.

[The prepared statement of Charles W. Freeman III follows:]

PREPARED STATEMENT OF CHARLES W. FREEMAN III, DEPUTY ASSISTANT U.S. TRADE REPRESENTATIVE

OVERVIEW

Chairman Stearns, Congresswoman Schakowsky, Members of the Committee, I appreciate the opportunity to testify before the subcommittee today on the U.S.-China trade relationship. This is a subject of considerable importance to the Administration and the Office of the United States Trade Representative (USTR), in particular, in our capacity as the lead agency with responsibility for trade policy.

On December 11, 2001, after 15 years of negotiations with the United States and other World Trade Organization (WTO) members, China became a member of the WTO. Under the terms of its entry, China committed to implement a set of sweeping reforms designed to implement the WTO's market-oriented rules. It agreed to take concrete steps to remove trade barriers and open its markets to foreign companies and their exports in virtually every product sector and for a wide range of services. It also agreed to observe the WTO's national treatment standards, to protect and enforce intellectual property rights (IPR), to accept disciplines on the use of trade distorting subsidies and to make other changes to bring its legal and regulatory system in line with those of other WTO members and to add transparency and predictability to business dealings. China viewed joining the WTO as a means to preserve and expand China's access to export markets abroad, particularly the United States. In turn, other WTO members envisioned that faithful WTO implementation by China would reduce the ability of non-market forces, including government policies and officials, to intervene in the market to direct or restrain trade flows.

Total U.S.-China trade in 2003 topped \$180 billion, with imports from China exceeding U.S. exports by \$124 billion. China has now surpassed Japan and become the United States' third largest trading partner. China has become our second largest source of imports, with most of the increase displacing imports from other sources, including economies in Asia and Latin America. China has also become the sixth largest market for U.S. exports. In fact, China is currently the fastest growing export market for U.S. goods. Indeed, over the last three years, while U.S. exports to the world have decreased by 9 percent, exports to China have increased by 76 percent. China is now a major importer of U.S. manufactured exports, such as electrical machinery and numerous types of components and equipment, among other goods. China is also a major importer of agricultural products from the United States, and U.S. service suppliers in many sectors have been able to increase their share of China's market.

But, statistics are not the yardsticks by which the Administration measures China's compliance with its trade agreements. China's accession to the WTO, in particular, was conditioned on China's commitment to open its markets and to play by the rules of international trade. In that sense, the true measure of China's compliance with its WTO commitments is the extent to which China has institutionalized market mechanisms and curtailed direct governmental actions or complicity with nongovernmental actions to intervene in the marketplace. By that score, China's WTO compliance record falls short of the mark.

As suggested in USTR's second annual Report to Congress on China's WTO Compliance, issued last December, China has made important headway since its WTO

accession two years ago, and has completed much of the nuts and bolts work of WTO implementation. It has reviewed thousands of laws and regulations and made changes necessary to effect its new WTO obligations, established new transparency procedures in many national and sub-national ministries and agencies and the courts, and reduced tariffs to their committed levels, among other things.

Despite these gains, China's compliance with its WTO commitments has, over the past two years, been uneven at best. The Administration has engaged the Chinese government at every opportunity, whether through discussions in Washington or Beijing or at the WTO in Geneva, to address perceived shortcomings in Chinese WTO compliance. In some cases, USTR and other agencies were able to resolve U.S. concerns. For example, over the course of the past year, China has taken steps to correct systemic problems in its administration of the tariff rate quota system for bulk agricultural commodities. It relaxed certain market constraints in soybeans trade that allowed U.S. exporters to achieve record sales. It reduced capitalization requirements in certain financial services sectors. It opened up the motor vehicle financing sector. It solved outstanding concerns that had prevented China's membership in the WTO's Committee of Participants in the Expansion of Trade in Information Technology Products.

In its first year of WTO membership, China's incomplete implementation of WTO commitments could in some cases be attributed to startup problems or incomplete understanding of WTO rules and practices. These rationales are less meaningful two years into WTO membership, however. In fact, while China made significant initial strides toward WTO implementation in its first year, China's WTO efforts seemed to have lost a significant amount of momentum last year. Indeed, in a number of different sectors, including some key sectors of economic importance to the United States, some Chinese ministries seemed to spend as much energy avoiding China's WTO obligations as living up to them. Institutionalized market mechanisms remain elusive, and intervention by Chinese government officials in the market is largely unchecked.

We acknowledge that China's WTO implementation efforts have taken place against a challenging political and social backdrop. In 2003, China underwent a major leadership change, passed through a harrowing national SARS epidemic, undertook a sizeable restructuring of the government's economic and trade functions, and confronted a host of dislocations inherent in its transition from a planned economy to a more market oriented economy. These factors may have presented challenges, but they are not grounds for foot dragging or other incomplete WTO implementation efforts.

Our markets are certainly open to exports from Chinese companies, and we need to ensure that China operates with fair, transparent and predictable rules when it comes to our companies' access to China's market. That means, most importantly, that China must live up to the commitments that it made upon joining the WTO. We also need to ensure that China engages in fair trade when it comes to its exports to the United States. Our companies want, and are entitled to, a level playing field.

U.S. MANAGEMENT OF WTO IMPLEMENTATION CONCERNS

The Administration has stepped up its efforts to engage senior Chinese leaders. Over the course of the past year, as China's WTO implementation progress has slowed, President Bush met with the current President of China, Hu Jintao, and emphasized the importance of China's WTO obligations. United States Trade Representative Zoellick made two separate visits to China for talks on WTO implementation matters with China's Premier, Wen Jiabao, and Vice Premier Wu Yi. The Secretaries of Commerce and Treasury made similar trips to China, again carrying the message that China's WTO implementation was a matter of the highest priority. Sub-cabinet officials from various U.S. economic and trade agencies also met with their Chinese counterparts in China, Washington and Geneva to work through areas of concern, including WTO implementation issues, on numerous other occasions.

In 2003, the Administration also utilized the newly established sub cabinet dialogue on WTO compliance and other trade matters (the Trade Dialogue), which brings together U.S. economic and trade agencies and various Chinese ministries and agencies with a role in China's WTO implementation. Trade Dialogue meetings were convened twice in 2003, once in February, led by then Deputy United States Trade Representative Huntsman, and later in November, led by Deputy United States Trade Representative Josette Sheeran Shiner. The Trade Dialogue meetings have proven to be effective venues for raising, and seeking the resolution of, specific trade concerns, and in serving as an early warning mechanism for emerging trade disputes.

This year, in a concerted effort to solve bilateral trade issues, the United States and China agreed to elevate the annual Joint Commission on Commerce and Trade (JCCT) talks, with United States Trade Representative Zoellick and Commerce Secretary Evans chairing the U.S. side and Vice Premier Wu Yi chairing the Chinese side. Over the past three months, through a series of meetings in Beijing and Washington leading up to the April 21 talks, staff from USTR and the Commerce Department have been working with their Chinese counterparts to achieve tangible progress on the key issues. We are pressing China to take major, concrete steps in a number of areas where China's WTO compliance has been lagging, including:

- Substantially improved enforcement of intellectual property rights in China, including through the use of deterrent-level criminal penalties, and the crackdown on those who export or traffic in counterfeit or other IPR-infringing products;
- China's full adherence to commitments to open its agricultural market and to refrain from the use of arbitrary limitations on market access, including sanitary and phytosanitary measures and other restrictions not based on science;
- The removal or modification of discriminatory aspects of Chinese industrial policies and other measures that fail to accord U.S. and other WTO member firms national treatment and fair market access, particularly with regard to integrated circuits and wireless encryption technology;
- The lifting of excessive restrictions imposed by China's regulators on foreign service suppliers;
- China's use of fair and transparent technical standards and regulations, including the establishment of procedures that guarantee the public's right to notice and comment; and
- Full and timely liberalization in the areas of trading rights and distribution services.

Of course, while we prefer to resolve our concerns through collaborative mechanisms like the JCCT, we are not hesitant to use other means when necessary. Indeed, there are forces in China, as elsewhere, that are resistant to the changes wrought by WTO implementation. Despite the best of intentions of many Chinese trade officials, these forces have not been unsuccessful in limiting China's progress toward the goals the United States and other WTO members foresaw through China's WTO accession. As a result, some markets in China are not as open as they should be, and our engagement with China has not always been as useful as it should be.

One area where collaboration has not been successful affects key U.S. technology products, namely, integrated circuits. China provides preferential value-added tax treatment to integrated circuits produced or designed in China, thereby disadvantaging U.S. and other imports and distorting international investment. The United States believes that this discriminatory tax policy is inconsistent with the national treatment obligations that China assumed when it joined the WTO. The United States has repeatedly pressed its concerns with China, but it recently became clear that China was not prepared to address our concerns in any meaningful way. As a result, on March 18, 2004, the United States filed a case at the WTO regarding China's policy. This move commences a 60-day consultation period required by WTO rules. If a resolution cannot be reached within that time period, we can then request that a WTO panel rule on whether China's policy is consistent with its WTO obligations.

ENFORCEMENT OF TRADE REMEDIES LAWS

The rapid expansion of trade between our two countries has inevitably led in some cases to competition between our domestically produced goods and Chinese imports. When our industries face injurious trade with China, the Administration is fully committed to enforcing U.S. trade remedy laws and to exercising the important rights that the United States has under China's WTO accession agreement.

One of our tools is the use of the antidumping laws, which, under the terms of China's WTO accession, includes our ability to continue to apply a special "non-market economy" methodology to China. In 2003, more than 50 percent of antidumping orders put in place by the Department of Commerce involved Chinese imports.

China also agreed to two separate China-specific safeguard mechanisms as part of its WTO accession package. These mechanisms are designed to allow WTO members to cope with market disruptions caused by increasing economic integration with China following its WTO accession.

One of the safeguards agreed to by China is specific to textiles. It allows WTO members under certain circumstances to invoke limited import relief against Chinese imports—specifically, a 7.5 percent cap on growth in imports of a given textile category for up to one year (6 percent for wool products)—until December 31, 2008.

Late last year, the Committee for Implementation of Textile Agreements found for the petitioners in all three of the investigations that it conducted and, in December, the import relief contemplated by the safeguard went into force.

Another safeguard, now codified in U.S. law as Section 421 of the Trade Act of 1974, as amended, applies to any product imported from China and is available until December 11, 2013. Since the implementation of Section 421, five petitions have been filed requesting the imposition of import restrictions. In two cases, the U.S. International Trade Commission (ITC) found that our domestic producers' market had not been disrupted by imports from China. In three other cases, while the ITC found market disruption, the President weighed the costs and the benefits to the U.S. economy, as the statute contemplates, and determined that the adverse impact on the U.S. economy was clearly greater than the benefits of import restrictions. While to date no import relief has been granted under Section 421, the President, in his most recent determinations, has reiterated his commitment to using this safeguard when the circumstances of a particular case warrant.

CONCLUSION

While the U.S.-China economic and trade relationship is growing rapidly, there are a number of structural impediments that remain, making further improvements in that relationship problematic. The Administration is committed to resolving the United States' concerns through all available means. It will use bilateral engagement, whenever possible. For the most part, bilateral efforts have been effective or continue to hold some nearterm likelihood of success. However, when those efforts are not productive, or it becomes clear that bilateral engagement on a particular issue has reached stasis, as in the case of China's tax policy on integrated circuits, the Administration is fully prepared to assert the United States' rights under U.S. law and through multilateral means, including dispute settlement at the WTO.

Mr. STEARNS. Mr. Freeman, thank you. I'll start with my questions and I'm going to go to the heart, I think of this whole debate with China. I called attention to you earlier before the hearing the article by Robert Samuelson in today's Washington Post and I hope your staff got a copy of that for you.

And I think Mr. Strickland and people on this side, Mr. Brown, Mr. Davis and people on our side, this is, I think, the crux of what we're talking about here. It's almost a universal canon or common perception that China is taking away all of our jobs. And I'm going to ask you this question. Mr. Samuelson posits the question that China is not likely to be a significant cause of U.S. job losses. He indicates that adverse labor conditions in China may affect less than 1 percent of U.S. jobs.

So the first question, do you agree with that statement and he points out that if the United States practices protectionism, it will not create new jobs in this country and he points out the AFL-CIO's demand for tariffs would likely invite Chinese retaliation which would have an immediate negative impact on job growth in the United States.

So this universal canon—and I think people on both sides of the aisle feel this and it's universally accepted in America. Now it's a chance for you as a representative of the administration and USTR is to answer that question whether the adverse labor condition in China affects less than 1 percent of U.S. jobs.

Mr. FREEMAN. I'm not an economist, so I'm not qualified to categorize that percentage.

Mr. STEARNS. Okay.

Mr. FREEMAN. I will say that—

Mr. STEARNS. Obviously, you're not an economist, but you're involved with trade negotiations and you talk to a lot of economists. You have economists on your staff and I mean you certainly—do you agree with that statement, yes or no?

Mr. FREEMAN. I'm not sure. With respect to the AFL-CIO petition we've just received, we're looking at it, we're reviewing it. Let me say a couple of things about the petition.

Mr. STEARNS. Let me just ask you a question though. If the perception is that China is taking our jobs away and Samuelson is saying it's not, do you think he's correct or not? I'm putting you on the spot.

Mr. FREEMAN. You are putting me on the spot and I wish I was back on that plane, I'll tell you. Let me, again, let me say that one of the issues, we haven't been able to analyze. The AFL-CIO's petition—

Mr. STEARNS. I'll give you some leeway.

Mr. FREEMAN. Give me a little leeway.

Mr. STEARNS. Go to the AFL-CIO petition which he points out will invite Chinese retaliation and would have a negative impact. Do you think that's true?

Mr. FREEMAN. I will say in the course of U.S. history that protectionism has not resulted in job creation, in fact, quite the opposite. I'm not sure that that's what we need to be doing with respect to China.

I think the issue is making sure that the playing field is made increasingly fair. That said, it's hard to deny that the substance of the AFL-CIO petition which is that for all intents and purposes workers' rights in China are oppressed.

Mr. STEARNS. That we agree on.

Mr. FREEMAN. How that manifests in the trade relations is another question.

Mr. STEARNS. And how it impacts jobs is quite complex.

Mr. FREEMAN. And that's something which we need to look at in the context of our review.

Mr. STEARNS. Let me go through some quick things that really get to the jurisdiction of this committee. Please describe some of the restrictions on U.S. service providers in China. Are there specific restrictions that apply to insurance, to other financial services, to telecommunications services, to accounting services, and please comment on our strategy for encouraging more open market in China for services which is really directly our jurisdiction?

Do you want me to repeat that?

Mr. FREEMAN. I've got it.

Mr. STEARNS. Okay.

Mr. FREEMAN. I think the issue is with respect to services there are a number of areas that we're particularly concerned about. The primary thing we're concerned about is China seems to be really trying to limit the number of service providers that play in its marketplace and have these large players and just a limited number of them. So what they've done is they've set very high capitalization requirements for companies that do business there. The capitalization requirements have no relation really to what are prudential requirements. They just seem to be fairly arbitrary. So there's no real rhyme or reason to those requirements.

They've also limited the scope of businesses that service providers can engage in, seemingly arbitrarily. They've limited the geographic scope of some of these businesses. They've limited again, the scope of the kinds of businesses that they can engage in.

Really, the primary goal of these things seems not to be encouraging their own industries to grow, but really to prevent U.S. and other service providers to operating the marketplace. What we tell the Chinese is we have to come back and tell the U.S. Congress that we want to keep our markets open and you tell us you've got a comparative advantage in these X, Y and Z products. And we say well, we have a comparative advantage in services and high tech and certain manufactured goods, agriculture. Unless you're giving us a fair shake, unless there's reciprocity, we can't argue in front of Congress that we should keep our markets open to your products.

So in the area of services, we think we've got a comparative advantage. We think we've got a WTO deal that would allow us to assert that advantage and we're going to continue to achieve the goals of the WTO agreement.

Mr. STEARNS. This would include accounting service, telecommunication service, financial service, as well as insurance?

Mr. FREEMAN. Across the board.

Mr. STEARNS. Okay, my time is expired. The gentlelady, Ms. Schakowsky.

Ms. SCHAKOWSKY. I want to echo some of the concerns that were raised by Mr. Brown over remarks and I think Mr. Strickland as well, remarks that were made by the President and by the Commerce Secretary over the last couple of days. The President said "when you hear people talk about let us reconsider free trade agreements, what they're really saying is is that perhaps we ought to wall ourselves off from the rest of the world. See, I think that would be absolutely wrong for America to be so pessimistic about our ability to compete that we become economic isolationists."

And last week, Secretary Evens said, "America is not a fortress. It's a bridge. Traffic goes two ways. Economic isolationists are waving a surrender flag, rather than the American flag."

That last comment, something that I really took great exception with because I felt that that was questioning the patriotism. It seems that the term now "economic isolationist" is the term of the moment, of the week, of the month, to describe people who, in my view, are those that are concerned or alarmed about the job losses that in our view have accompanied free trade agreements and that's why the question by our Chairman is very, very important. It hadn't even occurred to me that one would think that our relations with China, with Mexico, wherever our jobs are going actually has nothing to do with job loss in the United States.

So I'd really like you to comment, first of all, if you think that those Americans that are out of work, who at least perceive themselves to have lost their jobs because they have gone overseas somewhere, are they economic isolationists? Are they not waving an American flag? What is the view of this administration? We continue to hear what I consider to be slinging of people who are concerned about the effects of these trade policies.

Mr. FREEMAN. I'm not particularly qualified to comment on whether or not workers or people who are concerned about job losses are economic isolationists.

Ms. SCHAKOWSKY. Well then, who are they? Who are the economic isolationists?

Mr. FREEMAN. Again, my job is to focus on market access issues with respect to China and to open the markets so that people in this country that are working extraordinarily hard to put food on the table for their families and to produce quality products are able to make sure that those products reach the markets that they're intended to reach. And my strong sense is that this administration is committed 100 percent, 110 percent if you like, to making sure that that happens.

We continue to focus on across the board with respect to China certainly, to make sure that the goal of this administration is to open markets overseas, not to necessarily, not to shut down our markets here.

Again, I'm not going to suggest, to get into the debate on economic isolationism. I think the key for this administration is opening markets overseas and not closing markets here.

Ms. SCHAKOWSKY. It is important—the real crux of the issue was the question though that the Chairman asked, whether or not this administration acknowledges that as we open up, as we do trade with countries like China, who have policies that exploit cheap labor, whether we acknowledge that that has an impact on jobs at home.

To me, it's a no brainer. It's obvious to me that that is the case. When I went to Ciudad Juarez, saw maquiladoras that are moving from Mexico to China, leaving behind workers for a pursuit of even cheaper labor, the jobs were lost. We see it along the U.S. border, on the U.S. side, jobs leaving. So it seems to me troublesome at the very least if there's not an acknowledgement that we are losing jobs to other countries.

Mr. FREEMAN. I think the issue is the jobs are going—there certainly is labor costs that factor in moving production overseas, absolutely. There's no argument there. But the question is whether with respect to trade agreements you're actually gaining more jobs here than you lose and that again, I'm not an economist and I'm not going to cite the number of jobs that have been gained through any number of trade agreements with which we've engaged, but certainly from our statistics, jobs have been, the growth has been positive.

Ms. SCHAKOWSKY. Do you believe that labor rights are important to be part of our trade relations with other countries?

Mr. FREEMAN. I think certainly this administration has shown that it's willing and able to forcefully push for labor and environmental rights within new trade agreements. I think that's part of our fundamental policy.

Ms. SCHAKOWSKY. And where have we seen that?

Mr. FREEMAN. We've seen it in the Jordan agreement, the Chile agreement and the Singapore agreement.

Ms. SCHAKOWSKY. Isn't it true you wanted to renegotiate the Jordan agreement, am I wrong about that, that some of the labor rights that—I thought the Jordan agreement was negotiated under the Clinton Administration and that some of those positions, am I wrong about this?

Mr. FREEMAN. There was some, maybe you can help me, I don't think that's the case.

Mr. STEARNS. You certainly can get back to us, if you want.

Mr. FREEMAN. Absolutely.

Mr. STEARNS. The gentlelady's time has expired.

Ms. SCHAKOWSKY. Thank you.

Mr. STEARNS. The gentleman from Michigan, Mr. Upton.

Mr. UPTON. Well, thank you, Mr. Chairman, and thank you again, Mr. Freeman for being here this morning. We have coffee in the side room if you need a little bit.

I appreciate your statement and strongly underscore that the goal is to open markets overseas. But I have a lot of concerns. I look at a Congressional Research Service and a bulletin that was published just this last week and it says China's restrictive trade and investment practices are a failure to provide adequate protection for intellectual property rights. China has made significant progress in meeting its WTO obligations, but a number of major problems remain, especially in regards to agriculture, services, IPR protection, tax policies, trading rights, distribution, transparency of trade laws and regulations and in your formal written statement and I quote on page two, you say "by that score, China's WTO compliance record falls short of the mark."

As I look at the trade numbers, not only last year 2003, but 2001 and 2002, the trade deficit went from \$83 billion to \$103 billion to \$124 billion in terms of the deficit. The amount, interesting to note, is that the increase in each of those years of Chinese exports here, the increase from the previous year exceeds our total exports to China. Not very promising numbers.

And I'd be curious to know where do you think these numbers are going in 2004 and 2005? I've never been to China. Let me just make one other point before I hear your answer. I've never been to China, but the many people that I've talked to have been there, many of which have urged me to go. They've said it's not the first visit to China, it's the second, third and fourth so you can actually measure the progress of what China is doing and as I look at these numbers, I'm very alarmed, particularly as I read your statement in here of not complying with the WTO and other independent reports that share exactly the same information.

Where are we going in 2004 and 2005?

Mr. FREEMAN. I haven't done any independent analysis, but I would be very surprised if we didn't continue to rise.

Mr. UPTON. I'm sorry, say that again?

Mr. FREEMAN. I haven't done any independent analysis. I would be very surprised if the deficit didn't continue to rise. What we're attempting to do is try to slow the growth of the increase. One of the things about the rise in deficit though is it's not simply a bilateral concern. A lot of what we've seen in frankly in other markets is we've actually seen a decrease in our deficit with other markets particularly in Asia and to a lesser extent Latin America.

Mr. UPTON. But isn't that in large part because of the currency manipulation? I mean because of the weakening of the dollar has helped us in exports, but of course, we don't have that same measure for China because of their currency manipulation?

Mr. FREEMAN. Actually, I think what's happening is that China actually is running right now itself running a trade deficit with the rest of the world. If you take us out of the equation, they're running a rather large trade deficit. What's happening is frankly a lot

of the countries that used to supply us with low labor, labor intensive products are actually supplying through China and then there's additional labor and value added in China and that's exported to us.

Mr. UPTON. Let me just ask one quick question before my time expires and that is where are we in terms of progress in the currency manipulation? We've seen legislation introduced here. We had a test vote earlier this year. Do you see any movement by the Chinese with regard to this issue in the next couple of months?

Mr. FREEMAN. Again, I think this is an area, as you know, currency has always been the area that the President and the Secretary of the Treasury have unique oversight of, so this is an area where USTR doesn't traditionally comment. We have heard about the petition on Section 301 that's coming from people in the community and we'll look forward to reviewing that when we see it.

Mr. UPTON. I yield back.

Mr. STEARNS. The gentleman yields back. Mr. Strickland.

Mr. STRICKLAND. Thank you, Mr. Chairman. Mr. Freeman, I don't want to quibble over a word, but words are important and I noticed that you said a little earlier that we should be working to make sure the playing field is made increasingly fair. What I wished you had said is that we are working to make sure the playing field is fair.

I think that's what we all want. We don't want this incremental maybe 10 years from now things will be better than they are and it seems that you and other members of the administration have a responsibility to this country and to our workers and to our domestic industries to absolutely insist that whatever rules there are, that they are fairly implemented and fairly enforced.

Given the fact that we have this trade deficit with China and the fact that you've said that if our interaction with China was taken out of the equation that China would actually have a trade deficit, is this economic relationship that exists between our country and China more beneficial to China or more beneficial to us, currently?

Mr. FREEMAN. Well, I'm going to argue it's more beneficial to China, certainly. We certainly benefit from the relationship, but when you have \$150 billion customer in the United States, that's a pretty big customer. That's a pretty big benefit. That's one of the reasons that we are so forceful and do believe we will make progress in some of our key trade concerns because at the end of the day when you have \$150 billion sack of cash that gives you some leverage.

Mr. UPTON. So it seems to me that if this relationship is more significant currently to China than to us, that should give us leverage. China needs us as trading partner, desperately. And it seems that that ought to give our government, you and those you work with the ability to exert some appropriate pressure on China to deal with things like environment and labor and all those kinds of things. And quite frankly, I don't see that happening. Maybe it's happening quietly, behind the scenes, out of the public's view and scrutiny, but it seems to me that we give more than we get and that that's fairly constant.

Mr. Freeman, the National Association of Manufacturers has pointed out that under GATT, Article 11, WTO members are not

supposed to restrict exports except for very narrowly prescribed reasons. Just recently, it has come to our attention that China has placed restrictions on the export of coke and that that is having a direct impact on our U.S. steel production and it's exacerbating the shortage of steel products in this country.

They are currently the largest exporter of coke to this country, but press and industry reports indicate that they plan to further reduce exports substantially this year, further limiting access to coke. And at the same time, they are buying nearly every bit of scrap that they can get from this country. I met in my District a few days with about 25 industry leaders who are terribly concerned.

This is my question and I only have a little time. Will you and your agency make it a priority during the upcoming April JCCT session to discuss these matters with China, both the coke and the scrap issue?

Mr. FREEMAN. We do have a very active discussion with the Chinese right now on some broad structural concerns and that includes their use of export controls, export restrictions on certain products and their large purchases of scrap.

One of the things that's striking to us, China is a huge net importer of steel products. And a huge consumer of steel products. One of the things we're concerned about is that they continue to build capacity to produce steel when there's this enormous over capacity in the global steel market. So there are certain things—China often says to us, we're a market economy, we demand market economy status in the context of your anti-dumping laws and we say well, if that's the case, then why are you doing things which don't seem to be a case of supply and demand? Why are you doing things which seem to be fairly government sponsored in nature?

So it is an area of focus.

Mr. STEARNS. The gentleman's time has expired. The gentleman from Idaho.

Mr. OTTER. Thank you, Mr. Chairman. Mr. Freeman, in my opening remarks you heard me mention something about getting some folks on the team that have been part of the real world and I want to apologize if I offended anybody that is presently on the team. But it seems to me that that would be a reasonable expectation for us to have people that are going to be negotiating our quote unquote economic lives overseas to actually have with overseas trading partners, to actually have somebody there that has worked in the real world.

Do we have that on this team coming up for China now? Do you have anybody on there that's been in the entertainment business, actually had to make a paycheck or met a payroll from the entertainment industry?

