CURRENCY MANIPULATION AND ITS EFFECT ON U.S. BUSINESSES AND WORKERS

HEARING

BEFORE THE

SUBCOMMITTEE ON TRADE

OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

JOINT WITH THE

SUBCOMMITTEE ON COMMERCE, TRADE, AND CONSUMER PROTECTION

OF THE

COMMITTEE ON ENERGY AND COMMERCE

AND THE

SUBCOMMITTEE ON DOMESTIC AND INTERNATIONAL MONETARY POLICY, TRADE, AND TECHNOLOGY

OF THE

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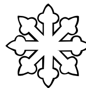

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CURRENCY MANIPULATION AND ITS EFFECT ON U.S. BUSINESSES AND WORKERS

WEDNESDAY, MAY 9, 2007

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON TRADE, JOINT WITH

COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON COMMERCE, TRADE, AND
CONSUMER PROTECTION, AND

COMMITTEE ON FINANCIAL SERVICES,
SUBCOMMITTEE ON DOMESTIC AND INTERNATIONAL
MONETARY POLICY, TRADE AND TECHNOLOGY
Washington, DC.

The Subcommittees met, pursuant to notice, at 9:39 a.m., in room 1100, Longworth House Office Building, Hon. Sander Levin (Chairman of the Subcommittee on Trade, Committee on Ways and Means) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON TRADE

FOR IMMEDIATE RELEASE CONTACT: (202) 225–6649
May 02, 2007
TR–4

Chairman Sander M. Levin Today Announced A Tri-Partite Subcommittee Hearing On Currency Manipulation and Its Effects on U.S. Business and Workers

Ways and Means Trade Subcommittee Chairman Sander M. Levin today announced a tri-partite subcommittee hearing on currency manipulation and its effects on U.S. business and workers. Three subcommittees will participate in the hearing: the Ways and Means Subcommittee on Trade; the Financial Services Subcommittee on Domestic and International Monetary Policy, Trade, and Technology; and the Energy and Commerce Subcommittee on Commerce, Trade and Consumer Protection. **The hearing will take place on Wednesday, May 9, in the main Ways and Means Committee hearing room, 1100 Longworth House Office Building, beginning at 9:30 a.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be heard from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the three Subcommittees and for inclusion in the printed record of the hearing.

FOCUS OF THE HEARING:

The purpose of this hearing is to consider: (1) whether, and to what extent, the Chinese renminbi (RMB) and the Japanese yen are undervalued as a result of foreign government intervention in the currency markets; (2) the immediate and long-term impact an undervalued RMB or yen has on the economies of the United States and other countries and on the global economy; and (3) what action, if any, the United States should take to address exchange rate manipulation.

BACKGROUND:

Over the past several years, economists and U.S. stakeholders have expressed growing concern regarding the value of the RMB and the yen, and the role of the Chinese and Japanese governments in determining those values.

For over ten years, China has fixed its exchange rate by intervening in currency markets. Economists have estimated that the RMB is undervalued by at least 9.5 percent and by as much as 54 percent, according to a recent survey by the Congressional Research Service. In July 2005, China began to allow the RMB to appreciate, and it has appreciated 7.3 percent since then. Nevertheless, in December 2006, U.S. Federal Reserve Chairman Ben Bernanke stated that the currency situation "has likely worsened recently," as the RMB's trade-weighted effective real exchange rate has fallen about 10 percent over the past five years. He described the Government of China's currency policies as a "subsidy to exports" from China. The Government of China must accumulate foreign exchange reserves to maintain the fixed exchange rate. As a result, the Government of China today holds more than $1.2 trillion in foreign exchange reserves—more than any other country in history. (U.S. government foreign exchange reserves are approximately $69 billion.)

Although Japan has not formally intervened in its currency market since 2004, the Japanese yen has been described by *The Economist* magazine recently as "perhaps the world's most undervalued currency." This year the trade-weighted value of the yen fell to its lowest level in more than 30 years. J.P. Morgan recently estimated that the yen was 14 percent undervalued relative to the U.S. dollar. As a result of currency interventions in the recent past, the Government of Japan now holds over $900 billion in reserves, the second highest level in the world.

In 2006, the U.S. goods trade deficit with China was $232.5 billion (a world record) and $88.4 billion with Japan. An undervalued RMB or yen could contribute to these deficits, although other factors, including disparities in personal savings rates, also may play a role.