Mr. FREEMAN. What we have is a very strong advisory process in which people from the entertainment industry, from a variety of other industries tell us exactly what their priorities are. We have a very good line into what business really wants from us. So we think while they may not be at the table with us, we know exactly what the agenda is.

Mr. OTTER. I think that's good, but I've been on lots of advisory committees. I was on the World Bank, Eximbank Advisory Com-

mittees when I was the president of a large international agribusiness company and I know that there's a lot of difference in being on an advisory committee and in an advisory capacity and simply having an ad hoc position as opposed to actually having a seat at the table and where that foreign negotiator recognizes that I have driven the combines, so I know about the wheat. I have shot the movie. I have been part of that creative effort by the entertainment industry. And so I have something very personal here. This is not esoteric. This is not far fetched. This is the real world that I want to deal with.

I still believe that if you don't have somebody on that team, you're anemic in your ability to really be able to challenge these people in all potential aspects. I say again, I have asked through the Department of Agriculture, through the USTR before, especially on ag. products, for them to put somebody, put a farmer, put a rancher on that negotiating team with a vote just like everybody else has, with an ability to argue just like everybody has; and a person out of a plant from out of a bargain unit.

I don't know if you've ever negotiated with farmers or unions, but I'll tell you they're tough and they've got a good product and they know what their product is worth and I believe that's what we need on our teams when we meet foreign trading partners is somebody tough at that table that knows what our products are.

So I would encourage you, if you could, to expand that team and get those kind of folks on it.

Thank you, Mr. Chairman, I yield back the balance of my time, unless it's gone.

Mr. STEARNS. Mr. Brown, the gentleman from Ohio.

Mr. BROWN. Thank you, Mr. Chairman. Thank you very much, Mr. Freeman. I was a little surprised by your comments that this trade arrangements is more "more beneficial to China than to us" and I've heard others in the administration say that we get all kinds of benefits so it's equally beneficial to both countries and I appreciate your honesty because it pretty clearly is—I don't think it's more beneficial to Chinese workers, but it's more beneficial to the People's Liberation Army and more beneficial to the Chinese communist party and more beneficial to U.S. investors as part of that trilogy to coin a phrase, maybe.

I want to talk about Jordan and I appreciate Ms. Schakowsky's comments and others about the Jordan trade agreement. As you recall, Jordan was actually negotiated by President Clinton in past in the year 2000, I believe, and the interesting thing about Jordan it passed by a voice vote. I was in the hall, as many others were. There was not one dissenting vote. If I recall, it wasn't even a recorded vote as a result. But Jordan was supported by people across the board, people that always voted for free trade agreements, people that always vote against free trade agreements and everybody in between, in large part because it included strong environmental and labor standards and the enforcements systems were similar to those available for the agreement's investment protections.

As I said, it passed without dissent. Now the difference, when we talk about Chile and Singapore, Chile and Singapore appear to have labor and environmental standards, but they're not ILO, International Labor Organization standards, they're standards that

are enforceable, but they're standards that only need to comply with their own labor standards. In other words, all they have to do is commit to enforcing their own labor standards, whether they're stronger or weaker than ILO standards.

Now the problem with that is one, their standards already are weaker. Second, and that's perhaps, arguable, but second, it's clear that investors from outside will put pressure on those countries, on those two parliaments or legislative bodies or countries to weaken their environmental standards and labor standards, and then they can enforce weaker standards. So that's the problem with Chile and Singapore. And to equate Chile and Singapore with Jordan is a bit inaccurate.

Now my question is this, Tom Donohue said, the President of the Chamber of Commerce, talking about Jordan said "trade promotion authority should be unencumbered by requirements to advance unrelated labor, environmental and other social agenda objectives as part of trade negotiations." But 3 weeks ago, your boss, the USTR Ambassador Zoellick said because of the Jordan FTA "trade between the U.S. and Jordan has nearly tripled in only 3 years."

Who's right? Is Zoellick right or is Donohue right? Not to speak ill of your boss.

Mr. FREEMAN. I would never speak ill of my boss. My boss is always right for the record. And I'm not a Jordan trades expert so I will close with that.

Mr. BROWN. Comment on that, give me your thoughts. Jordan seems to be working with labor and environmental standards. Why is this administration not—I'll ask it this way, then why are they not pushing for similar kinds of standards, ILO standards, not enforce your own standards in these other bilateral agreements.

Mr. STEARNS. The gentleman's time has expired. Why don't you finish answering the question.

Mr. FREEMAN. My strong sense is that this administration is very committed to the policy that was used in both Singapore and in Chile to include these key elements of a trade agreement. I don't believe that those agreements have any weaker provisions than Jordan. I truly do not.

Mr. STEARNS. I thank the gentleman. The distinguished chairman of the full committee, Mr. Barton.

Chairman BARTON. Thank you, Mr. Chairman. I would ask unanimous consent that my opening statement be in the record.

Mr. STEARNS. By unanimous consent, so ordered.

Chairman BARTON. I just have a few brief questions. Obviously, the committee supports a trade relationship with China, but it certainly does appear to be one sided when there's a 5 to 1 imbalance between exports and imports. Is that something that concerns the U.S. Trade Rep. that we have such an imbalance and it appears to continue to be growing?

Mr. FREEMAN. It absolutely concerns us and not just because of the raw number but because of the impact of that imbalance on the public psyche and the support for open markets. Really, that number and it's in and of itself is showing. And when you have that kind of shocking number it stimulates debate, it stimulates concern and it really stimulates some of the real pressures that we feel to justify our trade policies.

That said, it's also a very useful tool when discussing with the Chinese the need for them to follow through on their WTO commitments. When we are able to say look, this trade imbalance really is a key part of our trade relationship, unless you do something about opening your markets and following through on your market access commitments, we can't sustain support for this relationship in the long time. So it is a key part of our—

Chairman BARTON. You can correct me, my memory for statistics may be faulty, but back in the 1970's and 1980's we had a huge trade imbalance with Japan that became a very large part of many of the Presidential campaigns and we don't get see that with China, but the percentages are worse with China than they ever were with Japan. I think a step and I know that this has been raised at the highest levels between our administration and the Chinese officials, but the false valuation of the Chinese currency has got to be a contributing factor to this. What are the prospects of having the Chinese more correctly value their currency versus the rest of the world financial currencies?

Mr. FREEMAN. Again, I've got take a cop out on that because it's a Treasury Presidential issue with respect to currency. Administration officials are not allowed to comment on currency valuations.

Chairman BARTON. We won't tell anybody.

Mr. FREEMAN. All right. Well, in that case—on that score, I think the President and the Secretary of the Treasury have a very active engagement with the Chinese and I think a very effective engagement with respect to discussing moves that the Chinese need to make and can make in order to move to a more liberalized market.

Chairman BARTON. My time is about to expire. My final question is much more parochial and closer to home. I have a company in my District that the most cost-effective converter of scrap steel into new steel products, Chaparral Steel. And the price of scrap steel is just skyrocketing primarily because there's a huge demand for it in China. What, if anything, can we do about that?

Mr. FREEMAN. We've love to talk to them. I'll put it this way. We've had discussions with other scrap users in this country and we're really trying to get a handle on this. So I'd really invite you or your constituent to give us a shout.

Chairman BARTON. Thank you, Mr. Chairman.

Mr. STEARNS. Thank you, Mr. Stupak?

Mr. STUPAK. Thank you, Mr. Chairman. Sorry I was late. I ask unanimous consent to put my opening statement in the record?

Mr. STEARNS. By unanimous consent, so ordered.

Mr. STUPAK. Thank you. Mr. Freeman, I've been sitting here and I was late, but listening to questions and all that, it seems like we're doing a lot of talking with China, are we doing anything else?

Every question has been well, we're talking to them. We've had trade agreements with them since 1979 and I don't know of one that they've honored yet. Are we going to do something other than just talk about it or are we going to do something about it?

Mr. FREEMAN. We did just recently file the first WTO case that's been filed against China, so I think we are doing more than simply talking.

Obviously, the issue is you do have a trade agreement and you do have a bilateral arrangement. It's a lot easier to solve problems

through discussion and dialog and we have made great progress. We've solved problems that allowed record sales of soybeans into China. We've allowed—

Mr. STUPAK. When do those start?

Mr. FREEMAN. What's that?

Mr. STUPAK. When do those soybean sales start?

Mr. FREEMAN. We sold \$2 billion of soybeans last year.

Mr. STUPAK. You look at it, \$2 billion, okay. Our deficit with them is \$124 billion. It gets bigger every year. So obviously, the talking isn't working and we're not selling enough soybeans and I read recently here some reports that China is implementing an industrial policy that seeks to protect and support its domestic auto industry. So how can the U.S. prevent China from implementing this policy that's been reported here in the United States that protects its domestic industry and restrict imports?

Mr. FREEMAN. We actually think we're going to resolve that problem, whether it's through discussion or case—

Mr. STUPAK. Have you even brought it up yet?

Mr. FREEMAN. Absolutely.

Mr. STUPAK. How are you going to resolve it?

Mr. FREEMAN. My strong sense is that we will resolve it within a very short order.

Mr. STUPAK. No, how?

Mr. FREEMAN. I think China will amend its policy to make it WTO compliant.

Mr. STUPAK. And if they don't?

Mr. FREEMAN. If they don't, we'll take appropriate action?

Mr. STUPAK. Such as?

Mr. FREEMAN. If we need to take a WTO case, we shall do so.

Mr. STUPAK. So we've only had—China has been in WTO now what, about 3 years and we've had one case so far, just recently filed?

Mr. FREEMAN. That's correct.

Mr. STUPAK. What about intellectual property rights? We've had this discussion for years in this committee and it's now an \$18 billion loss to our U.S. industry on piracy and the Chairman mentioned last election, I think the last election we were running around about CDs or something that China was stealing the CDs. That's almost 4 years ago and every year, again, intellectual property theft goes up \$18 billion. What's being done on that aspect?

Mr. FREEMAN. I hate to say we're talking to them again.

Mr. STUPAK. We're talking to them.

Mr. FREEMAN. We're talking to them again and we think we're making progress.

The issue there is it's hard to get your hands around and it's a problem that's not going to go away tomorrow, despite whatever we do. So we're going to keep pressing.

Mr. STUPAK. You're right, it's not going to go away tomorrow and we've lost our manufacturing jobs, basically to China, and they keep saying, the administration keeps saying we've got to think better and we've got to have the new knowledge, what is the new source of it, but yet, we look at China and our intellectual property rights are being stolen all the time. So why would the American

worker want to move from manufacturing to intellectual when it's being stolen all the time and we're not doing anything about it?

Mr. FREEMAN. The issue is genuine. I think we are doing a lot about it.

Mr. STUPAK. Besides talking, what else are we doing?

Mr. FREEMAN. My sense is if they don't comply with their commitments, if they don't move to make their system more effective to protect IPR, we'll take appropriate action?

Mr. STUPAK. Which is what, WTO again?

Mr. FREEMAN. Presumably.

Mr. STUPAK. How about this Agreement on Trade-Related Aspects of Intellectual Property Rights that they've signed, but are violating. Is there any remedy in that agreement?

Mr. FREEMAN. The issue there is whether their legal system is effective, is an effective system to enforce intellectual property rights. I would argue certainly that it is not effective. We certainly are talking to our industry and I think you'll hear from some of them later today.

Mr. STUPAK. Before we enter into these trade agreements, shouldn't we make sure there are courts and legal systems in place to enforce agreements or violations of regulations? Why do we enter into trade agreements and then we try to help them with their courts and help them with the value of their dollar and if we're going to do trade agreements, how come these things aren't in place before we approve these trade agreements?

Mr. FREEMAN. The courts that protect IPR in China are in place and they were in place before they entered the WTO. The question is whether they're effective and I think that's something that we'd argue again that they're not.

Mr. STUPAK. The administration talks a lot about in any disagreement there would be criminal violations and criminal prosecution. Has there been any in China on intellectual property rights?

Mr. FREEMAN. There has. Not what we'd like to see and the issue there is not simply to get one or two criminal convictions or criminal prosecutions, but actually to see the number increase so that you have deterrence and again, one of the issues there is the Chinese say how many criminal prosecutions do you want to take? How many IPR violators do you want us to throw in jail? We always have problems with you guys over human rights, now you're telling us to throw more people in jail?

It's a fairly cynical thing to say, but the point is the number of IPR violators in China is so high that you need to start small and build on that.

Mr. STUPAK. We should prosecute the government officials and then it would get done quicker.

Mr. STEARNS. The gentleman's time has expired. Mr. Sullivan? Waives.

Mr. Shimkus?

Mr. SHIMKUS. Great, perfect timing. I thank my roommate for the courtesy. First, I've got a guest here, the Mayer family, Brian with his wife and niece and daughter and son and they were just about to sneak out the door of this scintillating testimony and questions. I think they want to see the Air and Space Museum, but the reason why I'm glad they're here is our debate really and our

good friend, Mr. Stupak, is not just about jobs today, but it's really about jobs in the future and we see the young children there, we do want a growing economy for the future, so thank you for visiting us and now you're part of the official transcript of the committee hearing and we'll get you a copy, but have a great day as you visit Washington.

But the one thing that gets lost in this debate, you know, that if we raise tariffs, we encourage manufacturing to move overseas. I mean if we really get in a trade war, it just makes it easier for people to move. It's just another incentive for manufacturing to move. So we want to have these negotiations and we want the debate because we want lower tariffs, and as I understand, Mr. Freeman, really that's your job is to help us get market access of U.S. products to China.

So we have some challenges in doing that. The three things, can you talk about our FIF debate as far as the—you're not going to mention that.

Are we less competitive because we double tax our manufacturers? You're going to weasel out of that one too?

Mr. STEARNS. I encourage the gentleman—perhaps weasel is not the right word.

Mr. SHIMKUS. Okay, okay.

Mr. STEARNS. Euphemistic word—

Mr. SHIMKUS. All right, we're not going to talk about currency. We're not talking double taxation. That's really our problem. Our Nation's problem is we double tax our manufacturers. Most countries do not. A tax in the country in which the manufacturers occur. So we have a problem there.

How about the—as I mentioned in my opening statement the whole intellectual property realm. Can we get to a point where we employed a WTO system to address intellectual property?

Mr. FREEMAN. I think we can and I think we're coming closer to it. One of the issues that we've had in bringing a case on intellectual property in the past, WTO or otherwise, has been a lack of consensus within our creative industries about bringing such a case. There really has been—one of the issues that China has been able to utilize effectively and preventing us from taking strong action on different areas is our industries are over there. They are fearful of retaliation if they are perceived to be pressing the U.S. Government to be taking action against China. So in the area of intellectual property rights there has been less than unanimity among our creative industries and our innovative industries about bringing action on WTO.

One of the things that's changing these days on the IPR front is a lot of companies, especially small manufacturing industries, enterprises, that don't have any business with China are seeing their property ripped off and exported. So it's actually competing with them in different markets and that's changing the playing field significantly for us in terms of our ability to say hey, there's more than simply a case of us worrying about whether your industries are going to be retaliated against. We have genuine home town issues here that it's going to require us for principled as well as economic reasons to take action.

Mr. STEARNS. The gentleman's time has expired. The gentlelady from Missouri.

Ms. MCCARTHY. Thank you very much, Mr. Chairman.

Thank you very much, Mr. Freeman for sharing your thoughts with us today. I want to follow up on the frustration our entertainment industry has with regard to what's going on in China. And I know Mr. Papovich and others will be visiting with us in the next panel, but you won't be here to address the issues that they're raising that I read about in their testimony, so I want to raise them now and get your thoughts on what America should be doing that it's obviously not doing.

You know, we make these trade agreements, the United States, and we call on China to provide criminal remedies against this piracy that's at 90 percent now in China. And China tells the United States they will and it tells the WTO it will and then it doesn't. And I wonder what you as an individual are doing and can do so that we get China to transfer this whole issue out of the administrative world and into a prosecution, criminal prosecution mode, you as an individual and that we demand China make these changes, change from an administrative venue into one that is a prosecutor-oriented venue and that's—China has to change some laws and regulations to do that. And we need to demand that.

And then their police don't engage in this whole process because it's so administrative. The investigation end in China is very weak. And we've got to tell China that they either have to have private organizations be allowed to gather the information about this piracy so that it can be prosecuted or undertake that criminal investigation themselves. Again, it's something that we do with other countries and other trade agreements. We need to demand it of China.

And then I understand that the current law has such a high threshold of piracy before you can ever even begin an investigation that all of a sudden there's this huge loss of profits and revenues before they even begin to take a look at it.

I believe all of that should be something that you in your venue can negotiate. It's not working. The new WTO laws have no impact on what's going on. These are intellectual properties. These are ours. And yet they're being stolen from us and it's not just the loss of revenue which is outrageous, it is the insult to our creative community and our industry that supports them.

I'm going to stop and I would like you to address the specifics of what is being recommended by those affected and I'm lifting from their testimony and what you as an individual are doing about it?

Mr. FREEMAN. I just returned from a couple of days of negotiating just on this issue. I was waiting to see what the final memorialization of those days will be, but I feel very good that some of the issues that you raised are going to be addressed prior to the Joint Commission on Commerce and Trade, specifically on the issue of criminalized thresholds, specifically on the issue of the increase enforcement by judicial and prosecutorial authorities.

What's happened now as well as that previously when we had discussions about this issue, we were forced to talk to trade policy-makers or intellectual property rights policymakers, people that

were writing the laws. Now what's happened is that the police, Customs authorities and others have come into that dialog and we're actually starting to put in place a dialog between our Customs authorities and theirs.

With respect to intellectual property rights, here's one of the central problems that we face. The central Chinese authorities are absolutely sincere and I believe them, that they want to create an IPR enforcement regime that works for China because it's in their economic interest to develop an innovative industry. China has to—I saw with somebody this past week who said you have to understand, China needs to create 50,000 new jobs a day. We're not going to do that by going to these old line industries. We need new industries. We need to have our own innovative industries. We can't rely on ripping off other people's industries in order to produce these new jobs. We have to create our own brands, our own—we need IPR protection. The problem is that once you get past that central government in Beijing, the interests start to get a fuzzy and own on the local level, the support for IPR enforcement starts to go away.

We really need to see strong directives from the central government that say—

Ms. MCCARTHY. I agree.

Mr. STEARNS. The gentlelady's time has expired. I'll let Mr. Freeman just wrap up.

Ms. MCCARTHY. How do you get the central government to do that is my question.

Mr. FREEMAN. I think we're getting there.

Ms. MCCARTHY. I think I'd like a better answer. I would welcome, since my time is expired that those thoughts in writing at your convenience because a 90 percent piracy rate and sincerity are not going to make the change that we need.

Thank you, Mr. Chairman.

Mr. STEARNS. I thank the gentlelady. The gentlelady from California is recognized.

Ms. BONO. Mr. Chairman, I believe Mr. Norwood was here before.

Mr. STEARNS. Mr. Norwood is not on the subcommittee.

Ms. BONO. I'm sorry.

Mr. STEARNS. We take the members of the subcommittee first and then by unanimous consent, we can let Mr. Norwood—

Ms. BONO. I'm sorry. Excuse me for trying to act like I was the Chairman, Mr. Chairman.

Mr. STEARNS. That's okay.

Ms. BONO. I'm just trying to be nice to Charlie Norwood.

Thank you Mr. Freeman for being here today and I too have the same concerns that Ms. McCarthy does and all of my colleagues have expressed on piracy. In the MPAA testimony they have an executive summary that's pretty much a list wish which I appreciate and they have a specific hope and they say China should agree to a time table to reduce piracy from its current market share of over 95 percent to less than 50 percent by the end of 2004.

Is that a reasonable number? Other than just talking, can we actually achieve that number by the end of 2004?

Mr. FREEMAN. That would be terrific. We've tried to suggest to China that they put in certain metrics, some bench marking, to help them along. They haven't agreed to anything specifically.

Ms. BONO. And then also there are other barriers that are prohibiting American companies from entering the Chinese marketplace as well and further in their executive summary they state this, the MPAA again, "that they ask for a fixed time table with the removal of the various limits, restrictions and structural distortions which hobble the ability of American companies to enter the marketplace and to compete fairly and effectively for market share, for example, they say for theatrical exhibition, they need to increase the number of films in which U.S. distributors may share in box office receipts." So beyond piracy, the Chinese are not even allowing us to get into their country. It's effectively, I don't know if you want to call it a trade barrier or what, but there are other mechanisms in place that are keeping us from competing in what we do so well.

Can you address that a little bit about how the entertainment industry is structured over there, keeping our companies out?

Mr. FREEMAN. Yes, we've spent a certain amount of time trying to push this issue and trying to get them to increase the number of films that, for example, that they'll allow in for a particular year. This is something they negotiated within the WTO, a ceiling or a floor, a number that they would allow in per year. They've said we'll allow 20 films in per year. We've said that's a floor. So that's the minimum number you should allow and you should feel free to allow in as many after that as you can.

They've said to us oh no, no, no. Our WTO commitment is very clear. It's 20 films. That's what we'll allow in. And then we say we unilaterally in the United States increase market access all the time when it's in our interest. It's in your interest right to do so with respect to that film limitation. And the response to that has not been as encouraging as I would hope.

Ms. BONO. So they, in effect, this is an example of them encouraging piracy because it's sort of a hypocrisy, heaven forbid, right?

Mr. FREEMAN. I would agree. I think one of the problems is if you limit the number of legitimate product that comes into the marketplace, you have a certain amount of demand, that demand is going to be filled by counterfeit product. What we've tried to stress is that linkage to the Chinese. So far they have not been as receptive to that argument as we believe they ought to be.

Ms. BONO. Thank you. Changing gears a little bit, he's not paying attention, maybe I can go on really fast, agriculture is my No. 1 industry. China has long held different sanitary and phytosanitary regulations not based on science that affect my growers. Can you talk a little bit about the progress we're making in agriculture?

Mr. FREEMAN. There are a lot of limitations on products or standards, policies that prevent U.S. agriculture products from going to China. We don't think that they're science-based, so therefore they're not sanitary and phytosanitary issues to us. They're technical barriers to trade. So we address them on that basis, that there's no rationale for them and therefore they should be taken out.

We've made some good progress on some key areas, particularly with respect to soybeans, again, but also with respect to certain other SPS issues or nominally SPS issues that are generally TBTs, but we have a long way to go.

Mr. STEARNS. The gentlelady's time has expired.

Ms. BONO. Thank you very much, Mr. Chairman.

Mr. STEARNS. We have one more remaining member of the committee, Mr. Whitfield for your questions?

Mr. WHITFIELD. Mr. Chairman, thank you very much and Mr. Freeman, welcome and thank you for your testimony. I was wondering if you would maybe just list four or five of the major commodities or items that we do export to China and the dollar amounts?

Mr. FREEMAN. I'll have to get back to you with dollar amounts. I'm not good at that, but I will deliver that in writing, if I may.

The No. 1 export, believe it or not, of U.S. to China is electrical machinery. We also have a variety of other machine parts and components that we export overseas. Agriculture is a very large export. The No. 1 single product that we send to China, that we export to China is soybeans.

Mr. WHITFIELD. Soybeans. Okay.

Mr. FREEMAN. We sell a lot of cotton.

Mr. WHITFIELD. I missed your testimony, but I was wondering if you might just briefly explain the gist of the complaint that you recently filed with the WTO against China?

Mr. FREEMAN. We've actually been talking again with the Chinese for about 16 months on this issue trying to resolve it. It's a fairly discrete issue. What it is is Chinese provides a rebate, a value-added tax paid on semi-conductors that are produced and/or designed within China. So therefore, if you export semiconductors to China, you pay a certain value-added tax, 17 percent, but you don't get the benefit of that rebate. If you design and build your chip in China, you get the benefit of that rebate.

This was clearly designed to encourage investment by semiconductor manufacturers in China and it's been fairly successful. The issue really is that you're allowed to subsidize within certain limits industries in China or anywhere. You're allowed to subsidize certain industries or to have industrial policies which encourage development of certain industries. You can't have discriminatory taxes. And what they've done is essentially because of the way they're rebating the value-added tax, it's equivalent to charging a different tax on the semiconductor itself. So that's clearly, in our view, and in the view of certain other key WTO members a violation of China's WTO commitments.

Mr. WHITFIELD. So it's a discriminatory tax primarily then.

Now what options are available to the Trade Representative's office when you view that they are engaged in unfair trade practices. What are the options available to you?

Mr. FREEMAN. Again, it depends on if it's a market access issue, a market access concern. The ultimate process there is WTO enforcement. We do have a number of trade remedy laws and specific safeguards that we have available to us through both the WTO agreement and through China's specific session package.

We have some fairly robust tools and I don't think we're afraid to use them.

Mr. WHITFIELD. Have you utilized any of them at this point?

Mr. FREEMAN. We've utilized the special safeguard on textile, some textile categories. I think we had one case, there was one category of textile industries or textile product there was a 28,000 percent increase and so what we've done is we've capped that and there's a 7.5 percent growth for this year on that product. So it actually acts as a sort of speed bump on new Chinese imports to the U.S.

Mr. WHITFIELD. I see my time has expired, Mr. Chairman.

Mr. STEARNS. The gentleman's time has expired and Mr. Norwood is recognized. He's not a member of the committee, but by unanimous consent we'll allow him to ask some questions.

Mr. NORWOOD. Thank you very much, Mr. Chairman. I'm grateful for that.

Mr. Freeman, you do understand these little gatherings aren't personal, but I want to tell you I think your answers have been as poorly constructed as anybody I've seen in a long time in not answering the question.

My attitude is that you just want to say as little as possible and get out of here as quick as possible. And that attitude stems from I'm thinking you're having a hard time justifying the trade policy that's 5 to 1 and you know it's a problem just like I do.

Simple question. Is China cheating?

Mr. FREEMAN. Yes. China is cheating on a certain of its WTO commitments in our view.

Mr. NORWOOD. Would you consider them cheating in a lot of areas, not just with us, but around the world?

Mr. FREEMAN. Here's the problem. I often get asked, can you grade China's WTO compliance with its WTO commitments. And people say it's C, it's B, it's F—

Mr. NORWOOD. No, no. My question was are they cheating in a lot of areas?

Mr. FREEMAN. I think they're cheating in some key areas to us.

Mr. NORWOOD. Intellectual property rights would be one. They're dumping all over the place would be two. Are all those things true?

Mr. FREEMAN. They are dumping. There is cheating on intellectual property.

Mr. NORWOOD. And you could name a lot more than I could too if I had more than 5 minutes.

Now the question is did I understand you right to say that we had one case to the WTO?

Mr. FREEMAN. That's correct.

Mr. NORWOOD. Which is where we solve these problems. And it is like pulling teeth to get you all to institute special, the safeguards, very hard to get your office to do any of that. It took us a year to do anything about the textile industry. And all I'm saying is if they are cheating and they're tearing us up, which they are and if you travel in Georgia rather than China, I'd show you some. We can't live through this forever. And we can't wait on you all every time to maybe take something to the WTO and then wait another year maybe for the WTO to act. And all I want you to do is being concerned about that.