The Omnibus Trade and Competitiveness Act of 1988 (P.L. 100–418) requires the Secretary of the Treasury to determine whether foreign countries manipulate their exchange rate with the U.S. Dollar for the purpose of "gaining unfair competitive advantage in international trade." Such a finding would require the Treasury Secretary to initiate negotiations on an "expedited basis" for the purpose of eliminating the unfair advantage. The Treasury Department has repeatedly declined to find that either China or Japan manipulates the rate of exchange. The Treasury Department was required to submit its most recent report to Congress on international economic and exchange rate policies on April 15, 2007. That report has not yet been submitted to Congress.

The Office of the U.S. Trade Representative (USTR) also has decided not to investigate China's currency practices under Section 301 of the Trade Act of 1974, or to initiate a World Trade Organization (WTO) case to address these practices. In September 2004, members of the public (the "China Currency Coalition") and several Members of Congress requested a Section 301 investigation. USTR refused the request, stating that an investigation would be counterproductive to Treasury's efforts toward achieving a more flexible, market-based exchange rate for the RMB. Members of Congress filed another petition seven months later, in April 2005. USTR again declined to accept the petition, but acknowledged that "China is now ready to move toward a flexible, market-based exchange rate and should move without delay in a manner and magnitude that is sufficiently reflective of underlying market conditions." In December 2006, Chairman Bernanke again called for a "greater scope for market forces to determine the value of the RMB".

The Administration has engaged China on the currency issue under the "Strategic Economic Dialogue" (SED). The first SED took place in Beijing in December. The next SED will begin in Washington, D.C., on May 23, 2007.

"This is an innovative hearing to address the serious problem posed by currency manipulation," stated Trade Subcommittee Chairman Levin, in announcing the hearing. "Currency manipulation places American workers, farmers and businesses at a competitive disadvantage and this Congress will work with the Administration to hold trading partners accountable to the rules of trade."

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "110th Congress" from the menu entitled, "Committee Hearings" (*http://waysandmeans.house.gov/Hearings.asp?congress=[18]*). Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, completing all informational forms and clicking "submit" on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You MUST REPLY to the email and ATTACH your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business **Wednesday, May 23, 2007**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and ***MUST NOT*** exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://waysandmeans.house.gov*.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman LEVIN. I think we will start. If everybody could take their seats, we are a couple minutes late.

This is the first of two hearings, the first scheduled for this morning at 9:30, and there are two for seven witnesses. Then at 2:00 o'clock we will reconvene to hear from three representatives of the administration. So hopefully all of us will be able to return, because we want very much to get the reactions of the administration, the Assistant Secretaries of Treasury, Commerce and USTR, to the testimony that we have all heard this morning.

As you can see, this is a rather unusual hearing. I don't know that we have held a hearing with three Subcommittees before. What we are going to do is ask the chair and the ranking of each of the three to make a brief opening statement. I know the practice has varied Committee to Committee.

But I hope it is acceptable that everybody else who has an opening statement will submit them for the record. If there is no objection, we will proceed on that basis.

Then after the opening statements, we will proceed with the witnesses.

In the case of Energy and Commerce, Mr. Rush will be recognized and he will have the privilege of yielding to the Chairman of the Committee.

This, as I said, is an unusual hearing, three Subcommittees. The reason why is because this is an exceptional issue. There clearly is an exceptional problem.

We have unusual trade balances. We have unusual reserves held by two countries, historic, two trillion plus among them. We also have currencies that virtually everybody acknowledges are very much undervalued.

We have had in the case of China statements that they were going to take steps. But today, in part because of their intervention, it is not the only reason. In real dollar terms, the valuation problem remains the same.

With Japan, we have a somewhat different situation, in the sense that for the last years there hasn't been direct government intervention. But what we have had are government policies leading to the same situation. For example, *The Economist* magazine recently said that the yen was perhaps the world's most undervalued currency.

I close by just saying, and we will have testimony as to this, this has had real life impact on the United States, on its businesses and on its workers.

I met several weeks ago with companies, most of them small and middle size companies, often family-owned, in the fiber business. The raw materials that they use are essentially the same throughout the world. The cost to them is essentially the same. But what has happened is that there has been an influx and often the cost of the final product is about the same in those cases of imports as the cost of the original resource. These companies made it clear that one of the problems was the undervaluation of the currencies in the countries with whom they are dealing.

So, we have called this unique hearing. Someone asked has it happened before, and Mr. Dingell has been here the longest, and I don't think he can remember when there were three Subcommittees holding a hearing together. It is because of the importance of the problem and the fact that it hasn't been resolved.