Now the Chairman asked you, I thought, a fair question. I asked something else in a hearing the other day the same question. Nobody answers and it would seem to me you'd need to know the answer to this in order to help guide what is our trade policy and that is are we exporting more jobs to China than other countries are importing to America using our trade policy?

Now nobody, Secretary Evans wouldn't answer that either. It looks like you need to know that question. Are we sending more jobs out of this country than other countries are sending to us to set up business here? It's pretty clear to most of us who are out in the Districts and out in the States every weekend. It's not a hard answer, but somehow or another you all find it hard to figure that out.

One other question, how many trade agreements have you been involved in or has Mr. Zoellick been involved in in the last 3 years, just a rough number?

Mr. FREEMAN. Six.

Mr. NORWOOD. Can you name one where the United States of America got more benefit than who we made the trade with?

Mr. FREEMAN. I'd argue that the benefits are equal, generally.

Mr. NORWOOD. Well, they aren't. They generally aren't. Just name one where we came out ahead as the United States. At least ahead of what the other country did. You know, if we lower our tariffs 50 percent and somebody else lowers theirs 10 from 50 percent, we're not ahead. They've got a tariff.

I want you to take some time to think about this country was founded on. You said open markets. Go back and look at that carefully. I think we funded the Federal Government for years with tariffs when we first started. Second, you implied to this committee that oh boy, we're shipping cotton to China. China had a drought last year, so we finally got to sell them some cotton. But that's the first time. Up until then it had been the other way around. Am I over?

Mr. STEARNS. The gentleman's time has expired.

Mr. NORWOOD. I'm sorry.

Mr. STEARNS. I think we've finished all the questions for you, Mr. Freeman. I'll just give a quote from F. Scott Fitzgerald, "the test of a first class mind is the ability to hold two opposing views at the same time and still retain the ability to function." So you've been able to, I think, function very well and I want to thank you very much for your time and we appreciate your patience.

And with that, we'll have the second panel come up. Mr. Fritz Attaway, Executive Vice President and Washington General Counsel, Motion Picture Association of America; Mr. Bill Primosch, Director of International Business Policy, National Association of Manufacturers; Mr. Alan Tonelson, Research Fellow, the U.S. Business and Industry Council Educational Foundation; Mr. Joe Papovich, Senior Vice President, International Recording Industry Association of America; Mr. Douglas Lowenstein, President, Entertainment Software Association; Mr. Mark Levinson, Chief Economist and Director of Policy, UNITE.

So I appreciate all your patience waiting. We had almost 22 members here. Normally, we don't have that many so that's why it's taken a little longer, but you've been kind enough to stay and

I think what we'll do is start to my left, Mr. Attaway with your opening statement.

We're asking each of you to hold it to 5 minutes, if you can. I'll probably tap here because we have six witnesses and we probably will have a round of questions, obviously, so if you can hold it to 6 minutes, 5 minutes that will be helpful.

So Mr. Attaway, welcome, and we anticipate your opening statement.

Do you want to have some time here to work on your PowerPoint and we can start with Lowenstein?

Mr. ATTAWAY. I don't know if it's my PowerPoint or—

Mr. STEARNS. Well, why don't we keep moving, Mr. Lowenstein, why don't you start and Mr. Attaway, you can work with your staff.

STATEMENTS OF DOUGLAS LOWENSTEIN, PRESIDENT, ENTERTAINMENT SOFTWARE ASSOCIATION; FRITZ E. ATTAWAY, EXECUTIVE VICE PRESIDENT AND WASHINGTON GENERAL COUNSEL, MOTION PICTURE ASSOCIATION OF AMERICA; WILLIAM PRIMOSCH, DIRECTOR OF INTERNATIONAL BUSINESS POLICY, NATIONAL ASSOCIATION OF MANUFACTURERS; ALAN TONELSON, RESEARCH FELLOW, THE U.S. BUSINESS AND INDUSTRY COUNCIL EDUCATIONAL FOUNDATION; JOSEPH PAPOVICH, SENIOR VICE PRESIDENT, INTERNATIONAL RECORDING INDUSTRY ASSOCIATION OF AMERICA; AND MARK LEVINSON, CHIEF ECONOMIST AND DIRECTOR OF POLICY, UNITE

Mr. LOWENSTEIN. Thank you, Mr. Chairman, members of the subcommittee. I appreciate the opportunity to appear before you this morning. The Entertainment Software Association members that I represent produce the games that 149 million Americans play on their video game consoles, their personal computers, their PDAs, their Gameboys and even their cell phones. Over the last 5 years, this has been the fastest growing entertainment industry in the world. U.S. sales alone of hardware and computer software and videogame software have now exceed \$10 billion and forecasts are that the game industry will exceed \$15 billion in revenue in the United States alone within the next 3 or 4 years.

Our message with respect to China is quite simple. While the market offers tremendous promise, massive piracy makes realizing its potential more a faint hope than a near term reality. In fact, we estimate that the annual value of pirate entertainment software in the Chinese market today is more than \$500 million.

I thought it would be helpful to use some photographs to dramatize the scope of the problems American game publishers face in China today. I'm going to hopefully have a working PowerPoint presentation here.

This first photo shows a counterfeit PC game complete with packaging and documentation that has been localized by pirates into China for local sale. This kind of factory production of high quality counterfeit disks is one reason the PC game market in China is rife with pirate goods.

In this next photo we see workers assembling counterfeit Nintendo Gameboy cartridges. Millions of these pirate products are produced each year by Chinese factories, particularly in Guangdong

Province and then exported throughout the world. As a result, potentially lucrative foreign markets for U.S. publishers who make some of the most popular games for the Gameboy are effectively ruined.

In this third picture, I wanted you to see how perfect the copies are. The left image shows an examine of a counterfeit game cartridge and on the right you see the genuine product. I actually have the two right here. This being the legitimate product and this being the pirate product. And you can see——

Mr. STEARNS. Why don't you have staff bring them up so members can actually see them.

Mr. LOWENSTEIN. So you can see they're virtually indistinguishable, particularly to the uninitiated.

This next photo shows what are called circumvention devices such as mod chips which you see on the left, again, here's an actual mod chip. And these are used to rig videogame consoles to bypass the hardware's access control system, thus enabling the hardware systems to play the pirate games.

Nearly all the consoles in China have been molded in this way, virtually obliterating demand for legitimate products.

And this last photo shows one of the 200,000 internet cafes in China, each with 100 to 300 seats. These cafes are the primary source of internet access for millions of Chinese citizens and if all of them purchased legal games, that would really be a boon to the software market, but unfortunately, in most cases the games they make available to their customers are pirate products.

Now these pictures somewhat of a discouraging story, but despite the enormous rifts our industry is making a serious effort to create a legitimate and viable market in China. Indeed, several leading companies, including some of our major American PC publishers, as well as Nintendo and Sony, are seeking to launch their hardware systems into the Chinese markets despite these challenges. But their efforts cannot succeed unless China makes a sustained and massive commitment to reduce piracy levels from the current 95 percent range.

And we urge the subcommittee to encourage the United States Trade Representative to include the following specific actions in the upcoming JCCT discussions. First, China should launch a highly publicized nationwide crackdown on piracy and counterfeiting operations that also reaches factories engaged in the production of pirate and counterfeit entertainment software.

Second, China should lower monetary thresholds to trigger criminal prosecutions for piracy. We've heard some discussion about that, so I won't dwell on it.

Third, China must criminalize the circumvention of technological protection measures like these mod chips I showed you and the trafficking of these circumvention devices and they should quickly exceed to the WIPO internet treaties.

Fourth, China should adopt laws such as the Hong Kong Organized and Serious Crime Ordinance, a RICO-like statute that can be a powerful tool to crack down on intellectual property violations. And both China and Hong Kong should be strongly encouraged to use this law against organizations involved in piracy and counterfeiting.

And finally, China should be discouraged from instituting policies like import restrictions, protracted content review procedures and holographic “stickering” requirements that only saddle legitimate publishers with costs and delays while strengthening the position of pirates in the market.

In conclusion, we believe that if China mounts a serious effort to root out piracy, the winners will be not just American software publishers, but the creative talent in China which in today’s environment has absolutely no chance to flourish.

Thank you for your time.

[The prepared statement of Douglas Lowenstein follows:]

PREPARED STATEMENT OF DOUGLAS LOWENSTEIN, PRESIDENT, ENTERTAINMENT SOFTWARE ASSOCIATION

Mr. Chairman, Ranking Member Schakowsky and Members of the Subcommittee, thank you for the opportunity to discuss U.S.-China trade issues as they relate to the entertainment software industry. We are pleased to assist this Subcommittee in identifying trade impediments—some that we currently experience and others with real potential to thwart healthy and growing commerce in legitimate entertainment software products in the Chinese market, and to share some thoughts on issues the Administration should address through the Joint Committee on Commerce and Trade (JCCT).

I appear on behalf of the Entertainment Software Association (ESA), a trade association serving the business and public affairs needs of companies that publish video and computer games for video game consoles, personal computers, handheld devices and the Internet. ESA members account for more than 90 percent of the \$7 billion in entertainment software sold in the U.S. in 2003, and billions more in export sales of U.S.-made entertainment software to fuel the \$20 billion global game software market.

It should come as no surprise that by far the most significant trade barrier in China is piracy in its many forms. It must be understood that in China, the problem is not just the flooding of local markets with pirated goods; the problem continues to be, at least for certain products, the export of Chinese-made pirated product throughout the world. In my testimony, I will provide an overview of industry-specific piracy concerns, suggest a few productive directions for achieving solutions, and identify several other market conditions that actually help to fuel the demand for pirate product by slowing or reducing the commercial availability of legitimate product in the Chinese market.

Let me be clear at the outset that while we have many problems in China, our industry remains enthusiastic about the opportunities to build a viable market there, and we are grateful for demonstrations of renewed interest in addressing industry concerns. Undeniably, though, more can and must be done. Our comments suggest constructive and substantive actions that China can take to enhance, by an order of magnitude, the protections that can be afforded to ESA member products developed in or sold in the Chinese market.

THE PROMISE OF THE CHINESE MARKET

The Chinese market presents a conundrum. It is a market with such obviously great potential but also, for industries dependent on intellectual property protection, great risk. Our industry knows there is a huge audience for—as well as a sizeable and growing demand for—entertainment software products in China. While there are already millions of game consoles and tens of millions of PCs in Chinese homes, increasing demand is perhaps best exemplified by the exploding popularity of massively multiplayer online games (MMOGs) where literally thousands of players can compete against one another simultaneously.

Just a year ago, forecasters estimated that there would be 7.4 million users of MMOGs in the Chinese market by year’s end—accounting for online revenues of roughly \$95 million. But in an update to their 2003 study, to be published on April 2, 2004, International Development Group & Niko Partners will report that actual 2003 data for both the number of MMOG players and online game market revenues will have exceeded those initial 2003 projections by 40-45%, marking greater than expected demand for this type of game.

The exploding popularity of online games brings with it even further increases in the popularity of Internet cafés, where these and other games can be played. It is

estimated that there are currently 200,000 Internet cafes nationwide, many housing between 100 and 300 seats, and that 60% of the activity in these cafes involves game play.

We are concerned that the bulk of new demand may be met by pirated rather than legitimate product. We know that overall piracy levels for entertainment software consistently exceed 95%—meaning that only one in twenty copies in circulation is acquired legitimately. The overall value of pirated entertainment software product found in the market each year is estimated to be in the hundreds of millions of dollars.

Notwithstanding obvious risks, our industry is responding to growing demand. Several entertainment software publishers have been bringing PC-based games to the market, and this year, Sony and Nintendo announced entry into the market with various dedicated console products. Successful entry into the Chinese market means more jobs and revenue for the U.S. game software companies that create products for these platforms, which also results in additional tax revenue and contributes to a more favorable balance of trade. Companies are moving forward very much aware of the enormous piracy threat they face, yet proceeding on the good faith assumption that the Chinese government will improve its enforcement regime to protect their market footholds.

Measures protecting and supporting intellectual property, of course, would also benefit and help foster the growth of China's domestic entertainment software industry in a far more direct, dramatic and meaningful way than would artificial restrictions on the availability of imported entertainment software product.

PIRACY AS A MARKET BARRIER

In this section, I want to address the overall piracy problem we face in China, and then break it down into subsets, including the domestic pirate market within China, the export of pirate product made in China to other markets, and piracy in Internet cafes.

1. Overall Piracy in the Chinese Market

Our most recent estimates again reveal incredibly high piracy rates across all major entertainment software platforms. We estimate piracy levels of 97% for PC products, 75% for console products (such as games for the Sony Playstation® and Playstation2®), and 99% for handheld products (such as games for the Nintendo Gameboy® and Gameboy Advance®). Sustained piracy at these levels reduces significantly the size of the legitimate market, and makes it extraordinarily difficult to build legitimate distribution and sales.

Our member companies face different forms of piracy in the market—including optical disc piracy of console and PC games, counterfeit cartridge-based games, piracy at Internet cafes and the recent emergence of online download sites for illegal “warez” copies. Pirated hard goods copies of games for the PC and game consoles remain widely available in the domestic market, both in the form of factory-produced optical media discs and infringing copies resulting from CD-R “burning.”

Although console manufacturers only officially entered the market early this year, consoles have been present in the market for many years. Virtually all of these have been modified to enable the play of pirated copies of video games. This is done through the installation or use of modification devices (often called “mod chips,” “game copiers” or “game enhancers”) that circumvent the technological protection measures used by publishers in connection with these works. The widespread use and availability of circumvention devices (and circumvention services) underscores the need for China to accede to the WIPO Internet Treaties, which make mandatory the protection of technological protection measures used by right holders to protect their works. Addressing this problem must be a high priority for U.S. policy.

2. Production of Pirated and Counterfeit Products in China

Large-scale piracy of products made available on optical media, such as on CDs, CD-ROM, or DVD, continues unabated. This form of piracy, as well as CD-R and DVD-R “burning,” has always impacted the entertainment software industry. Recently our members have observed the emergence of exceedingly high-quality, pirated PC game product that has been fully localized into the Chinese language for sale in the domestic market. We share concerns that such product is not being produced solely for China's market, but that it is also being exported to satisfy the demand for Chinese language product throughout the region.

China has also historically been the world's leading producer of pirated cartridge-based games for play on handheld devices. Guangdong Province is home to numerous factory operations that operate openly and without fear of being shut-down by government authorities. These large-scale pirate operations use and even program

microprocessors containing stolen software code and assemble these, with counterfeit plastic casings, into finished products violative of publishers' copyrights and trademarks. Still other factory operations specialize in the production of the components used in game counterfeiting—including the plastic casings, labels, instruction booklets and packaging materials that enables the pirated product to sell at a premium.

These pirate enterprises operate openly, raking in millions in illegal profits without incurring the research, development or marketing costs already borne by the legitimate publishers. All of this significantly hampers the ability of entertainment software publishers to recoup the investment required to bring their products to market—costs that can now exceed \$10 million for some top quality titles. Neither are these pirate operations forced to incur the risks that are part and parcel of the entertainment software publishing business. Pirates lose nothing when a game that has cost millions to bring to market does not become a hit—indeed, pirates prefer to copy games which are already heavily anticipated and thus likely to be best-sellers.

The volume of pirate production remains staggering. In 2003, enforcement undertaken by just one ESA member, Nintendo, resulted in the seizure of 4.7 million counterfeit items in China (including finished cartridges, counterfeit chips and fake packaging and inserts). Despite the raids against several factories in the Guangdong Province, the Chinese market remains flooded with pirate and counterfeit handheld games, further accounting for the estimated 99% piracy levels for these products.

3. Pirated and Counterfeit Production for Export

Illegal copies of handheld products are churned-out systematically, not only for domestic pirate consumption, but for export throughout the world. While in the late 1990's, China had taken meaningful steps to curb pirate optical media production for export, counterfeit cartridge games produced in China continue to be found in countries across Asia, Eastern and Western Europe, the Middle East and the Americas. Though the Guangdong administrative authorities (specifically the Technical Supervision Bureau (TSB)) have been helpful in orchestrating raids against several factories, these administrative raids have done little to curb production of counterfeit video game cartridges, as the factory owners are not prosecuted criminally nor have any of them been subject to sufficiently high administrative fines so as to deter further infringing activity. Indeed, there have been numerous instances where a factory that was previously closed is soon re-opened under a new corporate name—sometimes in a different location, but often at the very same location.

They are high volume, high profit ventures operating seamlessly across borders. There is substantial and mounting evidence of the tight connection between individuals and operations in Taiwan (as the supplier of counterfeit chips and capital), China (a key assembly point), Thailand (a rising large-scale assembly point) and Hong Kong (a key transshipment point). As suggested later in my testimony, this situation points to the urgent need for new legal and enforcement tools to combat criminal enterprises, and to bring these tools to bear against enterprises that cross borders. There also needs to be more cooperation between authorities on the Chinese mainland and Hong Kong to further quell worldwide export of finished, pirated product.

4. Piracy in Internet Cafés

I mentioned previously that there are estimated to be approximately 200,000 Internet cafés in the country, each with an average of 100 to 300 seats—and the Internet Café industry is really just beginning to take shape. But already, piracy in the cafés has become a significant problem for the industry. Some cafes, for example, may buy only one legitimate copy of an entertainment software title, but load it on hundreds of computers—machines that are then used to attract clientele and bring profit to café owners. Café owners also may turn a blind eye to patrons who use the facilities to commit further infringements of entertainment software and other digital products—and even allow customers to burn infringing product to CD—all while charging patrons an hourly access fee. Such flagrant piracy, undertaken for a commercial purpose, is precisely the sort of activity that the TRIPS agreement was intended to address.

Our industry is excited about growth of the internet café industry in China. We embrace it as a great opportunity for our products because, given the economic realities of the average family in China, these outlets, at least for the foreseeable future, will remain the primary means by which most Chinese citizens enjoy the benefits of entertainment software. It is our understanding that the Internet café industry is in a state of flux, and that the government has begun to take steps to further guarantee its success and thus the availability of these services to the Chinese pop-

ulation. To the extent that these measures will involve further regulation of the café industry, including requirements for companies permitted to own and run them, it is essential that the U.S. insist that the Chinese include in these regulatory regimes measures to ensure copyright compliance.

ENFORCEMENT IMPEDIMENTS AND LEGAL REFORMS

Addressing the myriad piracy and counterfeiting problems in China will require high-level leadership, both to assure a meaningful departure from past history and a sustained commitment to enforcement that brings real deterrence. We are hopeful that the reinvigorated efforts by the U.S. and China to consider these issues at the highest levels, including through the Joint Commission on Commerce and Trade, will be both fruitful and efficient.

There is a great deal of work that the Chinese must begin to undertake in terms of reforms in its legal and enforcement regimes, and these objectives should be clearly spelled out to the JCCT delegates. Membership in the World Trade Organization entails obligations to which China must adhere. We suggest several enforcement- and legal reform-related objectives below, which, I should mention, are entirely consistent with those identified in House Resolution 576, introduced last week by Representatives Watson, Lantos and Chairman Hyde—a measure we wholeheartedly endorse.

1. Criminal Enforcement

One of the key legal reforms that must be undertaken immediately is in the area of criminal enforcement. Much immediate deterrence can be achieved by a swift and sustained nationwide crackdown on piracy and counterfeiting operations. China has done this before and indeed was successful in shutting down many of the illegal optical disc factories in the 1990's. China needs to take the same comprehensive measures against the factories illegally replicating copyrighted material on optical discs and against those producing counterfeit cartridge-based video games. However, reform should also address long-term goals of keeping piracy at minimum levels and this would require providing the Vice Premier with sufficient authority and resources to coordinate the national anti-piracy enforcement effort. National and provincial enforcement agencies should likewise be provided with adequate resources to effectively undertake a greater level of enforcement actions. These stepped-up enforcement measures should be accompanied by a (widely publicized) increase in the levels of administrative penalties and fines to deterrent levels, as well as a lowering of the threshold for initiating criminal action against intellectual property violations such that criminal investigations and prosecutions of pirates and counterfeiters become a regular and functional part of an overall enforcement regime.

It bears emphasizing that once these legal reforms are in place, they must be utilized and actually enforced in practice. Deterrence requires more than successful raids being conducted. Although our industry remains grateful for the government's efforts in this regard, with some raids having resulted in the seizure of millions of pirated and counterfeit products and component parts, the sheer volume at issue illustrates the ease with which pirate operations can withstand periodic raids and seizures as a cost of doing business. Qualifying raids and seizures should and must bring about the initiation of prosecutions. Prosecutions should proceed swiftly to their conclusion, including, as warranted, convictions with the imposition of sufficiently deterrent fines and terms of imprisonment.

Consider the following rare but promising example. In its 2004 "Special 301" filing submitted to the U.S. Trade Representative in February, one ESA member company makes specific reference to a major pirate and counterfeiter of cartridge-based video games. Raids against this individual's factories resulted in the seizure of over three million infringing items, including finished counterfeit cartridges, instruction booklets and packaging materials. The factory owner was detained (and continues to be detained, at least as of early February) and criminal charges against him (and four senior associates) are under consideration—a first against an infringer of video game products. It remains to be seen whether China will take this opportunity to show it is committed to combating piracy through consideration of appropriate criminal sanctions. Should the case be brought and proceed to timely resolution, it would be a first signal of a welcome change in China's approach to entertainment software piracy. It would certainly give pause to others engaged in this illegal activity. However, if the ultimate resolution results in a slap on the wrist, the message to pirates will continue to be clear: China is an enforcement-free zone within which you can operate with impunity.

2. *Enforcement Against Criminal Enterprises*

Converging signs point to the increasing involvement of organized criminal enterprises in systematic intellectual property abuses. Both the International Intellectual Property Alliance (IIPA) and the International Anti-Counterfeiting Coalition (IACC), in their respective 2004 Special 301 submissions to the USTR, provide rich examples of such involvement, including the cross-border nature of large-scale piracy and counterfeiting operations. We believe that the ability to address the growing threat of criminal organization involvement in high-volume intellectual property crimes is therefore a logical and necessary accompaniment to an improved criminal enforcement regime. Addressing this problem would include, but also would go beyond merely assuring the availability of appropriate legal tools. It requires, in our view, a rethinking of how criminal investigations are undertaken.

Specialized legal tools and enforcement techniques used by governments to combat the involvement by organized criminal entities in other forms of illegality should also be brought to bear against the highly organized criminal enterprises involved in piracy and counterfeiting operations. Investigative efforts of copyright owners simply cannot achieve the immediate impact and long-term deterrence of appropriately-placed criminal actions. It instead falls to governments to protect the legitimacy and integrity of its communities and economies by defeating organizations that are well-funded, oftentimes protected, and operate with impunity across national boundaries.

China should assess the adequacy of its legal authorities and enforcement mechanisms to address and root-out criminal organizations involved in systematic intellectual property crime. A few months ago, we encouraged the USTR to include on its list of action items for China the adoption of measures similar to those contained in Hong Kong's Organized and Serious Crime Ordinance (OSCO), which offers a comprehensive package of tools that can be brought to bear against these criminal organizations. The Hong Kong law is the essential tool. China should adopt similar measures, and together China and Hong Kong should ensure that these tools are capable of being used—and are actually used—against intellectual property rights offenders. The U.S. should insist on such steps.

Enforcement officials should also be encouraged to think anew about the ways in which such investigations are undertaken given the ever-increasing likelihood of organizational involvement. China's policymakers responsible for the administration of criminal justice should consider developing an incentive system that rewards efforts by investigators to develop evidence against progressively higher subjects within criminal organizations. They should not be content merely with seizing clearly infringing products, but should also seek and obtain regular seizure and subsequent analysis of documentary evidence obtained through criminal raids and investigations. Prosecutors should base their valuations of the severity of an underlying offense not only on the wholesale value of pirate product and components obtained in a particular raid, but on the documentary evidence of the quantity of harm brought about, over time, by the entire enterprise.

Effective investigations of this nature are destined to be of only limited success without a functional international component. Recognizing this inevitability, China should seek to improve communication and cooperation with other countries' law enforcement agencies, particularly with the territory of Hong Kong. The most well-funded and well-organized pirates increasingly operate with impunity across national boundaries. They should not be further rewarded by having their conduct stymie ongoing investigations and effectively immunize these most deserving criminals from appropriate criminal sanction.

3. *Internet Piracy*

The increasing availability of illegitimate content on servers worldwide, including those in China, calls for making available adequate and effective remedies to online piracy. Because of the speed with which unlawful distribution of copyrighted works can and does occur, adequate and effective remedies must also include the means by which copyright owners can act immediately to effectuate removal or disablement of clearly infringing product found online. We note with concern that there now appear to be a significant number of Chinese-language "warez" sites which make available virtually all varieties of pirated entertainment software for download.

In China's case, we believe that online remedies should also include the provision of NET Act-type criminal liability for large-scale distribution of infringing works, even when proof of a profit motive is lacking, and effective procedure that allows rightholders to monitor and obtain immediate removal of infringing content found online. (See the No Electronic Theft (NET) Act, Pub. L. No. 105-147.) Effective enforcement will also require a continuing commitment to training investigators and prosecutors in the appropriate handling of Internet piracy cases.

4. *WIPO Treaties Implementation*

Adoption and sound implementation of the WIPO treaties provides countries in China's position with the essential tools needed to assure the healthy development of online commerce in digital products. Given the role that online games and the availability of online product will play in the growth of China's entertainment software industry, a basic necessity is the ability to appropriately assert and protect rights in online products. The WIPO Copyright Treaty and Performances and Phonograms Treaty are the world's roadmaps for how these protections should be afforded and administered, and China, in our judgment and experience, would be well-served to embrace and enact its requirements.

A key requirement of the WIPO Treaties is the effective prohibition of circumvention of technological protection measures (TPMs). It is essential that these include strong civil and criminal prohibitions against the trafficking in circumvention devices. It is essential that circumvention devices, in this context, be defined in such a way as to include such items as "modification chips" and "game enhancers"—those items that quite literally, for a substantial segment of this industry, make piracy possible. For Chinese game developers, technological protection measures are the avenue by which they will make products available to consumers under a range of mutually agreeable contractual terms. They are deserving of protection in law and in practice.

ADDITIONAL MARKET ACCESS ISSUES

At a time when Chinese consumers are seeking new digital products and entertainment services in the domestic market, the government should avoid creating policies that serve as barriers to entry and, in some instances, actually serve to perpetuate the pirate economy. It is the experience of this industry that measures which reduce the availability of or delay the emergence of new and legitimate products in the market serve only to penalize legitimate interests. This delay fuels demand for pirated products and rewards pirates by granting them an exclusive period in which to sell their wares. Measures that hold the potential to create these disruptive effects include overt import restrictions, lengthy periods for content review that precede the release of new product in the market, and measures intended to assist in the identification of legitimate products, such as holographic "stickering" requirements, as further described below.

1. *Import Restrictions*

The Chinese government recently indicated that it would consider imposing restrictions on imports of entertainment software products from those countries that are its leading producers: the United States, Japan and, for the Chinese market, South Korea. Import quotas would purportedly strengthen China's domestic game industry. We believe it would instead perpetuate piracy and not produce expected increases in demand for Chinese-developed entertainment software.

The Chinese market is already replete with pirate and counterfeit video game products. To impose import quotas on legitimate entertainment software products at this stage would not change consumer preferences—but only exacerbate the void in the availability of legitimate product in the market—one already exploited effectively by pirates and counterfeiters. To foster the development of a domestic entertainment software industry, China needs to crackdown on pirate and counterfeiting operations. Local industries thrive where strong intellectual property protection exists, and when governments ensure effective enforcement against the theft of intellectual property. Import restrictions are likely to stifle potential market growth, and hinder the development of distributors, retailers and legitimate sales.

2. *Protracted Content Review Periods*

Entertainment software publishers are also hampered by the requirement that their products be subject to lengthy reviews by the Ministry of Culture before they are approved for release in the domestic market. It takes anywhere from several weeks to several months to complete this review process and receive approval for the game's release. During this time, entertainment software product destined for the market sits idly in warehouses, allowing pirates to saturate the market with pirated products.

For entertainment software titles, this delay is extremely prejudicial as videogame titles have a very limited window within which profitable sales can be made. By the time the product is cleared for distribution and release into the market, pirates will have enjoyed between several weeks and several months to peddle pirate copies—thus greatly diminishing sales of the legitimate product. It is also rather ironic that while entertainment software companies comply with these content review requirements, pirates do not. While legitimate software companies currently submit for re-

view all titles proposed for sale in China to the Ministry for review, pirated versions of the very same titles, which have been neither reviewed nor cleared for sale in China by the Ministry, are on sale all over China. Further, these unapproved pirated products are neither being seized nor taken off the streets by the Chinese government. We strongly encourage the Chinese government to consistently enforce its regulations prohibiting the sale of these pirated, unreviewed and unapproved titles during the time when the legitimate version is undergoing review and thereafter.

3. Legitimate Product Identification Formalities

Early in 2004, Chinese government officials indicated a willingness to require affixation of newly-designed identification seals to audio and video products as an anti-piracy tool to aid in the identification of legitimate product. In our and our members' experiences, these "sticker" requirements create—without fail—more problems than solutions. These programs are prone to fraud and corruption, with the result being that stickers are issued to third party importers who are not licensed to distribute the copyrighted material, and who use false documentation to support their application for stickers. The stickers themselves are subject to counterfeiting, and thus, "protect" pirate product as the attendant sticker serves to legitimize pirated product and deter its immediate seizure by law enforcement. They also add significant delay in the release of legitimate product as titles must remain off of retailers' shelves until the stickers are applied. In the meantime, pirated product remains readily available in the market.

Requiring the use of stickers also increases the costs for legitimate publishers. No sticker program, however well-intentioned, can substitute for aggressive and coordinated enforcement actions by law enforcement authorities. We discourage the government from considering this course of action, as in our experience it inevitably becomes an impediment to, not an enabler of, legitimate commerce.

CONCLUSION

I again thank this Subcommittee for its important work and for this opportunity to provide our industry's perspective on the piracy situation in China. We look forward to continuing to work with the Subcommittee, the U.S. Trade Representative and other government agencies to provide the benefit of our experiences as China continues to liberalize its trade policies and improve its enforcement practices in line with its obligations as WTO member and valued trading partner.

Mr. STEARNS. Mr. Attaway.

STATEMENT OF FRITZ E. ATTAWAY

Mr. ATTAWAY. Thank you, Chairman Stearns, Congresswoman Schakowsky, members of the committee, I appreciate this opportunity to be here today to present the views of the Motion Picture Industry on trade policy with China. I am particularly pleased to be here today with my fellow Idahoan and a classmate at the College of Idaho, Mr. Otter. Thank you very much for stating.

Regrettably, Mr. Chairman, for our industry the best word to describe the trade situation in China is bleak. The piracy market and the access barriers have reduced the largest potential market on earth for U.S. audio-visual entertainment to a land of unfulfilled hopes and promises.

My boss, Jack Valenti, is fond of describing the U.S. motion picture industry as the crown jewel in America's trade tiara. Our industry has a favorable balance of trade with every nation in which we do business. We contribute \$108.4 billion to the U.S. GDP and we employ some 500,000 U.S. workers.

In China, however, the trade climate is inhospitable for U.S. audio-visual entertainment. In fact, MPAA member companies lose far more potential revenues from piracy of their movies in China than they earn from legitimate exploitation. This situation must change.

As you can see from the table on the screen before you, piracy rates and losses in China are higher than any other country in the

region. The piracy rate in China now is about 95 percent, only slightly lower than it was in 1995 when it was 100 percent.

This astronomical piracy rate is reflected in the cost of piratical product. Pirate DVDs in China are sold for about 95 cents as compared with \$4.95 in Taiwan where the piracy rate is still unacceptably high, but less than half that in China.

The out of control piracy in China is also reflected in industry revenue figures. The chart before you shows that theatrical earnings have increased slightly since 1999 because more films are being allowed in, but earnings are still lower than they were in 1996. Moreover, the average earnings per film released in China has actually decreased 75 percent since 1998.

The home video picture is even more discouraging as the number of VCD and DVD players in China has mushroomed, revenue from legitimate sales has decreased to near zero.

There are two principal reasons for the high piracy rate and low earnings in China. One is lack of effective copyright law enforcement. In order to get piracy under control, the government of China must strengthen focused coordination and effectiveness of the various law enforcement agencies. It must take immediate action to stop the rising volume of pirate exports. It must establish credible legal deterrence to piracy, especially by lowering the criminal threshold for copyright violations.

It must build consumer awareness of the dangers and penalties for engaging in piracy. It must create strong well-coordinated, local enforcement entities and it must set a fixed timetable for bringing piracy rates steadily down from the current levels.

The second reason for the high piracy and low earnings in China is lack of reasonable access to the legitimate marketplace. Even with energetic copyright law enforcement, piracy would still exist at an unacceptable level because China will not allow American companies to meet demand for American movies, TV programs and home video material. China must provide meaningful market access. For theatric exhibition, China must increase the number of films from the current 20 in which U.S. distributors may share box office receipts and it must eliminate the current import monopoly and eliminate the current distribution duopoly. It must eliminate blackout periods when only local films can be screened and it must reduce the confiscatory taxes and fees.

In the home video marketplace, it must streamline and speed censorship. It must streamline and speed licensing procedures for retail outlets and it must relax its foreign ownership limits for video replication facilities.

Mr. Chairman, I began by saying the situation in China is bleak. I would like to end by saying that it is not hopeless. China has taken significant steps to bring piracy under control and to increase market access, but it must do much more. We look to the deliberations of the Joint Commission on Commerce and Trade to produce positive results and we are hopeful that China will take many of the steps noted above to meet its international obligations to protect intellectual property and open its markets.

This hearing is a very important vehicle for sending a message to China and I thank this committee for the opportunity to appear before you. Thank you very much.

[The prepared statement of Fritz E. Attaway follows:]

PREPARED STATEMENT OF FRITZ E. ATTAWAY, EXECUTIVE VICE PRESIDENT, AND
WASHINGTON GENERAL COUNSEL, MOTION PICTURE ASSOCIATION OF AMERICA

Chairman Stearns, members of the Subcommittee, my name is Fritz Attaway and I thank you for giving me this opportunity to present the views of the Motion Picture Association of America on U.S.-China trade relations. MPAA is a trade association representing the seven major producers and distributors of theatrical feature films, television programs and home video material. They are Metro-Goldwyn-Mayer Studios Inc., Paramount Pictures Corporation, Sony Pictures Entertainment Inc., Warner Brothers Entertainment, Inc., Twentieth Century Fox Film Corporation, Universal City Studios LLLP, and The Walt Disney Company.

Since 1995, when a bilateral intellectual property rights (IPR) agreement was signed between China and the U.S., American entertainment firms have labored to establish a foothold in the Chinese market. A combination of trade barriers and rampant piracy have thwarted these efforts, resulting in losses that top \$175 million in 2003 alone, the highest annual loss since 1995.

The American motion picture industry is a vital component of the U.S. economy. The American broadcast and motion picture industries accounted for \$108.4 billion of the 2001 U.S. GDP. The success of U.S. films abroad is a major facet of the industry's revenue. While most U.S. industries struggle with trade deficits, the American motion picture industry has a trade surplus with every country in which we do business, and directly employs 500,000 U.S. workers.

Unfortunately, market access restrictions and rampant piracy have blocked prospects for meaningful business in the large and increasingly vibrant China market, hurting both the American and Chinese film industries. In simple terms, both American and Chinese filmmakers are severely crippled by piracy and a restrictive bureaucracy. Moreover, China needs immediately to halt the production and export of pirated materials that have once again begun to flood world markets.

China must demonstrate its commitment to provide market access and effective protection against piracy now, before the situation deteriorates further. Market barriers that invite piracy and prevent legitimate distribution of U.S. entertainment must be removed. The enormous entertainment needs of the Chinese nation must be provided through legal channels, not by pirates who defy the law. This testimony reviews the situation and provides specific recommendations on what needs to be done.

MPAA GOALS FOR THE JCCT

MPAA hopes that the commitments made at the April 21 meeting of the U.S.-China Joint Commission on Commerce and Trade (JCCT) contain specific provisions on improving enforcement against piracy and improving access to China's market for all aspects of filmed entertainment (films, TV programs and home video entertainment). In the section below, I set forth the steps we believe need to be taken and the commitments we are hoping to secure at the JCCT. The balance of the paper describes the severity of the piracy problems we face and the barriers to market access that likewise need to be addressed to ensure availability of legal product to meet consumer needs and provide an alternative to pirated product.

PIRACY—What is needed is a series of commitments from China to address, on a fixed timetable, the organizational problems which have befallen the various agencies involved in intellectual property protection and the commerce of entertainment, with clear direction from the top levels of Chinese Government, coupled with publicity, and education, as well as a lowering of the criminal threshold for copyright violations, and the establishment of effective local enforcement entities. China should agree to a timetable to reduce piracy from its current market share of over 95 percent to less than 50 percent by the end of 2004.

1. Strengthen focus, co-ordination and effectiveness of the various Chinese enforcement agencies through strong direction from the top Chinese leadership.

For the overall Chinese anti-piracy effort, the single biggest problem is the lack of focus and overall co-ordination among the various Chinese enforcement agencies. Oversight of intellectual property, the film industry, and enforcement in China involves a plethora of entities, including the Press and Publication Administration, Customs, the Ministry of Culture, the Ministry of Public Security, the National Anti-Piracy & Pornography Working Committee, the National Copyright Administration of China, the State Administration on Industry and Commerce, the State Administration of Film, Radio, and Television, in addition to local organizations

such as the Beijing Anti-Piracy Alliance and the Shanghai Municipal Special Agency for Cultural Affairs.

No one at the top levels of Government heretofore has been providing forceful direction and monitoring performance. While various authorities have conducted periodic sweeps of pirate locations, and publicized "crackdowns," those activities have failed to truly make a dent in the problem. The various Chinese Ministries and agencies involved in the film industry and in IPR protection are sometimes fighting for control of specific issues. Too often when such conflict arises, the result is stalemate and nothing is done at all. Top-level direction and coordination of the Chinese Ministries and agencies involved in IPR and market access-related issues are urgently needed.

It is welcome news that Vice Premier Wu Yi has been named to head the group to enhance IPR protection in China. In order to be truly effective, the Vice Premier's responsibilities will need to encompass not only anti-piracy strategy, but the policies impeding market access if there is to be any hope for a viable legitimate film industry, which is now severely crippled. The Chinese Government has been talking about doing this for years, but implementation has been very slow; it is imperative that Vice Premier Wu Yi's work in this area move forward as quickly as possible.

2. Take immediate action to stop the rising volume of pirate exports from China.

The Chinese government needs to take urgent and decisive action to stop the rising tide of pirate exports to world markets. Specifically, the government should:

- Facilitate prompt investigations by police, Customs and other enforcement offices of factories that are supplying pirate optical discs to Chinese trading companies for export.
- Continue to inspect, and to seize pirate products intended for export at key locations throughout the country;
- Encourage prosecutors to criminally prosecute cases, to press for deterrent sentences on those responsible, and to ensure wide publicity of successful prosecutions.

3. Establish credible legal deterrents to piracy to include the lowering of the criminal threshold for copyright violations.

Credible legal deterrents to piracy are essential for effective control of piracy. To achieve credible deterrence, the criminal threshold for copyright violations must be lowered substantially. At present, a criminal copyright complaint is only triggered when an individual defendant has *earned profits* in excess of \$6,000 (or \$24,000 for a corporate defendant.) The threshold for criminal prosecutions under U.S. law is ten copies with a *retail value* of over \$2,500. Given the disparity of per capita income between China and the U.S., the monetary threshold in China should be much lower than in the U.S. Moreover, the measure in China should be market value, not earned profits. Under the Chinese standard, a pirate can be apprehended with a million pirate DVDs, but no criminal prosecution can be instituted if the pirate has not actually sold copies and earned a profit. Given the low price level of pirate product, and the lack of record keeping by pirates, there are seldom any criminal prosecutions.

It is equally important that Chinese enforcement agencies, courts, and all other parts of the Chinese government receive a clear and forceful order from the top that IPR protection is a "must." This will be the key to making progress and is a core requirement of China's WTO membership.

There is evidence that there has been some recent growth in criminal cases undertaken by public security bureau personnel in Beijing and Shanghai, using provisions of the Criminal Code which make illegal the sale of audio visual product not cleared for release in China. Last year, there were 19 such criminal cases, all in Beijing, involving piracy of American titles and for which custodial sentences were imposed. A further 30 cases were filed in Beijing and Shanghai by the end of the third quarter of 2003. Sentences for the 2002 cases (all of which were filed in Beijing) ranged from six months to six years, with the majority being sentences of two years or more. Unfortunately, these cases are too few to have had any real impact on the situation. If there is to be deterrent impact from strong and effective court action, there must be a quantum leap in the number of cases brought coupled with extensive publicity by the Chinese government on the penalties levied.

4. Build consumer awareness of the dangers and penalties of engaging in piracy.

The government also needs to make a much stronger effort to build consumer awareness of the dangers and penalties of engaging in piracy. Not only does piracy drain the national economy, it breeds expanding criminal activity, including tax evasion, and avoidance of censorship laws. There needs to be heavy government pub-

licity on the evils of piracy with stark media reports of what can happen to those who engage in it. All forms of enforcement action and prosecution should be backed up with heavy media coverage. The population should see daily that the government considers piracy a serious offence. The Chinese government has demonstrated that, when determined, it can shape powerful forces in society: it can also control piracy, if it decides to do so.

Over the past 18 months, the American industry has encouraged the Chinese government to use anti-piracy trailers to educate the public on the dangers of piracy. Samples of anti-piracy trailers used in the US and elsewhere have been given to the State Administration for Radio, Film and Television (SARFT), Ministry of Culture, China Film and the National Copyright Administration. There is apparent enthusiasm for doing trailers but bickering over turf and who pays to make them continues to slow action in getting them produced and shown to the public. These trailers would be but one tool to publicize the problem, and should be accompanied with other tools, including news reports, television programs, posters, and additional educational and promotional methods.

5. *Create strong, well co-ordinated local enforcement entities such as that in Shanghai.*

Shanghai has established a local enforcement entity that has proven effective. Piracy levels in Shanghai have dropped to around 50 percent, almost half the rate of piracy in the rest of the country. Similar bodies should be established in other major cities to provide a similar level of enforcement.

6. *Set a fixed timetable for bringing piracy rates steadily down from current levels exceeding 95 percent.*

An immediate goal should be to bring piracy below 50 percent by the end of 2004, as measured by independent market surveys.

MARKET ACCESS—What is needed is a fixed timetable for the removal of the various limits, restrictions, and structural distortions which hobble the ability of American companies to enter the marketplace and compete fairly and effectively for market share.

1. For theatrical exhibition: increase the number of films in which U.S. distributors may share in box office receipts (revenue sharing) beyond 20; eliminate the import monopoly; eliminate the distribution duopoly; eliminate or reduce “black out” periods when only local films can be screened; reduce taxes and fees.

China should commit to: (1) treating the current benchmark of 20 revenue sharing films annually as a minimum, not a maximum, and raising that level; (2) streamlining of the censorship process, reducing the period to a range comparable to other countries in Asia; (3) elimination of the Government import monopoly, (4) elimination of the Government distribution monopoly, (5) reduction or elimination of the “blackout periods” during which only Chinese films may be screened, (6) reductions in the taxes and fees paid on the importation and distribution of foreign film.

2. For home video: streamline and speed censorship; streamline and speed licensing procedures for retail outlets; relax the foreign ownership limits for video replication facilities;

The censorship process needs to be streamlined, reducing the period to a range comparable to other countries in Asia. The licensing process for retail shops also needs to be streamlined, such that approval from only one authority is needed to grant retail licenses. Foreign ownership of video replication facilities in excess of the current 49 percent limit should be permitted. China has recently unveiled a new DVD format. It is important that this format contain copy protection to insulate pre-recorded content on DVDs from widespread copying.

3. For television: grant broader permission for foreign satellite channels to be carried on local cable systems; streamline and speed censorship; reduce local content restrictions; reduce investment limitations; eliminate local uplink requirement; ensure that technology is implemented to support content protection.

More foreign satellite channels should be granted carriage on local cable systems. The censorship process should be streamlined. Local content restrictions should be reduced. Investment limitations should be reduced. Local uplink requirement for channels distributed by satellite should be eliminated. Government measures should ensure that new forms of technological protections are adopted to support content protection on digital broadcasts, such as the “broadcast flag” requirements recently adopted in the United States.

4. For E-Commerce: establish well-coordinated and effective Internet policies; issue regulations that clarify the copyright law to ensure protection against piracy.

It is critical that China set well-coordinated and effective Internet policies. At present, a see-saw battle is under way between various power groups interested in

controlling the Internet either for security reasons or for potential commercial gain. The State Council needs to step in and put in place a clear and comprehensive Internet policy, and clearly establish which agency is in charge of Internet oversight. Failure to do so will mean the rampant piracy we now see in film, video and TV will spread to the Internet, too, which could be the death blow to the film industry in China—and have ramifications outside of China. That would be a crushing development for the entire film industry agenda in China.

The ambiguities and deficiencies in the Copyright Law pertaining to anti-circumvention, alteration or deletion of electronic rights management systems, and temporary copies need to be clarified in a way which clearly meet the obligations of the WIPO Copyright Treaty.

China has recently unveiled a new DVD format. It is important that this format contain copy protection to protect pre-recorded content on DVDs.

BACKGROUND ON PIRACY

RESURGENCE IN PIRATE EXPORTS. The American film industry welcomed the 1995 and 1996 bilateral intellectual property rights agreements with China because of a concern that pirate exports of illegitimate goods from the People's Republic of China were threatening to destroy well-established markets in other parts of Asia. Tragically, this situation is repeating itself. In 2003 for the first time in six years, China re-emerged as a major exporter of pirated DVDs to world markets—just as it was in 1995. China is now the third largest source of export piracy, as measured by seizures by UK Customs in 2003.

Chinese pirated DVDs are showing up in alarming numbers in the European market. According to UK Customs, China's share of optical product seizures catapulted from an almost insignificant half of one percent of all seizures in 2002 to the third largest source of pirated optical discs in 2003. The 111,264 discs seized represent only a small fraction of the total value of pirated goods from China that are targeted at world markets. Forensics examination of pirated DVDs seized in Belgium, Italy, Canada (en route to the United States), Hong Kong, Taiwan and Japan all point back to production in China.

Despite the seizure in China of 24 optical disc production lines through the end October 2003, piracy has still received insufficient attention from Chinese authorities to deal with the rapidly increasing export problem.

MPAA has begun working on solutions to the export problem with Chinese Customs, particularly in the Guangdong area, since most of the shipments intercepted in the UK and the U.S. have originated out of Guangdong. We are sharing information gathered in customs seizures outside China. We had been informed that some successful cases were conducted in Fuzhou, however, results of these Customs cases have not yet been released. Chinese officials are quite positive about our joint efforts in tackling the problem and we will continue to press for more investigative action in tracking the source of pirate product in China.

WORSENING DOMESTIC PIRACY. The impact of DVD piracy has had a devastating affect on both the American and the Chinese film industry. Many Chinese studios are on the verge of collapse. No supplier of legal films, local or foreign, can compete with pirates who pay no taxes, endure no censorship obligations, and who carry none of the costs of running a studio and paying actors and actresses.

In 2002, the estimated piracy rate in China for American entertainment (films, home video and television) was about 91 percent. Last year pirates sold 95 pirated copies for every five copies that American companies sold legally in China. The current level of piracy is worse than it has been at any time since 1995, when the rate was 100 percent. In fact, China leads the Asian region in piracy; the rate of piracy in China is higher than that of other countries that traditionally have been plagued by piracy, including Malaysia, Indonesia, India, and the Philippines:

One indicator of the level of piracy is the price being charged for illegally replicated DVDs. As with any product, price levels are determined by, among other factors, abundance of supply. Price levels in China for pirated DVD discs have sunk to an all-time low—about 95 cents for a DVD, compared to a retail price for pirated goods in Thailand of \$3.50 or almost \$5.00 in Taiwan. The low prices in China are due to the great abundance of supply—lower than any other market in Asia.

There have been some encouraging developments related to domestic enforcement in recent months. On February 17th, Beijing North China's Hebei Province Public Security Bureau raided a pirated distributor who owned eight warehouses in Shijiazhuang City—the provincial capital city. The target is believed to be the major piracy supplier for Beijing's illicit market. In the two-day operation, six warehouses were raided and 230,000 pirated VCD and DVDs were seized. Approximately 70 percent are believed to be infringing MPAA member company titles. Two people were

arrested for further criminal investigation. MPAA will be assisting with the case and will push for criminal charges to be filed.

Also in February, the Shenzhen Custom's Anti-Smuggling Bureau intercepted three inland trucks in the Huidong and Huiyang areas and seized two million optical discs. Of this massive seizure, 269,000 copies were pornographic VCDs and the remaining were pirate VCDs of both local and foreign movies. Three people were arrested for further investigation and the trucks were seized. Shenzhen Customs believes that the seized products were headed for the local pirate market.

BACKGROUND ON MARKET ACCESS IMPEDIMENTS

COMMERCIAL BARRIERS. The piracy problem, itself a barrier to market access, is compounded by other, more formal barriers, such as (a) government monopoly on film importation, (b) quantitative limits on imports, (c) a slow and cumbersome censorship process, (d) a theatrical distribution duopoly, (e) limits on the retail sale of legal home entertainment, and (f) restrictions on foreign investment, foreign satellite channel carriage, and foreign program content in the television sector. Ironically, these restrictions further tilt the market environment in favor of pirates, who obey none of the government's regulations, while reaping at least 95 percent of the market's sales.

SLIPPING FILM REVENUES. Over the past half-decade piracy has seriously weakened the legitimate motion picture market in China. Total box office from all films in China declined 40 percent since the advent of VCD and DVDs, as customers substituted buying pirated copies of home entertainment for viewing at home instead of going to the movies. In 1996 Chinese audiences spent \$190 million dollars at the box office. Last year, they spent only \$120 million. This change in consumption patterns has dire, long-term implications for the health of the filmed entertainment industry in China, both for Chinese and U.S. films.

Earnings by MPAA member companies in China from theatrical distribution have also fallen during this period, both in terms of total box office revenues earned by MPAA member companies and in terms of the average amount earned by U.S. pictures released in Chinese cinemas. In 1998, the average U.S. film distributed to Chinese cinemas on a revenue-sharing basis earned \$1.9 million for the member company, but by 2002 that amount had fallen to \$500,000, and per company earnings for American filmmakers fell by 20 percent during the period.

The home entertainment market in China is estimated by one industry expert to total between \$1.3-\$1.5 billion annually, of which only five percent, or around \$65 million, is legitimate. Of this potential market, earnings by American companies fell 85 percent from 2000, to a low of less than \$3 million in 2002.

HELP FOR CHINESE FILM INDUSTRY. This situation has been particularly disappointing because American industry has done its utmost to expand support for and cooperation with the Chinese film industry. This has included co-producing films with Chinese studios; assisting in the distribution of Chinese films outside China; investing in multiplex cinema development and industry-related projects; training Chinese in all aspects of film making; conducting seminars to educate authorities regarding copyright enforcement practices; hosting many trips to the U.S. for Chinese officials for educational and business exchanges; and sponsoring Chinese film festivals in Los Angeles, San Francisco, New York and Washington—a collective investment of many millions of dollars.

American industry hopes Vice Premier Wu Yi's mandate will extend beyond pure anti-piracy enforcement and to also address the market access problems that result from the government's continued efforts to maintain restrictive controls. The Ministry of Commerce is working to get all weak Chinese industries on stronger commercial footing and should also play a larger role in providing a policy environment that will stimulate the growth of the film industry.

IMPEDIMENTS TO THEATRICAL DISTRIBUTION

DIMINISHING REVENUES. Box office results of American films imported to China have been decreasing every year. Current revenues earned by our member companies are now hardly sufficient to meet the costs of servicing the market. As quickly as a film is released in the U.S., pirates flood the Chinese market with pirate VCD and DVD copies, gutting the potential market. By the time American films are approved by Chinese censors, passed through the slow import and distribution process, and finally become available to the public, they have lost much of their value, as most consumers will have already seen the films in pirate versions many months ahead of the theatrical release.

So far this year, the average total box office revenue for each U.S. film in China has been in the range of U.S. \$1.8-2.0 million dollars, of which the U.S. rightsholder

is allotted 13 percent by the Chinese state distributor, yielding, on average, anywhere from \$234,000 - 260,000.

Against these meagre proceeds are then posted the costs of bringing in films, which can range up to \$250,000, including the costs of the physical elements needed to duplicate the film, sound materials, publicity materials, copies of prints, contributions towards marketing the film, and related publicity events.

This uneconomic revenue picture is the result not only of piracy, but of a series of more formal market access barriers.

LIMITED IMPORTS. The American film industry greatly appreciated USTR's achievement in raising the annual number of revenue sharing film imports from 10 to 20—yet there is an important difference of opinion regarding that achievement. Some Chinese officials view the 20 annual revenue sharing imports benchmark as a “maximum” number of imports, rather than a “minimum,” which is the normal WTO interpretation of such commitments. And this 20 “maximum” is for all foreign films, so supply to the market remains artificially choked off.

So far in 2003, there have been 18 films approved for import, up slightly from last year. However, this is far, far short of what the market requires—and a far cry from what the US industry is capable of supplying. Theatrical demand and video demand increases every year but the number of titles supplied to both of these markets is simply not sufficient to satisfy the market and wean consumers off piracy. In 2002, over 400 feature films were released in the US, the majority of which were U.S. productions. With the severe shortage of legal films across China, some outlying cinemas desperate to stay alive have returned to the bad old days of the mid-1990's of pirate screenings, this time projecting unlicensed DVDs instead of the VCDs of that earlier time.

SLOW CENSORSHIP. Film censorship in China still often takes a month or more, sometimes even longer. This is in sharp contrast to other markets where censorship is normally done in a week or less.

Asia—Average Censorship Times

Theatrical and Home Video

China	15-30, sometimes longer
Japan	7 days to clear Customs (no censorship)
Korea	7-10 days
Singapore	7 days
Taiwan	5-7 days

Whether this sluggish process is a way to enforce unstated quotas, or is simply the result of antiquated procedures is not known. What is clear is that the inordinately slow censorship process is killing the business before it can get started. As markets across the world turn to multi-national simultaneous releases (known in the industry as “day and date” releases) to beat pirates, China has yet to change the same slow censorship pace it has followed for the past 50 years. It is vital that the censorship process be shortened if there is to be progress in rebuilding the legitimate market and in beating the pirates. Again, there is heartening talk of speeding up censorship but little actual follow-through. Meanwhile, the pirates move freely and easily in the market with no censorship or other restraints, satisfying consumer demand.

MONOPOLY CONTROL. At present, Chinese authorities permit only one film importer and two film distributors to operate—China Film Corporation and Hua Xia Film Distribution Company (both components of the same monopoly managed by the Film Bureau). A healthy market the size of China needs more than one importer and far more than two distributors, and importers and distributors should be allowed to operate independently in a free and openly competitive market environment. The current structure of importation and distribution of films remains tightly controlled by the government, which pays little attention to the commercial needs of a large and hungry market.

Because of monopoly control, Chinese distributors dictate commercial terms, setting them at levels far, far below anything experienced anywhere else in the world, leaving no real opportunities for American companies to negotiate individually on a normal competitive, commercial basis. This lack of market access provides a further advantage to pirates, who are now running an industry that far surpasses the sales and profits of the legal industry.

Under the terms dictated by State-run Chinese distributors, the MPAA member company share of the box office is averaging only 13 percent. Although such terms

are elsewhere individually negotiated, and vary from territory to territory, they are more typically in the neighbourhood of 50 percent or more in other markets.

BLACKOUT PERIODS: Another continuing problem are the “blackout periods” for which the Government decrees that no foreign films may be screened, with the market totally reserved for Chinese films. This practice bites huge holes out of the business.

TAXES, DUTIES, FEES. An additional severe drag on the very limited legal business is the continued heavy burden of taxes, duties, and fees. The American industry greatly appreciated USTR’s achievement in reducing the film import duty from nine percent to five percent. SARFT has continually promised to reduce the tax and fee burden but nothing has materialized (other than what USTR achieved on the import duty) and there are few solid signs that it will.

IMPEDIMENTS TO HOME VIDEO DISTRIBUTION

The American industry’s home video business began a number of years ago with the Ministry of Culture promising to put home video on a commercial footing and to ensure that it be run like a business rather than an ideological enterprise. Unfortunately, that drew the ire of the Propaganda Department, which ordered Culture to slow down video imports, using the censorship process as its tool for doing so. To its credit, Culture tried to evade the restrictive orders from Propaganda, but unsuccessfully. None of this is openly admitted, but many American films are either rejected flatly or processed very slowly in Culture’s censorship process. There is much encouraging talk from Chinese officials but the restrictions remain.

SLOW CENSORSHIP. It currently takes at least a month for most American video titles to pass censorship, a period which, as indicated above, lags far behind the typical duration of the censorship process in the region. The Ministry of Culture has promised that the pace of video imports will pick up and that censorship will be much faster. That remains to be seen.

At the same time, films produced in Hong Kong go through censorship in only a few days. Asked about this, the Ministry of Culture says Hong Kong films are now treated as local pictures, which means they are processed through censorship faster. This is an unintended but frank admission of the discriminatory treatment foreign titles receive. Meanwhile, pirates move their stolen product easily into the market without censorship or any other restraints.

The pirate DVD industry is now so confident and developed that many pirate operators invest in marketing materials and infrastructure. The pirate product is presented so professionally that consumers do not know they are dealing with pirates. The American companies must slog through a slow and inefficient system while the pirates are able to operate quickly and effectively to serve the market.

There are enormous frustrations dealing with the slow and inept bureaucracy. For example, the Ministry of Culture issues only one “original” censorship certificate. Customs and several other offices each want an “original”, which means special efforts are required to be sure the right people get the right paperwork. This is one small example of an overall bureaucratic process that causes delay for legal suppliers and leaves the market to the pirates.

TOO FEW RETAIL OUTLETS. While pirated videos are ubiquitously distributed on the street, within bars and in restaurants, market barriers to legitimate businesses that sell videos are a significant impediment to the growth of legitimate video in China. The American industry is urging that Ministry of Commerce (MOC) redouble its efforts to get the video industry on the strong commercial footing it has so long promised. There have to be more licensed distribution outlets for legitimate home entertainment fare.

Current estimates are that there are more than 80,000 licensed home video retail outlets in China. That may at first glance appear to be a high number, but for a country as large as China, with its huge appetite for filmed entertainment (witness the spectacular success of the pirates), this is far short of what is needed. Moreover, many of the retail outlets in China are old and not conveniently located. Outlets need to be located where many Chinese now go - shopping malls, hypermarkets, supermarkets, and convenience stores.

One important step will be to make it easier for conveniently located and modern hypermarkets, supermarkets, and convenience stores to get a single license that authorizes them to provide home video products throughout their entire chain of stores. Current procedures require approval from both the Ministry of Culture and the Ministry of Commerce, as well as from a number of provincial and local authorities to license each individual store. This system is simply unworkable and must be changed.

The American industry is in discussion with Culture and Commerce about this at the present time. Having the U.S. Government raise the problem could help get it resolved. A key part of beating the pirates is to have an adequate number of legitimate retail outlets with ample and up-to-date legal product. China should treat video like any other consumer item. Once a title has passed through censorship, it should be able to move quickly into as many retail outlets as possible throughout the country.

INVESTMENT RESTRICTIONS. The growth of the legal DVD market in China requires secure, affordable DVD replication. Chinese law requires foreign video companies to do their replication in China. That means product cannot be imported from secure, well-priced replicators outside the country.

Foreign ownership of replicating facilities is currently limited to 49 percent. This limit must be relaxed in order to attract highly capitalized investors needed to expand replication facilities within China. The 49 percent limit also hinders effective sales and marketing because the minority partner does not have adequate control of these critical components of the business. The result is that less is done on sales and marketing as is needed.

Overall, these restrictions contribute to a situation in which legal supply of DVDs is far too low to meet the needs of the market, a situation which the pirates exploit fully.

IMPEDIMENTS TO TELEVISION DISTRIBUTION

The Chinese government has maintained tight control over the television industry, which it uses as a medium for disseminating State propaganda. Although the industry has developed considerably and its revenue-generating potential is becoming more apparent, the government continues to ensure that Chinese television remains under its control and subject to strict regulation. All aspects of the television industry are tightly controlled by the government, including program importation and production. While development in technology has facilitated limited participation of foreign parties in program co-production, advertising and infrastructure development, the government continues to prohibit foreign involvement in Chinese media outlets.

There has been a great deal of discussion by the Chinese government about opening and liberalizing the industry. Progress in this area, however, continues to be extremely slow.

MARKET ACCESS. Foreign satellite channels are not allowed carriage on local cable systems unless specifically approved by SARFT. A few foreign satellite channels have received government approval to do "trial distribution" in the southern part of the country. Carriage of satellite channels remains restricted to three to five star hotels, government buildings and foreign institutions.

CENSORSHIP. All television programs that are broadcast in China, whether produced locally or overseas, are subject to censorship. The Censorship Committee and Review Committee within SARFT handle the censorship function. The process is exceedingly slow, especially for overseas programs, which can drag out to 12 months. Such bureaucracy benefits pirates who undergo no censorship (or other restraints) as they move illegal TV product into the market.

FOREIGN INVESTMENT. No foreign investment is allowed in the broadcasting, cable and satellite sectors. There is talk of new, more liberal investment regulations but they are slow in coming.

FOREIGN CONTENT. Foreign programming is restricted to no more than 25 percent of total airtime by television stations and banned during prime time between 6:00 PM and 10:00 PM. Foreign cartoon programming is restricted to 25 percent of total time set for youth programs and 40 percent of total cartoon time.

UPLINKING RESTRICTIONS. Foreign satellite channels beaming into China are required to uplink from a government-owned encrypted satellite platform (Sino-Sat) managed by SARFT. The fee for doing so is U.S. \$100,000. The result of the current regulatory structure is that the supply of legal product is far short of the market needs. The result, not surprisingly, is more piracy. Provincial television stations routinely make unauthorized broadcasts of MPA member company titles. They will often rely on counterfeit "letters of authorization" or "licenses" from companies in Thailand, Hong Kong and Taiwan, which purport to convey broadcast rights. There are now several thousand registered cable systems in China, all of which routinely include pirate product in their programs. Very few enforcement actions have been taken to date.

REGULATORY MUDDLE. Overall regulation of the Internet is incoherently structured. A number of government Ministries and agencies have expressed interest in controlling the Internet (and potentially benefiting from it). The result is at least five existing separate sets of regulations on Internet. Furthermore, the NCAC and the Ministry of Commerce are expected to develop additional regulations. This is leading to a situation which, as with anti-piracy enforcement in the physical world, is likely to be uncoordinated and confusing, to the detriment of copyright holders and businesses seeking to invest in e-commerce opportunities.

The State Council has indicated it will issue a comprehensive set of regulations, especially focusing on copyright protection, sometime early next year. If this happens, in addition to clarification of supervision and consolidation of disparate roles and rules, specific improvements in Chinese statutes are called for.

China has not met all of its WIPO Copyright Treaty (WCT) obligations. Both technological protection measures and electronic rights management systems are protected against circumvention, although as set forth below those protections are not fully compatible with WCT requirements and were not sufficiently addressed by the December 2001 regulations to the copyright law that went into effect on September 15, 2002. It is also unclear whether the copyright law provides sufficient protection for temporary copies.

More specifically:

- **Anti-Circumvention.** While the Law [Article 47(6)] provides anti-circumvention protection, it does not fully implement the WIPO treaties obligation, in that it: 1) does not expressly prohibit the manufacture or trade in circumvention devices, components, services, etc.; 2) does not define “technical protection measures” to clearly cover both “copy-controls” and “access controls”; 3) does not make clear that copyright exceptions are not available as defenses to circumvention violations; 4) does not expressly include component parts of circumvention technologies (assuming devices are covered); 5) imposes an “intent” requirement as to acts (and business/trade if such activities are covered), which might make proving a violation difficult; 6) does not provide for criminal penalties for circumvention violations (since the copyright law only deals with civil and administrative remedies). Unfortunately, none of these deficiencies was dealt with in the implementing regulations.
- **Rights Management.** While the law protects against “intentionally deleting or altering the electronic rights management system of the rights to a work, sound recording or video recording” without consent of the right holder [Article 47(7)], this protection may not fully satisfy WIPO treaties requirements and requires further elaboration in the implementation process. For example, the Law does not expressly cover “distribution, importation for distribution, broadcast or communication to the public” of works or other subject matter knowing that rights management information has been removed or altered without authority, as required by the WIPO treaties, nor does it define “electronic rights management system” in a broad, technology-neutral manner.
- **Temporary Copies.** Temporary copies are not expressly protected as required by the WIPO Treaties. As with the Copyright Law prior to amendment, protection of temporary copies of works and other subject matter under the 2001 copyright law remains unclear. According to an earlier (February 2001) draft amendment of Article 10, “reproduction” as applied to works was to include copying “by digital or non-digital means.” The phrase “by digital or non-digital means” was removed from the final version of Article 10(5) prior to passage. Article 10(5) also fails (as did the definition of “reproduction” in Article 52 of the old Law, which was deleted, and Article 5(1) of the 1991 Implementing Regulations) to specify that reproductions of works “in any manner or form” are protected. Addition of either of these phrases might have indicated China’s intent to broadly cover all reproductions, including temporary reproductions, in line with the Berne Convention and the Agreed Statement of the WIPO Copyright Treaty. As it stands, the current Article 10(5) description of the reproduction right includes “one or more copies of a work by printing, photocopying, copying, lithographing, sound recording, video recording with or without sound, duplicating a photographic work, etc.”

Mr. Chairman, again I think you and the members of the Subcommittee for this opportunity to testify before you. I would be pleased to answer any questions you may have.

Mr. WHITFIELD. [presiding] Thank you, Mr. Attaway.

Mr. Primosch, if you would give your opening statement.

STATEMENT OF WILLIAM PRIMOSCH

Mr. PRIMOSCH. Mr. Chairman and members of the subcommittee, thank you very much for inviting the National Association of Manufacturers to be here today at this hearing. For many of our members, China is both the symbol and the reality of the new global marketplace. On the one hand, it is a relatively large and untapped market for a wide range of our products. On the other hand, it is a fierce competitor that sells quality products, often at cut rate prices.

When manufacturers, say therefore, that they are challenged as never before in the global marketplace, they often immediately refer to China even though the competition comes from many quarters.

Several years ago, China exported mainly low value products like toys and clothing and athletic footwear. But now it is exporting a wide range of manufactured products from computers and auto parts to furniture and tools and metal and plastic components used throughout U.S. industry. And the impact of China's industry is felt not only in competition for customers, but also for raw materials. In the past several months, for example, China has been buying so much scrap steel, iron ore and coke that it has nearly single handedly raised world prices of steel to near record levels.

Let me be clear though. The NAM wants a positive economic relationship with China and we recognize that China is a major emerging market for U.S. manufacturers. However, overall, the bilateral trade relationship remains heavily unbalanced in China's favor as the trade surplus that China has indicates. If recent trade trends continue, we estimate that in 4 to 5 years, China's trade surplus will top \$300 billion.

One key reason the trade imbalance is so large is that Chinese trade and economic policies are perpetuating an unlevel playing field. These policies raise barriers to U.S. products and provide unfair advantages to Chinese products in the U.S. and global markets. Although China has made progress on its WTO obligations, it is still not living up to them fully.

I have identified several problems in my prepared statement. Let me emphasize three that are particularly important for U.S. manufacturers. The first is China's policy of deliberately undervaluing its currency, the yuan. This has had the effect of raising the price of U.S. exports to China significantly and lowering the price of Chinese products in the United States. Some economists estimate that the undervaluation is as high as 40 percent. One important indication of undervaluation is the high level of foreign exchange reserves, \$416 billion as of January of this year, 3 to 4 times what the IMF and World Bank would recommend.

The second broad issue of concern relates to indirect subsidization of production in exports. Chinese products are selling in the United States at prices that don't reflect market costs, according to many manufacturers. We believe that this is occurring because of a variety of indirect subsidies, easy bank credit to insolvent state enterprises, discriminatory taxes, particularly value-added taxes, below market energy costs and other incentives.

The third broad concern relates to rampant counterfeiting in China. No longer just software and media products as my col-

leagues have brought to your attention, but also pharmaceutical, health care products, auto and truck parts, food products and many other consumer and industrial products. We are encouraged that U.S. trade officials have successfully raised the profile of this issue, indeed to the point where the respected Vice Premier Wu Yi has assumed overall responsibility in China for anti-counterfeiting efforts, but China will have to take action on several fronts, including legal reforms, stepped up enforcement and education to address the problems. We don't expect an instant solution, but we do insist on steady, concrete and meaningful progress.

Finally, Mr. Chairman, we also have to do more ourselves to redress the trade imbalance. Both industry and government need to put more effort into export promotion. We have proposed a network of American trade centers in Chinese cities to address that need. The JCCT should deal firmly and frankly with all these concerns and lay out a practical plan of action that will achieve real results in the year ahead.

Thank you, Mr. Chairman.

[The prepared statement of William Primosch follows:]

PREPARED STATEMENT OF WILLIAM PRIMOSCH, DIRECTOR, INTERNATIONAL BUSINESS POLICY, THE NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. Chairman and Members of the Committee: Thank you for giving the National Association of Manufacturers (NAM) the opportunity to testify on U.S.-China trade and preparations for the upcoming meeting of the Joint Commission on Commerce and Trade.

The NAM represents 14,000 manufacturing companies, both large multinational corporations and over 10,000 small and medium-size firms. With a loss of nearly 3 million jobs since July 2000, the manufacturing sector has undergone painful adjustment. Virtually every segment of industry finds itself competing intensely in the global marketplace. Import competition has increased but so also has the competition for export markets. In fact, the decline in manufactured goods exports, which fell from \$645 billion in 2000 to \$577 billion in 2003, has had a bigger impact on manufacturing jobs than the increase in imports, which rose by only \$24 billion in that same period.

No trading partner has attracted as much attention as China for manufacturers interested in exporting or concerned about increasing import competition. The fastest growing large economy in the world, China has emerged within a short span of two decades as a strong international competitor in a wide range of manufactured products and a key market for U.S. manufactured exports. More recently China has also gained prominence as a huge consumer of industrial raw materials, with demand so large that it has significantly boosted world prices of important inputs such as steel and copper scrap, iron ore and coke used in steel production. It is not surprising, then, that U.S. manufacturers pay close attention to China's trade and economic policies, and how they affect not only bilateral trade and investment but the entire global marketplace.

In 2003 China exported \$438 billion in goods, mainly manufactured products, making China the world's fourth largest exporter. At the same time, high rates of business and government investment and rising personal incomes have fueled a strong demand for foreign products and services in which the United States is highly competitive. China imported products valued at \$413 billion in 2003, an increase of 40 percent over 2002. —

While China ran a relatively small trade surplus with the world, the trade imbalance with the United States has become even more highly skewed in China's favor. Chinese exports to the U.S. in 2003 were valued at approximately \$152 billion and imports, approximately \$28 billion, according U.S. Department of Commerce data. As China produces a large volume of its manufactured exports from parts and components made elsewhere in Asia (e.g., Japan, South Korea and Taiwan), these economies also benefited substantially from the large U.S.-China trade imbalance.

This large and growing trade imbalance often serves as a lightning rod for criticism of China's trade and economic policies. Let us be clear. The NAM supports a positive, mutually beneficial economic relationship with China. But our members

also insist on a level playing field, one that enables U.S. manufacturers to compete fairly in a more open Chinese marketplace while ensuring that Chinese products receive no special advantages in the U.S. and other foreign markets. At present, that playing field is not level.

That is why China's membership in the World Trade Organization (WTO) is important for U.S. manufacturers. It provides an internationally accepted set of rules and standards to evaluate China's behavior. The United States should insist that China comply fully with its WTO obligations, on both trade disciplines and market-opening commitments. But we hope that the Chinese will also see that it is their interest to go beyond explicit WTO obligations and work to develop a bilateral economic relationship that provides genuine mutual benefit and quickly resolves trade and other business problems that arise, whether they are related to the WTO or independent of those obligations.

KEY ISSUES FOR U.S. MANUFACTURERS AT THE JCCT MEETING

The United States has established a variety of channels to discuss trade issues with China but none is more important than the Joint Commission on Commerce and Trade (JCCT). The JCCT is a well established bilateral forum that brings together senior officials as well as trade and economic experts to discuss key issues of concern to both sides. The upcoming meeting on April 21-22 provides a timely opportunity to seek progress on several important concerns and work creatively to obtain the kind of openness for U.S. products and services in China's market that Chinese products and services currently enjoy in the U.S. market.

The NAM would like to see this year's JCCT meeting focus on the following key issues:

- Joint efforts to continue and accelerate recent increases in U.S. manufactured goods exports to China, including through the establishment of American Trade Centers in major commercial centers.
- Effective steps by China to halt the production and export of counterfeit U.S. branded products.
- Progress in reaching new understandings to stop the indirect subsidization of Chinese exports.
- Ending the discriminatory application of value added taxes on semiconductors.
- Obtaining agreement by China to harmonize its wireless encryption standards (so-called WAPI standards) with international standards and to stop requiring foreign firms to partner with Chinese firms as a condition for producing wireless products in China.
- Rolling back restrictions on China's export of industrial raw materials such as coke.
- Reforming the application of the CCC mark system to reduce the cost of compliance for foreign companies and enable U.S. testing and certification bodies to offer their services in China on the same basis as national bodies.
- And finally, while currency issues are not within the JCCT's purview for negotiation, making clear that currency undervaluation is an important concern that must be addressed because of its distorting impact on U.S.-China trade.

JOINT EXPORT PROMOTION EFFORTS IN CHINA

Many manufacturers are taking advantage of China's rapid economic growth to sell more of their products there. In fact, some large member companies have told us that China is their most important foreign market for increasing export sales. Smaller companies are also benefiting from increased exports to China. But for a variety of reasons (e.g., language, culture, lack of transparency in business regulations, and limited infrastructure and business facilities in many commercial centers), China remains a difficult place to do business. Small and medium-size companies, even those successful in other foreign markets, often have difficulty entering the market and developing profitable business relationships.

Unless U.S. exports increase at a much higher rate, the bilateral trade deficit will grow to levels that are politically unacceptable within a relatively short period of time. If past trends were to continue for the next four years, for example, the NAM estimates that the bilateral trade deficit would exceed \$300 billion. Failure to break down trade barriers is depriving China, particularly interior markets, of a wide range of U.S. quality products and advanced technology that would benefit China's development and expand consumer choice. For these and other reasons, therefore, it is in China's own interests to work with the United States to facilitate a rapid increase in U.S. exports and greater U.S. access to China's consumer and business markets.

The NAM supports the establishment of American Trade Centers in major commercial centers to assist U.S. businesses, particularly small and medium-size companies, in selling their products and services. In the Omnibus Appropriations bill, Congress has authorized six Commerce Department positions in China to begin work on the project. China's national government should be encouraged to support the initiative by officially endorsing the idea and actively urging provincial and municipal governments to provide suitable office space and all necessary local authorizations for the centers to operate.

HALTING COUNTERFEIT PRODUCTION AND EXPORTS

Counterfeiting of branded products—from movies and software to auto parts and pharmaceutical products—remains a serious concern of U.S. manufacturers. The counterfeiting is occurring on a massive scale, with production being sold in China and foreign markets, including the United States. NAM member companies are encouraged by the increased attention that the U.S. Trade Representative's Office has given to the problem. They also applaud the designation of Vice Premier Wu Yi, a respected senior official who is also heading the Chinese delegation to the JCCT, as the coordinator for Chinese efforts to address counterfeiting issues. U.S. manufacturers, however, will not be satisfied until they see steady, concrete progress in halting both the production and the export of counterfeit products.

The NAM believes that significant progress will not be made until China seriously addresses the following key issues:

- Stopping the export of counterfeit goods at the Chinese border, as China committed in its bilateral agreement with the United States.
- Clarifying in the Chinese criminal code that exporting counterfeit products per se constitutes a "sale" and therefore a restricted act under the criminal code. The current ambiguity on whether an "export" constitutes a "sale" of counterfeit products, under which a manufacturer of counterfeit goods can hide behind a facially legitimate trading company, must be eliminated. Criminal prosecutions must ensue after counterfeit merchandise is seized on the docks.
- Sharply increasing the number of criminal prosecutions for producing, packaging and selling counterfeit products. While Chinese authorities have taken civil actions against counterfeiters, they have no evident deterrent effect and are insufficient by themselves.
- Destroying not only fake goods for sale but also the equipment used to produce and package them. Today, counterfeit enterprises operating entirely outside the law simply go right back into business after a raid on inventory. Nothing changes. This situation will remain the same until the primary assets—the machine tools and production equipment—are also seized and destroyed.
- Training judicial officials in the prosecution of counterfeiters.
- Actively encouraging police and customs officials to enforce anti-counterfeiting laws as a national policy.
- Taking action against local officials who abet counterfeiting or who don't enforce anti-counterfeiting laws.
- As part of the JCCT process, establishing a working group that meets regularly and frequently to carry out an agreed anti-counterfeiting work program and monitor progress.

In light of the Vice Premier's responsibility for anti-counterfeiting efforts, we would urge an in-depth discussion of counterfeiting issues that focuses on making progress in these key areas.

MAKING PROGRESS ON INDIRECT SUBSIDIZATION

We continue to receive reports that Chinese products (e.g. tool-and-die products, chemicals and other metal products) are being sold in the United States at prices that appear to U.S. manufacturers to be well below the cost of production. A tool-and-die company, for example, reported that a Chinese competitor was selling a product similar to the company's for 60 percent less (\$40,000 vs. \$100,000), barely covering the cost of the raw material inputs. U.S. metal products manufacturers note that the price of Chinese metal products have not increased despite the sharp rise in steel prices in China and globally due in large part to China's own increased demand for steel and steel-making raw materials.

WTO rules prohibit the use of explicit export subsidies but they are less clear on other kinds of financial incentives and non-market-based financial transactions that indirectly affect exports. For example, Chinese banks continue to lend to state-owned manufacturing enterprises that are financially insolvent and export their products. Such loans, since they are on a non-market basis, could be viewed as indirect subsidies. If value-added tax rebates are not applied uniformly and on a non-

discriminatory basis on all foreign and Chinese companies, these could have the same impact as an indirect subsidy. So also could electricity and other energy supplies sold to Chinese manufacturers at below-market costs.

China's manufacturing sector is now so large that it can affect global markets for both industrial raw materials and final products. The United States needs to be sure that China's manufacturing base is developing on a market basis, and indeed it is in China's own long-term economic interest that it does so. At the upcoming JCCT meeting, U.S. officials need to flag the issue of subsidization and press to establish a joint working group to examine how Chinese policies and regulations relating to bank lending, energy pricing, VAT rebates and other financial incentives for manufacturing investment are affecting Chinese manufactured goods exports to the U.S. and third markets.

Ending VAT Discrimination on Semiconductors

The NAM has strongly objected to China's discriminatory application of the VAT on semiconductors and, therefore, welcomed the Administration's recent decision to file a dispute settlement petition with the WTO. The levy of a different VAT rate on semiconductors designed and manufactured in China compared to those either designed or produced and designed abroad is a blatant violation of WTO rules on national treatment of "like products." We urge that U.S. officials continue to press hard for prompt Chinese action to end the discriminatory treatment.

Accepting International Standards on Wireless Technology and Other Products

Technical standards are becoming increasingly important for market access in China as in other foreign markets. The JCCT, therefore, needs to give continuing attention to standards issues, working to resolve problems quickly and anticipating issues that will arise in the future. Two particular standards concerns merit in-depth discussion at the JCCT because of their broad-ranging impact.

The first relates to the Chinese announcement that later this year China will establish a unique technical standard for wireless local area networks (WAPI) that will be different from the international standard. The only way U.S. and other foreign companies can gain access to the encryption elements contained in the standard is by partnering with a Chinese manufacturer. This would require the affected U.S. companies to provide free access to their intellectual property and design specifications and expose them to the loss of proprietary information. Such a requirement is a clear violation of the national treatment rules of the WTO and should be dealt with firmly.

China offers a huge potential market for U.S. suppliers of wireless products. The satisfactory resolution of this dispute, therefore, has major commercial implications. While U.S. officials have already raised industry concerns at senior levels, they should use the JCCT to press the Chinese further with the knowledge that they have the firm backing of the broader U.S. manufacturing community.

The second issue relates to the China's definition of "international" technical standards in the internal market. China is requiring that certain products (e.g., electrical products) be manufactured only to "international standards" as determined in the Organization for International Standardization (ISO) or International Electrotechnical Commission (IEC). Other "international standards," notably those developed in the United States and widely used in the global marketplace, are not allowed. This does not conform with the interpretation of the WTO Technical Barriers to Trade (TBT) Committee that "international standards" need not be limited to ISO or IEC standards.

The National Electrical Manufacturers Association (NEMA) is establishing an office in Beijing to coordinate standards on electrical products in China. Chinese standards officials should be encouraged to work with NEMA to find a solution to this problem.

Reforming the CCC Mark System to Lower Cost and Allow Foreign Participation

The NAM has received numerous complaints, particularly from small companies, about the China Compulsory Certification (CCC) quality mark system. China now requires that a wide range of products (e.g., electrical products, air conditioning and refrigeration equipment) bear the CCC mark as an indication that all relevant technical standards have been met. Implementation of the CCC mark system, however, has raised additional market access barriers because of the high cost of obtaining the mark, the lack of clarity in the regulations and delays in the certification process.

One of the reasons for the high cost and delays is that U.S. factories making the products must be inspected, and only Chinese testing bodies are permitted to do

this. Well known U.S. standards testing and certifying organizations, such as Underwriters Laboratories, are not able to provide their services in China or certify in the United States that U.S. products or factories meet Chinese standards.

The United States should press firmly at the JCCT for improvements in the CCC mark system that would lower costs for small companies and enable U.S. testing and certifying bodies to provide their services in China at an early date. With the trade deficit so large and growing rapidly, the United States must insist that China take these standards-related concerns seriously and work to reduce barriers to market access.

Allowing Unrestricted Export of Industrial Raw Materials

Under GATT Article XI, WTO members are not supposed to restrict exports except for narrowly prescribed reasons. Just recently, however, it has come to our attention that China placed further restrictions on the exports of coke that are having a direct impact on U.S. steel production and exacerbating current steel shortages. China is currently the largest exporter of industrial coke to the United States. According to press and industry reports, China plans to reduce its exports substantially in 2004, apparently to limit supplies for its own rapidly expanding steel industry. While China is limiting its coke exports abroad, China is buying record volumes of scrap steel and other metals (e.g., copper) from the United States and other foreign suppliers for its own industry. Largely as a result of Chinese actions in the marketplace, U.S. steel prices have risen sharply and disruptions in supplies are expected later in the spring as demand outstrips production here in the United States.

The JCCT provides a timely opportunity to raise recent Chinese restrictions on coke exports and discuss more generally the impact of Chinese industrial development on global markets. The current shortages in industrial raw materials, driven in large part by China's unprecedented industrial expansion, also underscores the urgency of examining possible subsidization of Chinese industry via easy bank credit, below-market energy prices and other means. U.S. industry feels the pernicious effects of these indirect subsidies not only through increased import competition but also raw materials shortages.

Noting Currency Undervaluation as a Key Concern

China's undervalued currency continues to be a major factor distorting bilateral trade and inflating the U.S. trade deficit. By preventing the market from determining the dollar-yuan exchange rate, economists estimate that the yuan could be undervalued by 40 percent or more, giving Chinese products an unfair advantage over U.S. products in our domestic market. As of January 2004, China had accumulated \$416 billion in foreign exchange reserves, a multiple of what the IMF recommends as a cushion against fluctuations in trade and investment flows.

Continued pegging of the yuan to the dollar at a fixed rate of 8.28 appears to be part of a deliberate strategy to stimulate Chinese industry and boost the export of manufactured goods. The NAM and other members of the Fair Currency Alliance believe that this kind of currency undervaluation for commercial gain goes against the intent of GATT Article XV, which states that "Contracting Parties shall not, by exchange action, frustrate the intent of the provisions of the Agreement [GATT]."

The Fair Currency Alliance will be submitting shortly to the U.S. Trade Representative a Section 301 complaint against China for currency manipulation. While the JCCT is not the appropriate forum to negotiate exchange rate issues, we hope that the U.S. delegation will note the distorting impact on bilateral trade of the currency undervaluation and reiterate President Bush's statement that the Chinese "have got to deal with their currency."

Conclusion

In concluding, Mr. Chairman, let me reiterate that the NAM wants a strong economic relationship with China that provides mutual benefits. We supported Permanent Normal Trade Relations for China and its WTO membership to advance that goal, and we believe that it is achievable. Yet while China has made progress in opening its market and adhering to international trade rules, the economic benefits of the relationship still remain heavily one-sided in China's favor. Manufacturers continue to face an unlevel playing field that works to limit U.S. exports to China and gives Chinese products unfair advantages in the United States. The JCCT should deal firmly and frankly with these concerns and lay out a plan of action that will result in concrete progress during the year ahead.

Mr. STEARNS. Thank you, Mr. Primosch.
Mr. Tonelson.

STATEMENT OF ALAN TONELSON

Mr. TONELSON. Thank you very much, Congressman Whitfield and members of the subcommittee for inviting my organization to testify today. This is a critically important subject to the hundreds of mainly small and medium size manufacturing companies comprising the U.S. Business And Industry Council, companies that I should stress are firmly committed and this is rather unusual in the Washington business lobbying community, firmly committed to net new job creations in the United States, not overseas.

But China is also critically important for the entire Nation. It is becoming such a big force in the world economy that if the United States doesn't get China right, it will not get globalization right. And recent U.S. policy toward China has been a major failure, could not be more wrong headed and I hate to say it, it's been a major bipartisan policy failure as well.

But I'd like to emphasize in my remarks this morning are two areas in the U.S.-China trade policy that I don't think have received adequately attention. First concerns the national security threats that are presented by U.S. trade and economic policy toward China and second, the unbearable structural strains being imposed on the entire world economy by China's breakneck integration into that global economy, a breakneck integration that's been spearheaded by American policy decisions.

It's become commonplace, but it can't be said often enough national economic and technological strength are foundations of national security and global technological leadership has been essential to America's global super power status and the manifold benefits that this status brings. Yet, it is only the slightest exaggeration to say that U.S. trade policy toward China has been working overtime to transfer as much as possible in the way of resources and militarily useful technology to a country whose recent history has been highly volatile and whose future geopolitical intentions are just as uncertain.

One sign of this danger can be seen in our own high tech trade balance with China and I'd refer you to page 5 of my written testimony. In 1990, the U.S. ran a \$470 million high tech trade surplus with China; in 2003, a \$23.5 billion deficit. And this is in the overall context of a rapidly deteriorating U.S. global high tech trade to deficit.

The best way to understand international trade theory is recognizing that when a country trades most successfully, will be eventually what it makes most successfully and these trade figures tell us that high tech industry, high tech production is not the future of the U.S. economy and the implications for national security are frightening.

A most disturbing feature of U.S. trade policy toward China has been the near breakdown of export controls presided over by the last two Administrations, including this one, I mean. And this has largely been at the behest at relentless lobbying by the multinational business community in Washington. I would call the entire committee's attention to the 2002 GAO report on the development of the Chinese microelectronics industry which not only attributes its rapid development in this militarily crucial field almost entirely to U.S. and other foreign investment, but notes that U.S.

export control officials only rarely even ask the right questions when they review U.S. export applications.

Economically, the U.S. has made any number of specific mistakes in its China trade policy, but I would want to emphasize that these mistakes are best understood as the inevitable consequences of a larger and utterly misconceived global trade strategy. The past decade and a half had seen U.S. global policy marked by the almost indiscriminate opening of the U.S. market to the series of large Third World or former, excuse me, or former communist countries with enormous rapidly growing populations, rock bottom wages and incomes and towering unemployment rates. These countries have either been too poor, too broke or too protectionist to consume many U.S. exports and as a result calling them emerging markets as we got into the very sloppy habit in the 1990's is a complete travesty.

And again, since my time is running short, I would emphasize the figures in my prepared testimony, page 10, China's unemployment rate, the real unemployment rate today has been identified by Charles Wolf of the RAND Corporation and many other experts who I've spoken to in this country and also China at 22 percent. Can you imagine a 22 percent unemployment rate in this Nation? We would have armed guards around this building because Americans would be rioting to get in.

So we see that China—it's not that China has no consumption potential. It's not that China is not consuming and importing a great deal now. The problem is that China's import and consumption potential will always be much, much lower or certainly for the foreseeable future, much, much lower than its production and export potential that has been contributing to major structural growing dangerous U.S. global trade imbalances that are threatening the entire world economy with a dollar crash and a long and deep recession because and this is my final point, after more than a decade of the breakneck reckless globalization policies pushed so hard by the multinational business community in Washington, almost no other country in the world has figured out a way to grow viably other than mass exporting to the United States.

Thank you for your time. I welcome any questions or comments.
[The prepared statement of Alan Tonelson follows:]

PREPARED STATEMENT OF ALAN TONELSON, RESEARCH FELLOW, U.S. BUSINESS AND
INDUSTRY COUNCIL EDUCATIONAL FOUNDATION

Good morning, Chairman Stearns, Congresswoman Schakowsky, and Members of the Subcommittee. On behalf of the U.S. Business and Industry Council and its research and educational arm, the U.S. Business and Industry Council Educational Foundation, thank you for the opportunity to testify today on U.S.-China trade relations.

This subject is of great concern to the roughly 1,000 member companies of the U.S. Business and Industry Council, which themselves are predominantly small and medium-sized manufacturers. Since 1933, the Council has championed the cause of strengthening the domestic technology and manufacturing bases, and we are very gratified by the Subcommittee's focus on this critical issue.

But U.S.-China trade relations should be of urgent concern to all Americans. America's entire domestic manufacturing sector continues to struggle, and small and medium-sized industrial companies in general remain stuck in a downturn that has reached historic proportions. There can be no doubt that much of this distress—which threatens our national security; our future productivity, innovative capacity, and prosperity; and future as a healthy, middle-class-based society and democracy—

stems from ill-conceived trade and globalization policies. And a series of failed China trade policies are a big part of this picture.

Yet America's mishandling of China trade issues has created a series of special problems. Breakneck U.S. transfers of advanced, militarily useful technology to China are tremendously increasing the military-industrial potential of a nation whose geopolitical intentions are highly uncertain at best, while China's enormous and growing net export earnings from its trade with the United States have exponentially increased Beijing's ability to finance a large, modern military. In addition, America's indiscriminate opening of its market to Chinese imports has greatly aggravated the imbalances that are endangering global financial stability and rapidly bringing the entire world closer to a brutal, long-term correction. My testimony will focus on these two issues, which my organization strongly believes have been sorely neglected not only in U.S. China policy, but in the national debate that policy has generated.

These policy failures span Democratic and Republican administrations, and Democratic and Republic-controlled Congresses alike. The problem is not one of politics, but of perception—mainly, an inability of Executive Branch officials and legislators to identify and support the most important American economic interests. Without a thoroughgoing transformation of these trade and globalization policies, the domestic manufacturing and technology base will continue to deteriorate, and the aforementioned security, economic, and social costs will rise ever higher. Yet Subcommittee members—and the rest of the government—must understand that some of the most important changes needed in America's China trade policies may be inconsistent with America's obligations under current international trade regimes.

The U.S. Business and Industry Council believes that many fundamental changes in American policy are needed to repair the damage being done to key national security and economic interests by Washington's recent China trade policy, and to prevent future security and economic threats from arising. These changes will be discussed in more detail below, and unavoidably involve a series of better controls over technology transfers, trade restrictions, and better procedures for formulating U.S. trade policy.

NATIONAL SECURITY CHALLENGES

Wealth and technological prowess are closely related cornerstones of any country's national security. World technological leadership in particular is largely responsible for America's superpower status and all the strategic, political, and economic advantages that flow therefrom. China is a country that has undergone stunning change in recent decades. Its material progress has been impressive. Its economic reforms are opening its economy. Its prominence in international commercial and business affairs has risen rapidly. And its blanket early hostility toward the United States is clearly a thing of the past.

Yet despite the recent explosion of economic ties and expanding cooperation on a variety of security issues, the United States and China are not allies or even friends. Moreover, the volatility of late 20th century Chinese history strongly suggests that the gains achieved in bilateral relations beginning in the 1970s may be ephemeral. Finally, China's vast military-industrial potential alone makes it an object of inherent concern for the United States. In short, 's great uncertainties surround China's political and strategic future, and China is one of the few countries whose future matters greatly to the United States.

Consequently, the security implications of U.S. economic policies toward China should trouble all Americans. Although China's future posture is highly uncertain, it is only a slight exaggeration to say that U.S. policy towards China has been to transfer money and militarily useful technology to the People's Republic as fast as possible. The enormous and rapidly growing trade surpluses China has run in recent years with the United States have sent more than \$600 billion in hard currency earnings to China since 1996 alone. That figure is equivalent to 6 percent of total current annual U.S. economic output. This mountain of money can only greatly expand the resources available to the Chinese military. As long as this vast U.S. subsidy to the entire Chinese economy continues, moreover, China will be able to avoid many hard choices between guns and butter.

U.S. technology transfers to China potentially are more worrisome, as they could well enable China to take charge of its own technological development. Not only could China's military development proceed free of all external constraints. China's capacity to export weapons of mass destruction and their associated technologies would be liberated as well.

The conventional wisdom today holds that most of China's industrial production and exports to the United States consists of goods too primitive for Americans to

bother making anymore—e.g., shoes, clothing, toys, and low-end consumer electronics. This picture, however, has been changing so quickly that it is already hopelessly out of date. Today, most of America's leading high tech companies not only manufacture a wide range of sophisticated products in China. They are conducting more research and development in the People's Republic as well.

One indication of the impact of this work comes from the remarkable turnabout of the U.S.-China high tech trade balance. In 1990, the United States ran a \$471 million high tech trade surplus with China. In 2003, China ran a \$23.5 billion high tech trade surplus with the United States. International trade theory teaches that what countries trade most successfully, they will wind up producing most successfully. America's soaring high tech trade deficit with China (and the comparable deterioration of the U.S. global high tech trade balance) strongly indicate that high tech production will not be the future of the U.S. economy. Indeed, anyone looking at the trends in U.S.-China high tech trade would already be entitled to wonder which of the two is the third world country.

At the same time, these trade flows may represent only the tip of a rapidly expanding iceberg. The U.S. government gathers and publishes reasonably solid information on U.S. high tech manufacturing in China. But comparable information on technology transfer is nowhere to be found. Worse, clear signs have emerged that America's system of export controls, designed to monitor and regulate the flow of militarily relevant technology to countries like China, has all but broken down under the relentless pressure of lobbying by multinational corporations. In particular, a 2002 GAO report detailed how U.S. and other foreign technology transfers have enabled the Chinese to move to within one generation of current U.S. semiconductor manufacturing capabilities in only 15 years, and how U.S. export control authorities ignore some of the most common-sensical relevant considerations when evaluating export license applications—e.g., assessing only the potential military impact of the product in question, rather than reviewing the broader pattern of Chinese technology imports in a given field and anticipating the cumulative impact of such purchases.¹ U.S. government sources tell me that this situation has only modestly improved since the report's publication.

Moreover, the United States has never effectively used its considerable leverage with its military allies to convince them to limit potentially dangerous technology transfers to China. A multilateral export control list is indeed maintained by the so-called Wassenaar arrangement, but compliance is purely voluntary. Indeed, the European Union seems likely in the near future to lift its post-Tiananmen Square arms embargo on China.

Finally, on a 10-week research visit to China during the winter of 2002-03, I personally saw alarming evidence of America's lax technology transfer policy toward China. During a visit to the software research laboratory operated by IBM at Beijing's Qinghua University, I asked the lab manager whether the facility had ever been visited by a U.S. government official during his tenure there of several years. His response: "No." I then asked him whether he had any way of ascertaining whether employees he hired were either Chinese government employees, or spies. His answers to both questions was also "No." When I mentioned this incident to U.S. officials in China, they noted that the resources at their disposal for monitoring the tech transfer situation in the People's Republic were hopelessly inadequate.

In sum, the determination of official Washington and multinational corporations to shower China with resources and advanced technology is the height of irresponsibility. Tighter and smarter controls on U.S. trade policy are urgently needed.

GLOBAL ECONOMIC STRAINS

The other issue I would like to focus on entails the global economic implications of China's integration into the world economy. The view that China presents special problems for the world trading system is hardly unique to U.S. workers and companies critical of current globalization policies. Its implications were widely discussed by virtually the entire World Trade Organization membership and were directly responsible for the large numbers of special conditions attached to China's WTO entry.

In retrospect, however, even these concerns and measures underestimated the China challenge. By awarding the People's Republic virtually all the rights and privileges of WTO membership—especially including near immunity from the authority of U.S. trade laws aimed at combating predatory trade practices—Wash-

¹ See *Export Controls: Rapid Advances in China's Semiconductor Industry Underscore Need for Fundamental Policy Review* (Washington, D.C.: U.S. General Accounting Office), GAO-02-260, April 19, 2002

ington spearheaded a worldwide decision that has put the global economy on an unsustainable and possibly disastrous path.

China's sudden entry into the global economy can only greatly exacerbate a situation in which the world's producing populations and the world's consuming populations are splitting into two separate camps—a type of global specialization never envisaged by economic theorists and surely doomed to collapse. More specifically, the populations that the world increasingly relies on to produce goods and services lack the income to absorb a reasonable share of their output. Meanwhile, the populations the world increasingly relies on to consume are steadily being stripped of their capacity to pay for their consumption in a responsible way.

The last decade of the 20th century witnessed an epochal change in the global economy. Due largely to the fall of communism and the development of advanced communications technologies, record numbers of new countries and their gigantic, often rapidly growing populations were brought into the integrated world economy and made available to international businesses in an unprecedentedly short period of time.

China has clearly not been the only such country, but none other has proved to be simultaneously so populous and economically dynamic. In addition, improvements in education globally and business management techniques have enabled multinational companies to employ the vast populations of these third world and former Soviet bloc countries not only in the raw materials and light, labor-intensive manufacturing industries that had traditionally fueled their growth, but in much more sophisticated, capital-intensive and technologically sophisticated industries as well. These trends were given decisive impetus by the trade agreements of the 1990s, which overwhelmingly concentrated not on opening export markets in these new global economic entrants (often misleadingly called “emerging markets”) but on helping multinational companies supply rich countries like the United States from the new low-wage international actors. In fact, trade agreements such as NAFTA and the “normalization” of trade with China have actively encouraged such outsourcing arrangements by guaranteeing substantial market access from low-wage production sites.

Supporters of such globalization policies predicted that this trade expansion would quickly raise incomes in the third world and former Soviet bloc countries and thus create new markets in these countries that could be supplied by workers in rich countries. Unfortunately, policies that keyed rapid economic development in small countries, like the Asian export tigers, have been much slower to work in much larger countries. As I have emphasized in my recent book, *The Race to the Bottom*, the major reasons are (1) the very size of the populations of these global newcomers, along with their towering rates of unemployment, have created a vast oversupply of labor around the world that is exerting powerful downward pressure on wages in all countries; and (2) the decision of most global newcomers to pursue some form of export-led growth strategy has actively promoted domestic savings and discourage domestic consumption.²

China embodies all of these troubling trends, but its sheer size gives it special importance. Not only does it boast a population of some 1.3 billion that is increasing at an ostensibly moderate rate of one percent annually. Specialists such as Dr. Charles Wolf Jr. of the RAND Corporation estimate its real unemployment rate to be an astonishing 23 percent. Nor is the jobless problem likely to abate as China's robust economic growth continues. Indeed, partly because of the existing labor surplus, and partly because of the continuing privatization of inefficient state enterprises, Prof. Dorothy Solinger of the University of California, Irvine, expects that 40 million Chinese workers will have lost their jobs from 2001-2006, and that net new job creation during this period will range only from 1.75 to 2.5 million.³

From these figures, it is easy to see not only that wages and purchasing power for the vast majority of Chinese will be going nowhere anytime soon, but that even keeping the unemployment trends from spinning out of control and endangering the regime's survival will require even more Chinese reliance on export-led growth and less on domestic-led growth.

² Alan Tonelson, *The Race to the Bottom: Why a Worldwide Worker Surplus and Uncontrolled Free Trade are Sinking American Living Standards* (New York: Westview Press), 2000

³ “Fault Lines in China's Economic Terrain,” by Charles Wolf Jr., in *China's Economy: Will the Bubble Burst?*, Asia Program Special Report No. 111, Asia Program, Woodrow Wilson International Center for Scholars, Washington, D.C., June 2003, p. 4; “WTO and China's Workers,” by Dorothy J. Solinger, in *China Enters the WTO: The Death Knell for State-Owned Enterprises?*, Asia Program Special Report No. 103, Asia Program, Woodrow Wilson International Center for Scholars, Washington, D.C., June, 2002, pp. 3-4

This strategy is already creating major, growing strains in the world economy. China has recently garnered praise for running balanced global trade accounts—ostensible proof that it is generally conducting reasonable and responsible trade policies despite its huge surpluses with the United States. Yet a developing country growing as strongly as China (even if GDP figures have been exaggerated, as some scholars claim) should be running sizeable trade deficits if its economy is truly being shaped predominantly by market forces.

Research by economist Stephen Roach of Morgan Stanley further underscores the pronounced export orientation of China's economy. Not only did China alone generate an astonishing 29 percent of total growth in world manufactured exports in 2002, but exports represented fully 26 percent of China's economy that year and nearly three-fourths of all the growth that economy achieved. For good measure, the Bank of China estimated that, in 2002, 86 percent of the categories of manufactures produced by China were in oversupply.⁴

This data, and a plethora of additional evidence, add up to a critically important message for the entire global economy. China has been determined to fuel its growth and maintain its employment levels by subsidizing massive overinvestment in a wide range of industries and then exporting the surplus worldwide. Only slightly less important is the equally clear truth that, however China's domestic consumption increases in absolute terms, as a significant middle class emerges, its output is guaranteed to increase that much faster.

The size and uniqueness of America's trade deficit with China reminds us that the United States today is bearing an outsized share of the costs of China's government-driven export-led, development strategy. But China's singleminded determination to grow regardless of the problems it exports threatens most other countries as well. Other developing countries are already being crowded out of export markets they desperately need for their own development—including countries to which the Bush administration says it is determined to grant trade preferences to prevent them from producing or harboring global terrorists. The U.S. International Trade Commission has recently predicted that this problem will greatly worsen once the scheduled abolition of the Multi-Fiber Arrangement in January, 2005 significantly liberalizes world trade in textiles and apparel.⁵

Developed countries, for their part, will not only continue to see ever more sophisticated and high-paid jobs become victims of these mercantilist Chinese policies—abetted to be sure by U.S. and other foreign multinational companies. But the law of marginal effects indicates that China will increasingly be able to force down world price levels in a growing number of industries, depriving businesses of the margins needed to pay workers first-world wages, pay first-world levels of taxes to finance first-world social services responsibly, and continue investing in new products and processes.

Certainly, numerous member companies of the U.S. Business and Industry Council have been told by the multinationals either to meet a Chinese price (frequently a price less than even the cost of the product's raw materials), or lose the contract to a Chinese competitor. One member company has even been forced to transfer his proprietary technology to a Chinese competitor—in exchange for a final renewal of his contract.

In the end, however, the greatest economic danger posed by Washington's mismanagement of U.S.-China trade relations stems from the enormous contribution it has enabled China to make to the gargantuan U.S. current account deficit. Fueled increasingly by the mounting imbalances in U.S.-China trade, America's relentlessly increasing global deficit will inevitably produce a dollar crash—if conventional macroeconomic theory has anything to teach us.

The damage, moreover, would reverberate far beyond America's borders, especially since after more than a decade of breakneck globalization, few countries have found a viable growth formula other than major net exporting to the United States. What is good for the United States genuinely and ultimately is good for the world economy. But if dramatically better-balanced growth patterns do not appear soon globally, America's troubles will become the world's in spades. Imposing more discipline on Chinese economic policies is essential to restoring balanced global growth. And this discipline will in all likelihood need to be imposed unilaterally by the

⁴“Global Economic Forum: China's Global Status,” by Stephen Roach, February 14, 2003, <http://www.morganstanley.com/GEFdata/digests/20030214-fri.html> “Cut throat competitors,” by James Kyngé and Dan Roberts, *Financial Times*, February 4, 2003

⁵*Textiles and Apparel: Assessment of the Competitiveness of Certain Foreign Suppliers to the U.S. Market*, Investigation No. 332-448, sent to USTR in June 2003, publication 3671, U.S. International Trade Commission, January, 2004

United States, using the great leverage it still enjoys by virtue of being China's dominant export market.

POLICY RECOMMENDATIONS

Some of the policies that the United States needs to adopt are mainly substantive in nature. For example, the United States should impose an emergency across-the-board tariff on all Chinese products that increases until China's trade surplus with the United States falls below a certain percentage of the total value of two-way merchandise trade—and stays at that level for several years. A target of between 5 and 10 percent strikes us as being reasonable. Given the wide variety of subsidies permeating the Chinese economy, this tariff should not depend on reforms in China's exchange-rate policy. The United States should also respond with tariffs in response to specific Chinese mercantilist practices such as dumping, imposing civilian and military offsets, intellectual property theft, and product-specific abuses such as the semiconductor preferences currently being challenged by the Office of the U.S. Trade Representative.

Some of the new policies are more procedural in nature. For example, the United States should declare a moratorium on compliance with all WTO decisions pending fundamental reform of that organization to reflect America's predominant role in the world economy. This measure would free up the U.S. government to use the full authority of its trade laws to combat Chinese mercantilism. Accordingly, Washington should make it easier for individual domestic companies and other domestic economic interests to file and win trade law complaints. In addition, American policymakers and the public desperately need timelier and more detailed information from U.S. multinational companies about their outsourcing and exporting activities in China. And the United States should reform its trade policy advisory apparatus to ensure that domestic, not multinational, interests are the dominant voices. More China-relevant recommendations can be found in *To Save American Manufacturing*, which is posted on USBIC's www.americaneconomicalert.org website.

China has every right to promote its economic and security interests, but the U.S. government has a paramount responsibility to its people to ensure that China's gains do not needlessly come at the expense of America's domestic companies and workforce, and the nation's security. Washington must fundamentally reform its China trade policies to regulate more carefully the flow of militarily relevant resources and technology to the People's Republic, and to bring under control the economic imbalances that threaten the entire world's prospects for sound and durable growth.

It is most unfortunate that recent dangerous trends have been allowed to grow and intensify as long as they have, and that emergency trade restrictions have become indispensable for solving the problem. If anyone can offer alternatives that have not already been proven failures, the U.S. Business and Industry Council would be delighted to hear them. But we would also insist on asking, "What have you been waiting for?"

Thank you again for the opportunity to testify, and I welcome any questions and comments.

Mr. STEARNS. Thank you, Mr. Tonelson.
Mr. Papovich.

STATEMENT OF JOSEPH PAPOVICH

Mr. PAPOVICH. Thank you, Mr. Chairman. On behalf of the Recording Industry Association of America, I appreciate the opportunity to testify today. Exports and foreign sales account for over 50 percent of our members' revenues. However, 9 out of 10 recordings sold in China today are pirated. Why is this so? First, the Chinese government has chosen to rely upon the use of seizures and small fines as the principal remedy against sound recording piracy. They annually run thousands of raids and seize millions of CDs with almost no effect. Piracy remains at 90 percent for us because pirates making huge profits on each CD sold view such sanctions as just the cost of doing business.

Second, market access and investment barriers prevent our members from serving China in a timely manner which only increases the demand for pirated product.

Third, internet piracy is growing rapidly in China. Certain Chinese websites have become virtual CD warehouses for pirate syndicates. The upcoming mid-April meeting of the U.S.-China Joint Commission on Commerce and Trade could be a pivotal moment in our trade relationship. China must undertake a series of commitments to be fully implemented by the end of the year at the latest that significantly reduce piracy in China.

We recommend the following. A coordinated nationwide initiative mandated as a Chinese national priority that is different from previous campaigns with a powerful national figure leading the campaign so that unlike previous campaigns, China's enforcers, nationally, provincially and locally, take it seriously. Today, combatting piracy is not coordinated in China and it is not a national priority at the national, provincial or with really one exception, at the local level.

We understood that China committed to do this last fall to USTR and to the Commerce Department with a famous senior official leading the way, but so far we have seen absolutely no evidence of this. But even if this kind of campaign does occur, China must also do more than impose minimal administrative sanctions and in our view this means they must criminally prosecute major pirate producers, traders, distributors and internet pirates.

Today, China does not, in part, because they choose not to and in part, because their law authorizes criminal prosecutions for copyright piracy only if the pirate has documented revenues or profits that exceed specified levels. However, revenue is defined as goods already sold, a warehouse full of unsold pirated goods is excluded. Pirates keep no records, so the revenue or profits can't be determined.

Finally, China's regulatory procedures make it difficult for our companies to establish and operate in China so that the market is ceded to the pirates. Here's two examples. First, Chinese government censors are required to approve the content of foreign produced recordings, but not domestically made China recordings. China should terminate this discriminatory practice. In the meantime, since we don't expect that to happen over night, they must significantly accelerate the approval process. The process is now very time consuming during which pirates, which of course, face no censorship have the market to themselves.

Second, China requires an artificial division of labor separating who can record, who can publish, who can distribute and who can market music that slows to a crawl the process of getting new records to the market further benefiting the near monopoly of the pirates.

In conclusion, sound recording piracy in China remains rampant. Much more must be done by China to meet its bilateral and multilateral obligations. In addition, it is time for the Chinese government to acknowledge the nexus between market access and fighting piracy. The vacuum caused by China's market access restrictions will always be filled by pirates who adhere to no rules.

We urge the United States and the rest of the international trading community to increase pressure on China bilaterally and through the WTO to more effectively combat rampant piracy and to open the Chinese market to our products. Specific measurable commitments by China should be established at this JCCT meeting. Failure to do so should lead to prompt, firm and appropriate action by the U.S. Government. Thank you very much.

[The prepared statement of Joseph Papovich follows:]

PREPARED STATEMENT OF JOSEPH PAPOVICH, SENIOR VICE PRESIDENT
INTERNATIONAL RECORDING INDUSTRY ASSOCIATION OF AMERICA

Mr. Chairman and Members of the Sub-Committee, my name is Joseph Papovich and I am the Senior Vice President for International at the Recording Industry Association of America. On behalf of the RIAA, I appreciate the opportunity to testify about U.S.-China economic relations and China's role in the global economy at this time when well-deserved special attention is being given to this bilateral relationship.

The Recording Industry Association of America is the trade group that represents the U.S. recording industry. Its mission is to foster a business and legal climate that supports and promotes our members' creative and financial vitality. Its members are the record companies that comprise the most vibrant national music industry in the world. RIAA members <<http://www.riaa.com/about/members/default.asp>> create, manufacture and/or distribute approximately 90 percent of all legitimate sound recordings produced and sold in the United States.

International markets are vital to our companies and our creative talent. Exports and other foreign sales account for over fifty percent of the revenues of the US record industry. This strong export base sustains American jobs.

However, America's creative industries are under attack. The impact of piracy has grown in recent years with the advance of digital technology. High levels of piracy, in conjunction with market access barriers, particularly in China, plague our industry.

The upcoming April 21 meeting of the U.S.-China Joint Commission on Commerce and Trade could be a pivotal moment in our trade relationship. It is imperative that China agree to a series of commitments, to be implemented over a specified period of time, that lead to a significant reduction by the end of the year of the rampant piracy plaguing China. Meaningful reductions have been achieved in one city-Shanghai. If it can be done there, it can be done everywhere else. It is a matter of political will that does not exist at this time elsewhere in China. The remainder of my testimony sets out the specific problems we face and steps that China should take to address these problems.

Our Problems in China

RIAA has a long history of active involvement in intellectual property negotiations between the United States and China. We participated in negotiations led by the Office of the U.S. Trade Representative in 1995 and 1996 undertaken pursuant to Section 301 investigations, resulting in exchanges of letters obligating China to close factories producing and exporting pirate CDs that were causing catastrophic disruption of our global markets. While the Chinese government did indeed successfully disrupt the exportation of pirate products, it has not yet seriously tackled the problem of piracy within its borders, an obligation that was undertaken in these bilateral agreements, as well as in their World Trade Organization (WTO) commitments.

We have waited patiently for China to implement the various commitments it has made bilaterally and as part of its accession to the WTO. Initially, immediately after China's WTO accession, China made serious efforts to implement the obligations relating to our industry by undertaking reform of its copyright laws and regulations.

However, with rare exceptions, the sky-high piracy of sound recordings continues unabated in China. The new laws generated by the WTO accession process were not implemented in a manner that had any meaningful impact on copyright piracy. Our hopes that China's self interest in being a significant player in world trade and the information society would lead to a significant reduction of piracy have been unfulfilled.

Last year, despite China's various bilateral and multilateral commitments to the United States, the record industry lost \$286 million to pirate sales, and suffered a 90% piracy rate in China.

We continue to face three significant and related problems in China.

1. The Chinese internal market remains heavily pirated (at over 90%). This high piracy rate continues despite many raids, seizures and administrative fines that have been clearly inadequate to deter continued piracy. Mass quantities of pirated recordings are produced in China or imported from Taiwan, Hong Kong or elsewhere. Pirated music sales in China exceed half a billion dollars a year.

2. A series of market access and investment barriers prevent our members from serving the Chinese market in a timely manner, which only increases consumer demand for pirated product. A solution to piracy requires much greater progress on market access as well. One small example is that it can take weeks for us to obtain censorship approval for the release of our recordings, giving pirates exclusive rights to the Chinese territory for weeks while we await regulatory approval. This must end.

3. Internet piracy is growing rapidly in China. Many websites offer downloading of pirated music files, some for a financial charge, others for free. Certain China-based ISPs have become online "warehouses" for international pirate syndicates. Many of the same shortcomings that enable physical piracy to flourish in China plague the on-line environment as well.

China is currently the world's largest consumer of pirated products. Unless action is taken promptly, China may once again become the world's foremost producer of pirated materials as well.

The Solutions

We call upon China at the JCCT to make specific commitments that will, within a very short period of time, *significantly* reduce piracy. The following is what we believe must be done to accomplish this result.

1. *Anti-piracy*: China MUST criminally prosecute pirate producers, importers and distributors, as well as internet pirates and infringing ISPs. Commercial piracy is very rarely criminally prosecuted in China. One problem has been legal "thresholds" that have made it virtually impossible to prosecute copyright infringement. But these high legal thresholds are not the only problem. Another is that the Chinese authorities have not had the political will to criminally prosecute commercial piracy. Instead officials prefer weak administrative sanctions with no prison terms despite rampant piracy. As we have learned from experience elsewhere, without criminal sanctions, there is little likelihood that China will significantly reduce piracy rates.

China committed bilaterally to the United States in 1995 to provide criminal remedies against more serious infringing activity, both internally and at the border. And, when China joined the WTO, it committed to do so again, through its adherence to the TRIPS Agreement. Despite these two sets of commitments, China still is not criminally prosecuting larger scale commercial piracy. This is a serious problem and explains why a 90% piracy rate continues unabated in China.

Specifically we recommend:

- China's administrative enforcement authorities must begin transferring for criminal prosecution those responsible for willful piracy on a commercial scale, including such infringers on the internet.
- Criminally prosecuting pirates will require legal and administrative changes in China's current laws and regulations. For example, contrary to the practice in the U.S. and most countries, China does not permit private organizations like ours to conduct investigations in China to gather evidence.
- China's Public Security Bureau-their police-must begin to investigate the criminal element of sound recording piracy either. To date, China's police have not been inclined to do so, leaving anti-piracy enforcement solely in the hands of administrative agencies, which have authority only to seize product and impose small, ineffective monetary fines.
- China should either permit private organizations to gather evidence or undertake criminal investigations on their own initiative.
- The current law sets thresholds for initiating criminal investigations for copyright piracy only if the pirate has revenues or profits in excess of very high levels. "Revenue" is defined as the goods already sold, valued at pirate prices. Unsold seized pirate inventory is excluded. But revenues or profits are rarely possible to determine as pirates avoid record-keeping, and we are not permitted to undertake investigations that would assist the authorities. These thresholds must be eliminated or substantially reduced and/or redefined, for example, to permit unsold inventory to be counted and to establish whatever threshold is set by reference to the retail, not the pirate price. Such reform could be modeled after another provision in China's Criminal Code stipulating criminal prosecution for dealing in more than 500 units in infringing product.
- Another problem is that recently amended Chinese Customs regulations do not require the destruction of seized infringing merchandise, in direct violation of

the WTO TRIPS Agreement. Such merchandise may be, for example, auctioned off.

- A nationwide initiative must be mandated as a Chinese national priority; with someone like Vice-Premier Wu Yi leading the campaign so that China's enforcers-nationally, provincially and locally-take it seriously. Today, China's copyright enforcement efforts are not coordinated among China's various national enforcement agencies as well as among national enforcers and those at the provincial and local level.
- The Chinese Supreme Court and State Council must issue new interpretations, guidelines and instructions to judges, prosecutors and the Public Security Bureau to permit private investigations, to lower the current onerous thresholds and to direct enforcement authorities to actively investigate and criminally prosecute copyright piracy, including certain Customs seizures.

China committed in its 1995 bilateral agreement with the United States to address many of these problems. China did so again in its WTO Protocol of Accession, in part by agreeing to reduce significantly the existing onerous thresholds for initiating criminal prosecutions. Despite these commitments, China has not done so. At the JCCT, China should agree to do so by a fixed timetable-the end of 2004.

2. Market Access

Censorship:

(A) Chinese government censors are required to review the content of only legitimate foreign-produced sound recordings before their release. Domestically-produced Chinese recordings are NOT censored. Of course, pirated product is not censored either. China should terminate this discriminatory practice.

(B) Censorship offices are woefully understaffed, causing long delays in approving new recordings. The best result would be for censorship to be industry-administered, as in other countries. If this is not possible, steps must be taken to expedite the process so that legitimate music and motion pictures can be promptly marketed, preventing pirates from getting there first.

In the near-term, China should be pressed for a commitment to (1) end discrimination in censorship and (2) complete the approval process within a reasonable period (e.g. a few days). In the long-term, censorship should be abolished.

Producing and publishing sound recordings in China:

U.S. record companies are skilled at and desirous of developing, creating, producing, distributing and promoting sound recordings by Chinese artists, for the Chinese market and for export from China. However, onerous Chinese restrictions prevent this from occurring. For example, for a sound recording to be brought to market, it must be released through an approved "publishing" company. Currently only state-owned firms are approved to publish sound recordings. China should end this discrimination and approve foreign-owned production companies.

Further, production companies (even wholly-owned Chinese ones) may not engage in replicating, distributing or retailing sound recordings. This needlessly cripples the process of producing and marketing legitimate product in an integrated manner. China should permit the integrated production and marketing of sound recordings.

U.S. record companies may market non-Chinese sound recordings only by (1) licensing a Chinese company to produce the recordings in China or (2) importing finished sound recording carriers (CDs) through the China National Publications Import and Export Control (CNPIEC). China should permit U.S. companies to produce their own recordings in China and to import directly finished products.

Distributing sound recordings:

Foreign sound recording companies may own no more than 49% of a joint venture with a Chinese company. However, the recently concluded Closer Economic Partnership Agreement (CEPA) between China and Hong Kong permits Hong Kong companies to own up to 70% of joint ventures with Chinese companies engaged in distributing audiovisual products. China should grant at least MFN status to U.S. record producers per the terms of the CEPA.

Conclusion

Sound recording piracy in China remains rampant. Much more needs to be done by China in order for it to meet its bilateral and multilateral obligations to enforce against piracy. In addition, it is time for the Chinese government to acknowledge the nexus between meaningful market access and the ability to effectively fight piracy. Piracy cannot be defeated or effectively deterred by enforcement alone - it must be accompanied by market-opening measures. The continuous vacuum left by China's closed market will always be promptly filled by pirates who, by the very na-

ture of their illegal activities, do not adhere to legitimate market rules. We urge the United States and the rest of the international trading community to keep pressure on China through the WTO and other processes to much more effectively combat the rampant piracy in China and to open the Chinese market to our legitimate products. The JCCT meeting should be viewed as a watershed event. Specific, measurable commitments by China should be undertaken at this event. Failure to do so should lead to prompt, firm and appropriate action by the U.S. government.

Mr. STEARNS. Mr. Levinson. Thank you.

STATEMENT OF MARK LEVINSON

Mr. LEVINSON. Mr. Chairman and members of the subcommittee, I want to thank you for the opportunity to testify today. I especially appreciate, Mr. Chairman, your opening statement where you stress the importance of linking trade to labor rights and Bruce Raynor, the President of UNITE asked me to be sure and tell Congresswoman Schakowsky that all UNITE members are especially proud that one of our own members such as the distinguished member of this committee and of Congress and we look to you all the time for your important leadership.

We are in the midst of an incredible crisis for manufacturing workers in this country. Every month since this administration has been in office, manufacturing jobs have declined, 2.8 million manufacturing jobs have been lost since this administration has been in office. One of the reasons is our trade relationship with China.

On March 16, UNITE participated with the AFL-CIO in filing a petition with the U.S. Trade Representative under Section 301 of the Trade Act of 1974 asking the Trade Representative to take action to promote the human rights of China's factory workers. This is the first time in the history of Section 301 that a petition has invoked the violation of workers' rights as an unfair trade practice, although it is quite common for corporations to use Section 301 to challenge other unfair trade practices such as violations of intellectual property rights.

In Section 301, Congress said that it is an unreasonable trade practice if one of our trading partners persistently denies workers' freedom of association, rights to organize and rights of collective bargaining, freedom from all forms of compulsory labor, freedom from child labor, standards for minimum wages, maximum hours and safety and health. Even before the enormous loss of jobs to China in the last 3 years, Congress recognized that the denial of basic worker rights overseas was the cause of capital flight and the loss of U.S. jobs and Congress directed the President to act to stop it.

The AFL-CIO petition shows overwhelming that the two preconditions for Presidential action under 301 are met. First, China persistently denies the basic rights of its workers. And second, the denial of those rights adversely affects U.S. workers. The President has 45 days to decide whether to accept the petition and launch an investigation. If he denies the petition, he must publicly state his reasons. He must publicly declare either that China doesn't persistently violate its workers rights or that China persistently violates its worker rights, but that this has no effect on U.S. jobs. Either declaration would contradict the overwhelming evidence presented in the AFL-CIO petition. Indeed, Section 301 authorizes the Presi-

dent to take action on his own initiative, even before the AFL-CIO filed this petition, but he hasn't enforced Congress' will.

The AFL-CIO petition shows that China's violations of worker rights gives manufacturers a cost advantage range between 10 and 43 percent of overall production costs. That illegitimate cost advantage displaces approximately 720,000 jobs in the United States. I want to stress these are very conservative estimates. They're calculated from the trade model used by the International Trade Commission and they use the most conservative assumptions at every step in the calculation. China's illegitimate cost advantages probably displaces many more than 727,000 jobs.

The AFL-CIO petition doesn't challenge China's comparative advantage as defined by classical trade theory. China has a number of competitive advantages apart from its all out denial of worker rights, but China's all out denial of worker rights gives China an additional increment of cost advantage in its manufacturing sector and that increment is an illegitimate advantage. It's illegitimate under universal norms of human rights. It's illegitimate under congressional legislation.

Section 301 authorizes the President to take any actions within its constitutional powers to enforce fair competition and worker rights overseas. The AFL-CIO petition demands that the President take three actions to remedy China's persistent denial of worker rights. First, the President should impose trade measures against China that are sufficiently large to induce China to enforce worker rights and to stop the unfair competition.

Second, the AFL-CIO demands that the President negotiate an agreement with China to phaseout the trade measures in incremental steps as China complies with bench marks on compliance with worker rights, bench marks that are specific and verifiable by the international labor organization.

Third, the AFL-CIO demand that the President enter into no new trade agreements until all members of the WTO are required to comply with core worker rights as a precondition of enjoying the benefits and privileges of WTO membership.

Global trade rules should fairly enforce basic worker rights and end the race to the bottom. Thank you so much.

[The prepared statement of Mark Levinson follows:]

PREPARED STATEMENT OF MARK LEVINSON, CHIEF ECONOMIST, UNITE

Mr. Chairman and members of the subcommittee, I want to thank you for the opportunity to testify today regarding preparations for the upcoming U.S.-China discussions on trade and commercial ties.

On March 16 UNITE participated with the AFL-CIO in filing a petition with the United States Trade Representative under Section 301 of the Trade Act of 1974, asking the Trade Representative to take action to promote the human rights of China's factory workers.

It is the first time in the history of Section 301 that a petition has invoked the violation of workers' rights as an unfair trade practice, although it is quite common for corporations to use Section 301 to challenge other unfair trade practices such as violations of intellectual property rights.

The petition shows, first, that China persistently denies the fundamental rights of its factory workers. And, second, that China's violation of worker rights lowers wages and production costs in China and, as a result, displaces hundreds of thousands of manufacturing jobs in the United States.

China's brutal repression of worker rights is I believe the most important issue in the U.S.-China trade relationship. Yet it appears to be nowhere on the Administration's trade agenda with China. The 301 petition filed by the AFL-CIO seeks to

change that. The trade legislation enacted by Congress requires the President to take action.

CHINA DENIES WORKERS' RIGHTS

There is overwhelming evidence that China denies the workers' rights enumerated in Section 301. The petition amasses evidence from academics, the State Department, the ILO, labor unions, and human rights groups. The evidence clearly shows that:

China Denies Freedom of Association and Rights of Collective Bargaining. China prohibits strikes, and relentlessly represses attempts to organize unions that are independent of the All-China Federation of Trade Unions (ACFTU). The ACFTU is controlled by the Chinese government. It is officially and legally subservient to the policies of the Party leadership and to local officials who profit from export enterprises. Workers who attempt to strike or organize independent unions are arrested, imprisoned, beaten, and tortured.

China Encourages Forced Labor. Most of the workers in China's export sector are temporary migrants from the countryside. They work under bonded labor, a form of forced labor. China enforces a system of internal passports that is similar to the pass system in apartheid-era South Africa. Factory workers are permanently registered to live in their rural villages, and have no civil or political rights when they work temporarily in factory towns and cities. Upon arrival to the factories, migrant workers become heavily indebted in order to pay large "deposits" and other fees to their employers. They lose the deposit if they quit without the employer's consent. They are thereby turned into bonded laborers.

China Does Not Enforce Standards of Wages, Hours, and Occupational Safety and Health. Most manufacturers in China pay their workers much less than the minimum wage standards set by the central and provincial governments. Most manufacturers fail to implement standards of workplace safety and health. Government officials do not enforce standards of wages, hours, and safety and health.

The AFL-CIO's petition doesn't challenge China's comparative advantage as defined by classical trade theory. China has a number of competitive advantages apart from its denial of worker rights. Even if China fully enforced worker rights, wages would be low. But they wouldn't be nearly as low as they are now.

But China's brutal denial of worker rights gives China an additional increment of cost advantage in its manufacturing sector. And that increment is an illegitimate advantage. It's illegitimate under universal norms of human rights. And it's illegitimate under Congressional legislation.

THE BURDEN ON U.S. COMMERCE

U.S. workers today have to compete with factory workers who are forced to work under lawless working conditions. And it is taking a toll. The manufacturing sector in the U.S. has lost jobs for 43 straight months. The U.S. has lost a staggering 2.8 million manufacturing jobs since the President Bush took office.

The data on job loss by manufacturing sector is staggering. Employment in textile mills fell from 480,400 to 241,300 between 1994 and 2004. Jobs in apparel fell from 853,800 to 295,700 during the same period. In the textile and apparel sectors combined, employment fell by 54.4%, with a total job loss of 846,700 during the nine years since December, 1994. In the last three years, employment in the computer and electronic products sector has dropped by 538,000 workers or 28.8%; employment in electrical equipment and appliances has fallen by 133,000 or 22.8%; in machinery 312,000 or 21.6%; in fabricated metal products 282,000 or 16%; in primary metals 146,000 or 24%, in transportation equipment 212,000 or 10.7%, in furniture products 103,000 or 15.2%, in textile mills 124,000 or 34.1%; in apparel 175,000 or 37.3%; in leather products 89,000 or 14.9%, in printing 128,000 or 16.1%, in paper products 89,000 or 14.9%, in plastics and rubber products 13.8% the electrical equipment and appliances sector has lost 133,000. In the furniture sector, in just two years (from 2000 to 2002) U.S. manufacturers lost 11.5% of market share to China.

The AFL-CIO petition shows that China's violations of worker rights gives Chinese manufacturers a cost advantage ranging between 10 percent and 43 percent of overall production costs. That illegitimate cost advantage displaces approximately 727,000 jobs in the United States.

These are very conservative estimates. They're calculated from the trade model used by the International Trade Commission, and they use the most conservative assumptions at every step of the calculation. China's illegitimate cost advantage probably displaces many more than 727,000 jobs.

And the burden on U.S. workers goes far beyond the number of jobs lost. Twenty-five percent of displaced workers in the U.S. don't find new ones within six months

after losing their jobs. Those who are fortunate enough to find new jobs suffer big losses of income. Two-thirds earn less on their new jobs. And these figures on lost wages are from the years before the bottom fell out of the labor market for U.S. manufacturing workers in the last three years, when it's become even more difficult to transition into decent-paying jobs.

And beyond lost jobs and wages, workers displaced by China's violation of worker rights lose their homes because they can't keep up with mortgage payments, they lose their health insurance, they lose their pensions. They suffer increased rates of heart disease, of divorce, depression, and suicide.

CHINA'S MANUFACTURING CAPACITY

While U.S. manufacturing workers have faced catastrophic losses, China's manufacturing output, exports, and productive capacity have grown at unprecedented, accelerating rates—and are poised to grow even more explosively in the next five years. According to Richard D'Amato, the vice chairman of the U.S.-China Economic and Security Review Commission, we are witnessing “the actual transfer of U.S. national manufacturing capacity [to China] and the export back of the goods.” In light of China's currently escalating capital spending, the transfer of U.S. manufacturing capacity to China will accelerate in the next decade. The USTR should act now to prevent the imminent, irreversible loss of U.S. jobs due to China's illegitimate exploitation of its factory workers.

Even though China is still in a relatively early stage of industrialization, it is already the second leading exporter to the United States, surpassed only by Canada. China's exports to the United States now exceed the exports of such industrial powerhouses as Japan, Germany, and the United Kingdom, and will soon surpass even Canada's China's exports to the United States also exceed those of Mexico, the low-wage export platform immediately across our border.

Unlike Mexico and other emerging export platforms, China has made “the crucial leap” to producing not just electronic and other consumer goods for global and domestic markets, but also manufacturing the components for those goods, including the fabrication of computer chips. Guangdong Province encompasses the largest such production base for electronics in the world.

China now leads the world in the production of televisions, refrigerators, cameras, bicycles, motorbikes, desktop computers, computer cables and other components, microwave ovens, DVD players, cell phones, cigarette lighters, cotton textiles, and countless other manufactured products—and China's lead is growing at an accelerating pace.

China's exports of textile and apparel goods have increased 320 percent in the last two years, while U.S. employment in those sectors has fallen by 323,000. In the first eleven months of 2003, China's production of computers grew by 105.5%. Its production of micro-computers grew by 84.9%, power-generating equipment by 72.5%, optical communication equipment by 54.3%, air conditioners by 43.2%, semiconductor integrated circuits by 38.6%, metal-cutting machine tools by 34.1%, motor vehicles by 33%, chemical equipment by 30.5%, fax machines by 30.2%, household refrigerators by 27.3%, household washing machines by 27%, cell phones by 24.5%, electric motors by 26.8% electric-driven tools by 26.2%, steel products by 21.5%, and plastic products by 17%. China's output of many manufactured products showed *accelerating growth* in the *later months of 2003*. China has now become an export powerhouse in high-tech computers and electronics and machine parts, not just low-tech toys and garments.

But even while productivity rose rapidly in China in the last decade, the real wages of China's factory workers stagnated. The manufacturing boom in China has not been a train carrying China's workers into the middle class. China's workers can't bargain for higher wages because they lack basic worker rights.

The United States trade deficit with China is now the largest trade deficit the United States has ever had with any country. Last year, China's exports of goods to the United States grew not only at an historically high rate (nearly 22 percent) but at an accelerating rate. China's explosive growth in manufacturing exports is far greater than even the industrial powerhouses of Germany and Japan, and it's even greater than the export growth of our two neighbors, Canada and Mexico, who historically had dominated U.S. trade.

THE U.S. MUST ACT

The AFL-CIO Section 301 petition shows overwhelmingly that the two preconditions for Presidential action under Section 301 are met: First, China persistently denies the basic rights of its workers. And, second, the denial of those rights adversely affects U.S. workers.

The President has 45 days to decide whether to accept the petition and launch an investigation. If he denies the petition, he must publicly state his reasons. He must publicly declare either that China doesn't persistently violate its workers' rights, or that China persistently violates its workers' rights but that this has no effect on U.S. jobs. Either declaration would contradict the overwhelming evidence presented in the AFL-CIO petition. Indeed, Section 301 authorized the President to take action on his own initiative even before the AFL-CIO filed its petition, but he hasn't enforced Congress's will.

Section 301 authorizes the President to take any actions within his Constitutional powers to enforce fair competition and worker rights overseas. The AFL-CIO petition demands that the President take three actions to remedy China's persistent denial of worker rights:

First, the President should impose trade measures against China that are sufficiently large to induce China to enforce worker rights and to stop the unfair competition caused by China's violations. The AFL-CIO is not asking for protectionist barriers. If China enforces the basic worker rights announced by the international community, then it can enjoy normal access to U.S. markets, and it can create jobs that don't assault human dignity.

Second, in that non-protectionist spirit, the AFL-CIO demands that the President negotiate an agreement with China, to phase out the trade measures in incremental steps, as China complies with benchmarks of compliance with worker rights—benchmarks that are specific, and verifiable by the International Labor Organization, the United Nations agency responsible for promulgating and supervising international labor rights.

Third, the AFL-CIO demands that the President enter into no new trade agreements until all members of the WTO are required to comply with core worker rights, as a precondition to enjoying the benefits and privileges of WTO membership. If China alone is forced to comply with labor rights, it will complain that its producers are put at a competitive disadvantage against other countries. If China is not forced to comply, other countries will complain that enforcing labor rights will put them at a disadvantage.

Global rules should fairly enforce basic worker rights—to end the race to the bottom.

Mr. STEARNS. I thank you and I'll start with the first set of questions. Here we are, it's a little after noon and we've heard your opening statements and some of the complaints you have made are very valid and we've heard from Mr. Tonelson who indicated 23 percent unemployment.

Mr. TONELSON. Once again, that's the estimate of Charles Wolf of the RAND Corporation. Again, I—

Mr. STEARNS. I know, but I think most people would say that there are 200 million people who are unemployed in China.

Mr. TONELSON. A good way to look at it is there are more unemployed workers in China than there are workers in the United States.

Mr. STEARNS. That's a good way to put it. You can put it in perspective. So obviously the incentives are there for the people in China to work at a very low wage and when you hear Mr. Levinson what he would like to see it's a whole litany of things that he would like to see.

Mr. Attaway, I think I'll start out with you and ask you what would you like to see the U.S.-China Joint Commission on Trade accomplish for your industry? Can you just give me two or three points that would just again reiterate what you would like to see done?

Mr. ATTAWAY. Mr. Chairman, I outlined a number of specific steps we would like the Chinese government to take, but the one thing that covers everything is simply to set a timetable to reduce piracy to more acceptable levels. We would like to see the Chinese government set a goal—

Mr. STEARNS. You say in your testimony from 95 percent to less than 50 percent by the year 2004.

Mr. ATTAWAY. That's correct.

Mr. STEARNS. I mean do you think China can do that in that short amount of time?

Mr. ATTAWAY. Yes.

Mr. STEARNS. How would they do it?

Mr. ATTAWAY. They can do it—

Mr. STEARNS. Because it's a totalitarian state, so to speak, they should be able to do it better than most.

Mr. ATTAWAY. That's exactly right. They should be able to energize their law enforcement authorities.

Mr. STEARNS. You mentioned in Singapore and Taiwan they brought it down, so certainly Singapore is a free democracy and so is Taiwan. If they're able to bring it down you would think China then should be able to bring it down.

Mr. ATTAWAY. Throughout the region, when I first came to MPAA almost all of Asia was 100 percent pirate. Now most of the Asian markets are vibrant markets, not only for U.S. films, but domestic films and Korea, in particular. China can do the same thing, if it has the will to do it.

Mr. STEARNS. You heard me talk to the U.S. Trade Representative about have we lost jobs to China and he sort of indicated he could not speak on it because he was not an economist.

You said in your opening statement that the industry directly employees 500,000 U.S. workers. Can you tell me, has there been any fluctuation in this number due to piracy and if so, what quantitative analysis or statistics can you give me?

Mr. ATTAWAY. I can't give you any kind of quantitative analysis of how many more people in the United States would be employed but for the high piracy rate in China. However, it certainly—the more revenue the industry can achieve from China and elsewhere, the more money we can put into making films.

Mr. STEARNS. Let me ask Mr. Lowenstein, what in your opinion is the dollar value estimate of sales lost because of piracy and counterfeiting in China?

Mr. LEVINSON. We estimate the value of pirated software available in China is around \$500 million and that's an annual figure.

Mr. STEARNS. Five hundred million?

Mr. LEVINSON. Million. With an M.

Mr. STEARNS. Okay, and what do you think it's doing in terms of jobs in the United States? Is there any quantitative statistics that you have? Mr. Attaway said he does not have any.

Mr. LEVINSON. No, we don't have quantitative statistics vis-a-vis China, but I can tell you the typical American game software company is generating about 50 percent of its revenue by exporting games to foreign markets. Just the mere fact—and this has been a very high growth industry in the United States. So just the very fact that this huge market is effectively shut off, I would guess that a vibrant market in China could only have a salutary effect on employment in the United States.

Mr. STEARNS. Mr. Papovich, you mentioned in your testimony that the Chinese government has significantly curbed piracy in Shanghai, so now we have an example contrary to what we're hear-

ing that the China have actually done something to curb piracy. What have they done and why is it just isolated to Shanghai?

Mr. PAPOVICH. I have no idea why it's just isolated to Shanghai, but we have gotten reports in the last few months and this is very recent, that the authorities in Shanghai have put together a coordinated program, run by the city government, not by one agency competing with another agency, competing—

Mr. STEARNS. It's not a State, but it's a city government.

Mr. PAPOVICH. It's a city, but it's the biggest city in China. It's huge.

Mr. STEARNS. Sure.

Mr. PAPOVICH. They made it clear, I think this is the best way to put it, that people who are in charge, the mayor and the people around the mayor of Shanghai made it clear to all of those various people in the Shanghai government who are responsible for law enforcement that significantly reducing piracy is a city-wide priority. And we have seen the results. And the message—thank you for asking me the question because the message that I have then to the rest of the Chinese government is that this is what needs to be done. Until all of the various law enforcers around China who are responsible for all kinds of, the enforcement of all kinds of laws are instructed by someone who has that central authority like in the case of Shanghai, the mayor, that this needs to be done, it won't be done. But if someone says it must be done, it will be done.

It's not a matter of it being a totalitarian country, frankly. It's a matter of we do law enforcement. We do law enforcement here. They can do law enforcement there. For the time being, aside from Shanghai, the rest of the country from the national and the provincial and the local level has chosen not to do so with respect to our product.

Mr. STEARNS. My time has expired, but can you give specific how this has been curbed, like Mr. Attaway talked about 95 percent. He wants to bring it down to 50. Do you have statistics like that to say because what happened in Shanghai it went from 95 to 50 or something?

Mr. PAPOVICH. Coincidentally, that's exactly how much it dropped.

Mr. STEARNS. It dropped in a very short amount of time.

Mr. PAPOVICH. From 90 to 95 to 50.

Mr. STEARNS. In what kind of period of time?

Mr. PAPOVICH. I'm not certain, but I would say over 6 months.

Mr. STEARNS. Okay, my time is expired.

Ms. Schakowsky?

Ms. SCHAKOWSKY. Thank you, Mr. Chairman. Mr. Levinson, as UNITE members, you and I share a particular concern over the welfare of textile workers in the United States and in your written testimony the numbers you presented are just staggering.

China's exports of textiles and apparel are up 320 percent during just the last 2 years of President Bush's Administration while U.S. employment in the same sector has declined by 323,000.

If the President were to take action on the AFL's 301 petition, would that help the situation? Do we have hope of reclaiming those jobs?

Mr. LEVINSON. The situation in textile is a little different and in fact, we're on the verge of something much worse in textiles. The end of this year the global quota system that has regulated the apparel and textile industry for 40 years expires. That means there will be no quotas on any apparel and textile goods coming from China.

It is expected that China's share of imports in the U.S. will increase from its current level of about 13 percent to about 70 percent. That means our calculations are within 2 years of the expiration of quotas, about half a million U.S. apparel and textile workers will lose their jobs. That is why we are calling and others are calling for an extension of the quota system to head off what is really a catastrophe. This is a—and not enough people are aware of this—this is an issue really a little separate and apart from what we addressed in the 301 petition. But it's very important, nonetheless.

If what we're asking—if the administration did what we're asking for in the petition, it would definitely help and it would help not just the U.S., it would help developing countries around the world, millions of apparel workers in Africa, the Caribbean, Mexico, Asia are on the verge of losing their jobs when all quotas come off China. So for developing countries around the world, they're also facing a catastrophe here. And they simply cannot compete in an unregulated way against China with the kind of labor repression that exists there.

Ms. SCHAKOWSKY. I appreciate your getting on the record the fact of the expiration or potential expiration of these quotas and hopefully that's something that we're going to be able to address, perhaps at near future time as well.

If China enforced workers' rights, what would wages look like in China compared to the United States and wouldn't China still enjoy a significant advantage over the United States' labor force even at that level? How do we think about that?

Mr. LEVINSON. It would. And it's important to understand this distinction. China is a poor country. Even if labor rights were enforced, wages would be low. But they would not be as low as they are now. And wages would rise in China and that's good for Chinese workers. It's good for American workers. It would help China develop its domestic market. And what we point to in the petition, the job loss figures we point to are not all jobs lost to China. It's only the jobs lost due specifically to the artificial repression of wages.

So wages in China are extremely low, 15 to 30 cents an hour in some places.

Ms. SCHAKOWSKY. So when you calculate that job loss due to excessively low wages, you're not saying compared to the minimum wage or the average wage of that industry here in the United States.

Mr. LEVINSON. That's right. The figures that we point to are the job loss due to the artificial suppression of wages caused by the denial of worker rights in China and so if worker rights existed in China and wages, say tripled or even quadrupled, they would still be well, well below the levels in the U.S. and that I would argue is China's legitimate competitive advantage. What's illegitimate,

you know, it's suppressing wages even below that level which is what, in fact, exists.

Ms. SCHAKOWSKY. And on which you based your recalculation?

Mr. LEVINSON. Yes.

Ms. SCHAKOWSKY. Thank you.

Mr. STEARNS. I thank the gentlelady. You're welcome to stay. I think we're going to have another round, but I understand if you have another commitment.

I think I'll go to Mr. Primosch. You mentioned the need to halt production of counterfeited U.S. branded products. What is the impact? Do you have specific statistics or something on U.S. businesses? Most of your recommendations to address counterfeiting require changes to China's enforcement regime and what can the United States do? Can we help our own cause with better domestic enforcement or are there other alternatives to prevent this counterfeiting?

Mr. PRIMOSCH. First on the question of statistics, we don't have statistics, but just to give you an idea of kind of a global range of what the magnitude may be, there are estimates that global counterfeiting is about \$300 to \$350 billion and that China is the leading counterfeiter. In fact, in seizures worldwide by the Customs Service, I think it's between 46 and 50 percent of all the goods sold originated in China. So that's not a statistic, but it is, it gives you a sense of the scale of counterfeiting and also of China's participation in the counterfeiting.

On the question of what we can do and what the Chinese can do, certainly the Chinese can do a lot more. We've discussed here on the Panel a number of different things. I have some suggestions in my written statement. One of the most important things they can do and they have agreed to do it in a 1992 agreement with the United States is to stop counterfeit goods from leaving China at the Chinese border. And the Customs officials frequently get information on the export of counterfeit products. They are not taking action. Part of it is due apparently the result of lack of coordination, in part, it's also apparently because of the lack of clear legal authority. So we have made some suggestions on how to clarify the legal authority.

We would also like to see our U.S. Customs Service devote more time to examining imports for counterfeit products. We recognize that homeland security has to be its absolutely top priority, but we do think that more effort could be expended and that would help.

Mr. STEARNS. Mr. Tonelson, you painted a pretty bleak picture earlier for the future of the U.S. standard of living. I think you used such word as—also, you talked about possibly a deep depression, double crash, that was in China?

Worldwide.

Mr. TONELSON. If we take macro economics theory seriously, I hope that we do. We know that current U.S. trade deficits are running at entirely unsustainable levels. We know that the China deficit is an enormous and growing component of the overall total, so it's quite obvious that no one can predict the day of reckoning with any certainty, but what we do know for sure is that the farther we go down the road of the trade strategy that's been followed by this administration and the previous administration.

Mr. STEARNS. The Clinton Administration.

Mr. TONELSON. Absolutely, equally at fault, the farther and faster down this road we go, again, locking ourselves into structural deficits with enormous and extremely populous portions of the world that cannot possibly in any policy relevant future consume anything proportionate to what they can produce, the closer we get to that day of reckoning and it seems to me and to my organization that the height of responsible policy is trying to move us away from that day of reckoning, not ever closer to it.

Mr. STEARNS. So you would advocate tariffs.

Mr. TONELSON. Absolutely.

Mr. STEARNS. And tariffs across the board or in sector industries?

Mr. TONELSON. I think we need a very substantial across the board tariff on Chinese products. In fact, we are in such desperate shape with the American manufacturing sector and with our entire economy which is currently being propped up by short term financial, gimmicky low interest rates, heavy, heavy deficit spending. If we're going to put ourselves back on the path of healthy and sustainable growth, unfortunately, we're going to have to resort to substantial tariffs. Now I wish that this were not the case, but unfortunately we've gone down this road so far and so fast we have no choice. If there are any alternatives to this that are not already proven failures, I'd love to hear them.

Mr. STEARNS. You heard when I asked Mr. Freeman earlier about Mr. Samuelson's article in which he pointed out that the adverse labor conditions in China have really no effect on the United States. He said less than 1 percent. And he said protectionism will not generate job growth and so he went on to say the AFL-CIO's demand for tariffs would like invite Chinese retaliation which would have an immediate negative impact on job growth in the United States.

Most people respect him as an economist. He's been writing for many years. And so it's quite dramatic what he says compared to what you're saying.

Mr. TONELSON. It certainly is.

Mr. STEARNS. So you discount everything—you probably haven't read—

Mr. TONELSON. I haven't read it yet, but I certainly know his larger body of writing. And I was struck by this trade war point because Representative Shimkus made that also and we are talking about a U.S. market that consumes roughly 40 percent of China's exports and we're talking about a Chinese economy that at least as of 2002, according to Stephen Roach of Morgan Stanley, a very respected economist himself, with probably considerably more credentials in the field than Mr. Samuelson saying that China relied on exports for three quarters of its growth, again, an economy 23 percent unemployment rate, extremely low wages, relying for this robust growth overwhelming on exports. So the notion that there will be a trade war that we might possibly lose, I mean I don't play poker, but if I did, I would love to play it with Mr. Samuelson and in fact, with Representative Shimkus also because I think I would win a lot of money.

Mr. STEARNS. We should really have had a third panel and had the Chinese government here to talk about this too. But we're talk-

ing about some really fundamental issues. But I think we all would agree relative to the recording industry and the DVDs that have been pirated that this is something that the Chinese government can solve. I see in some of my notes in Singapore they had a policy there that was very effective and so that type of policy, Mr. Attaway, could be done in China. We've seen in Shanghai what they've done to bring it down from 95 to 50 percent, so the original purpose of the hearing was to explore what should be done and what the administration should relative to this Commission and the negotiations so I think we've laid out some of the things that should be done. But I think we're also trying to see in this committee what is the long term effect, not just in your particular industries, but what is the long-term effect in our present trade policy? Obviously, Mr. Samuelson has one particular view and you people have another and Mr. Levinson, is there anything you'd want to add what he mentions in terms of he paints a pretty bleak and dire picture? Do you sort of agree with him here?

Mr. LEVINSON. Yes, and I would just reiterate the point that China needs the U.S. market and as you said in your opening statement we should use the access to that market to achieve ends that we all believe in.

Mr. STEARNS. When you talk about a lot of the information you provide, is that true in the State-owned as well as the public industries? Does that apply to both of them, is it applicable?

Mr. LEVINSON. The petition that we submitted focuses on the migrant workers in China which for the most part work in the vast export sector.

Mr. STEARNS. I'm going to ask a few more questions and I think we've heard that one member would like to come down and ask some questions, so I'm going to continue before I close here.

Mr. Attaway, the administration has said they prefer to resolve trade concerns through a collaborative method like the JCCT. Now what happens if it's not successful? I'd like to ask, just go down here and tell me if it's not successful, what would you think should be done, what should be necessary to curb the piracy and put on the record some of your suggestions in the event nothing happens here.

Mr. ATTAWAY. In the unhappy event that negotiations are not successful, then the only alternative is for the U.S. Government to exercise its rights under international agreements, including the WTO. Now I am hopeful—

Mr. STEARNS. Take the court to the WTO and then fine China?

Mr. ATTAWAY. That's correct. I'm hopeful that won't happen, but that's the alternative if negotiations don't work.

I'd also like to point out one of the fellow panelists was talking about erecting barriers to imports into the United States. Well, I represent an industry that does what it does better— Mr. STEARNS. You have a surplus.

Mr. ATTAWAY. Than any other country in the world.

Mr. STEARNS. One of the few.

Mr. ATTAWAY. And when you start erecting barriers, we're the first American industry to be harmed because then other countries erect barriers to our exports.

Mr. STEARNS. Mr. Lowenstein, also what would you suggest?

Mr. LOWENSTEIN. I would echo Fritz' comment and hope that the JCCT process and the voluntary cooperative process is successful and we're certainly hopeful it will be. If it's not, then I think every remedy and option available to the American government has to be on the table and evaluated forcefully and used aggressively.

I'd also like to add one other point on the broader question here because I think on the one hand enforcement we've all talked about is the touchstone of progress in China right now and I think we all agree and the example in Shanghai is a rather visit testimony to how quickly the situation can improve with enforcement and the will to enforce.

It is a mistake to think it's only about enforcement though. There are, as we've outlined in our testimony, very clear deficiencies still in specific areas of the law in China. We talked about, I talked about the organized crime statute. I talked about the NET Act type laws that we have here that they don't have there.

Mr. STEARNS. The whole judiciary side.

Mr. LOWENSTEIN. Well, not judiciary, but the legal side. There is still deficiencies in the policy framework. There are no laws to criminalize trafficking and circumvention devices that I showed you earlier. So we need to keep our eye on both sides of the equation.

Mr. STEARNS. So actually we probably need to somehow ask them to put in place the legal remedies at the same time we're asking for the enforcement?

Mr. LOWENSTEIN. Absolutely.

Mr. STEARNS. And Mr. Primosch, my question is in the event that the Commission does not adequately solve this problem, what would you suggest? I mean Mr. Attaway, each of them are giving, so I'm just going to go down.

Mr. PRIMOSCH. A slightly different amplification. We believe that we should use our rights under our U.S. law, but also and under international treaties and the WTO rules, but we feel very strongly that whatever action we take should be within the WTO rules because we can also be hurt if we violates those rules and that's what concerns us about the AFL-CIO petition is that there's no allegation that the international trade rules have been violated and that we would have to take unilateral action which would violate our obligations and it's very difficult for us to tell the Chinese, you're not living up to your WTO obligations when we are not doing it ourselves.

And you know, exports are so important. We tend to forget when we think about job losses, we tend to think of oh, it's imports that are causing so many job losses. We estimate that we have lost 900,000 jobs over the past 3 years because our exports have declined and actually imports have been relatively level. So we need to keep both parts of the equation in mind. Exports are very important for the U.S. economy and for U.S. manufacturers. The United States is the largest manufacturer in the world. We're also the largest exporter of manufactured goods. We have to keep that in mind.

Mr. STEARNS. My time has expired and Mr. Stupak is here, so I'll let my colleague, I recognize him.

Mr. STUPAK. Well, thank you, Mr. Chairman. I'm sorry, I've been bouncing around all day, but it's just one of those days.

When I was asking Mr. Freeman questions about intellectual property rights, and I mentioned back in the 1990's we sort of had the same problems there and I was really, Mr. Lowenstein and Mr. Attaway, your statements and some of the visuals you had were quite revealing. Now back in the 1990's, we did crack down with China on the piracy and the counterfeiting things. Why can't we use that same mechanism to go to the film industry or to the games or why can't we use that same kind of scheme that we used back then to crack down on the illegal CDs that were going on?

Mr. ATTAWAY. We can. In the late 1990's the export market from China was growing tremendously and USTR negotiated actions by the Chinese government that pretty much shut it down. Unfortunately, now it's coming back again. But they can do it. It can be done, it just is a matter of the will to do it and that's what we hope will come out of this joint committee meeting.

Mr. LOWENSTEIN. I would echo that. I think it's sort of the Yogi Berra deja-vu all over again. We see this with the Chinese government. There is a pattern. You reach the brink. He negotiate agreements. Progress is made. Then several years later you seem to be arguing the same issues all over again.

I don't think there's any question as Fritz said that one, there's a question of will and as I was saying earlier there's also a question of changes still in some of the fundamental legal areas, but I think that the fundamental point is that it's absolutely crystal clear progress can be made where the will is there to make the progress.

Mr. SHIMKUS. I was really amazed at the pictures that you showed of the factory producing counterfeit cartridge products. I mean obviously you know where they are and where they're doing them. I just can't for the love of me can't figure out why the administration is being so slow because if you take a look at it, it's \$18 billion or a couple percentage points of the gross domestic product and your video sales there went from \$20 million, you started off, to nothing, but yet the number of DVD players and VCRs have gone up in the country. It just defies logic that we would just sit back and do nothing about it when we have a pattern we can follow.

In the enforcement of time certain, I think, one of my colleagues asked that, have you suggested that to the administration, like the end of the year 2004 was one of your testimony to cut back like 50 percent and go from there? Have you suggested that to the administration and if so, what's been their response?

Mr. Attaway, it might have been your testimony, I guess.

Mr. ATTAWAY. Absolutely, we have suggested it and I believe that that is one of USTR's negotiating objectives. They haven't succeeded as yet, but as I stated earlier, I'm hopeful that they will.

Mr. STUPAK. This JCCT negotiation that's supposed to happen in April, is that going to be one of the issues you're going to bring up? Are you reasonably confident you're going to bring it up and push it?

Mr. ATTAWAY. That is my understanding and expectation, yes sir.

Mr. STUPAK. Mr. Primosch, on manufacturing, I've always said in order to have a strong economy any nation has to have a certain percentage of manufacturing as part of its base economy. Could you

give me some estimation of what you think that base economy should be? I mean is it 18 percent, 20 percent?

Mr. PRIMOSCH. I can't give you that kind of estimate. I can tell you though that the manufacturing as a percentage of our gross national product has remained relatively stable over the past 5 years.

Mr. STUPAK. What percentage is that?

Mr. PRIMOSCH. I think it is around 18 percent, 15 to 18 percent.

The employment has gone down steadily. A lot of that is due to probably most of it is due to productivity gains. U.S. industry is very productive and in a broad sense it is very strong and very dynamic and in many areas extremely competitive in the global marketplace, but it is challenged as never before and there's no question that China is part of that challenge, a big part of that challenge.

Mr. STUPAK. I've been here for a number of years, along with the Chairman. We started with NAFTA and a number of these trade agreements and I don't think it's just trade agreements, it's our tax laws that give incentives. We don't tax on foreign profits, things like that. There are numerous things we should do. But I guess my question I sort of alluded to with Mr. Freeman was back when NAFTA was going through this, okay, you're going from manufacturing to the computer age and from computers where do we go next? Some say it's the knowledge age.

Where do we go as a country and can we maintain an economy where manufacturing jobs stay on the average of about 44,000; service industry is about 23,000; and retail is about 19,000. So what's the next movement? What do I tell my people in northern Michigan, you lost your manufacturing job, they went back and got trained in computers and all that's been outsourced. Where do they go next?

Anyone care to comment on that?

Mr. PRIMOSCH. Can I just make one comment? I mean I certainly cannot predict where U.S. industry is going. We have a very strong industrial base, but I think one of the things that we need to be more focused on in this country is how do we continue to make the United States an attractive place to invest in manufacturing. I think that's very important for your State. And I think what we've found, we published a study in December of last year. You may have seen it. It's a study on relative cost of manufacturing around the world. We compared the United States with those of other countries and we found, I think, a very disturbing result that the nonproduction costs for manufacturers in the United States are about 22 percent higher than they are compared to our major competitors in Europe and Japan. And that this is a factor that is driving manufacturing out of the United States and I think we have to face up to this, legal liability costs, the high cost of energy, regulatory burdens, a variety of—the rising cost of health care, a variety of costs that are really putting our manufacturers at a disadvantage.

Mr. STUPAK. Yes sir.

Mr. ATTAWAY. If I can make just three quick points about the high cost of doing business in this Nation. First of all, we're a First World country. We should be happy about that. We've got First

World incomes. We've got First World levels of social services and they require First World levels of taxation. Three years ago, I published a book on globalization titled *The Race to the Bottom*. I hear a lot of talk again from the multinational business community that the only way the United States can remain competitive in its manufacturing is to start reducing cost levels toward Third World levels. I don't think most Americans want that. I don't think that Congress would possibly approve that and I don't think that would be good for our Nation as a whole.

The second point is that many of the multinational companies that are sending so many jobs overseas, whatever their effective tax rate is don't actually pay taxes. They're very good at avoiding taxes. So I'm not quite sure how much of a real issue this is as opposed to again what the rates look, what the rates look like on paper.

And the third point would be that if we continue to see our best paying jobs go overseas which are not only now manufacturing jobs which pay the highest wages on average in the whole economy, but the higher paying service jobs, IT jobs, professional jobs, we're not going to have a tax base. Unless we retain lots of high income jobs and unless they are the types of jobs that ordinary Americans most of whom still, the great majority of whom, three fourths, roughly, do not finish 4 years of college, can realistically hope to assume and that situation no matter what we do with our educational system will be with us for decades, I'm sorry to say, but it will be, and we have to face facts.

Unless ordinary Americans can hope to hold high wage jobs, we will have no tax base.

Mr. STUPAK. Mr. Levinson, did you want to say something. You're the one economist, the chief economist.

Mr. LEVINSON. Yes, I just want to reiterate the point that what's happening in manufacturing in the United States today is not business as usual. This is a crisis. Forty-three consecutive months of employment declines; 2.8 million jobs lost since this administration took office. This is a crisis. It is lowering the standard of living of the workers I represent and it is not sustainable, I believe, if the point is to maintain the American standard of living.

Mr. STUPAK. Thank you. With that, Mr. Chairman, than you for your courtesies.

Mr. STEARNS. Yes, I thank you. And we have concluded our questions for the second panel. I appreciate you staying over while we voted and also I thank you for your time, for coming here and I think we had a very successful hearing and I think my colleagues who did show and the subcommittee is adjourned.

[Whereupon, at 1:01 p.m., the hearing was concluded.]