We are today where we were years ago. We need to consider the next steps by the administration and also next steps that we can take legislatively. So, this is the real thing, this hearing, to get at a real problem leading hopefully to real action.

Mr. Herger, for your opening statement. Mr. Herger is ranking on the Subcommittee on Trade.

Mr. HERGER. Thank you, Chairman Levin. Today's issue is multifaceted. Yes, China's currency is unacceptably undervalued, which makes our exports less competitive. Yes, we run a large trade deficit with China because we import more from China than we export there. But although we demand more from China, we recognize that China's financial institutions are too fragile for us to reasonably expect an immediate, market-driven reevaluation of the RMB.

Japan's presence presents an easier challenge. The yen is weak, but Japan has not overtly intervened since 2004. Secretary Paulson has stated that the yen's value naturally reflects Japan's sluggish economy, not government policy.

As for the deficits, currency is not the lone culprit. Americans have been overspending and undersaving. In China and Japan, it is the reverse. We have created huge import demand in United States both for inexpensive consumer goods and manufacturing inputs which has kept inflation in check and provided our companies

with inputs needed to stay competitive, but has also fueled the deficit.

We can improve the deficit, not so much by curtailing our imports but by increasing demand for our exports, working with the Chinese and Japanese to reduce savings and increase consumption of our goods.

We also need to work with China to develop its financial services so that it can float its currency. The administration has made some progress, but more is needed. I hope that the SED talks later this month will bring us further progress.

But the lingering, more difficult question is, what do we do in the near term to address currency and undervaluation? Our approach must weigh the risks of too rapid a change in currency policy and domestic risks for the Chinese economy against the problems inherent in an exchange rate that is not market based.

My fear is that we force the Chinese to create a more flexible currency, we get what we have asked for, and then we see little or no impact on U.S. jobs or exports. Former Federal Reserve Chairman Greenspan shares this concern.

Given the complexities, perhaps it is easier to start with what we ought not to do. Some may say a retaliatory tariff is the solution. But retaliation should be a last resort, and I don't think we're there yet. We need to think carefully and act constructively.

I can't help but recall the overbroad Smoot-Hawley tariffs of 1930, which caused a drastic decline in international trade and contributed to the Great Depression. These tariffs and other beggar-thy-neighbor policies eroded trust among nations when international cooperation was needed most.

Both for economic and political purposes, we in Congress owe U.S. businesses and workers more than merely throwing up our hands in frustration, slapping punitive tariffs on imports and then moving on to the next problem. For starters, we need to insist that China comply with its WTO obligations, especially subsidies and intellectual property. We need to implement more export promotion programs for our small and medium-size enterprises. We need to allocate more resources to streamline the visa process for our Chinese customers and partners. Finally, we need to help the Chinese set technical standards that our companies can meet.

Let us focus on the total picture. This is too important to let our frustration get the better of us.

Chairman LEVIN. Thank you. Mr. Gutierrez.

Chairman GUTIERREZ. Good morning, Chairman Levin. I want to thank you for agreeing to convene and host this hearing, and I would like to thank Chairman Rush for your participation and for helping me ensure that we put a Chicago stamp on the proceedings.

This format is certainly unconventional but I think it's appropriate to highlight the difficult and unconventional problem we face in addressing currency misalignment or manipulation by China or Japan.

For the American economy and the American worker, currency undervaluation by China in particular is reaching critical mass. For over 10 years, China has fixed its exchange rate by intervening in currency markets. Economists estimate that the RMB or yuan

is undervalued by at least 9.5 percent and by as much as 54 percent. Many economists, including Federal Reserve Chairman Bernanke, characterize this underevaluation as a subsidy for exports from China.

We will hear from our witnesses on today's first panel about the impact of this subsidy on Chinese goods has on the U.S. economy, and the American worker. Suffice it to say, we cannot compete with this kind of ongoing government subsidy and we cannot continue down the path with our second largest trading partner, because the imbalance hurts U.S. workers and businesses and threatens the long-term stability of our economy and our relationships.

In 2006, the U.S. goods trade deficit with China rose by almost 15 percent to nearly $233 billion, a historic high. Meanwhile, because the Chinese government must buy U.S. dollars to keep the value of the yuan low, China holds more in foreign exchange reserves than other country in history.

Although there are other factors in play, the Chinese government's daily intervention in the currency market plays a key role in expanding U.S. trade deficit.

When it comes to Japan, economists indicate that the yen is at its weakest level in real trade weighted terms in more than 20 years. This clearly benefits Chinese exporters at a time—at the expense of U.S. manufacturers.

In the case of China, some economists believe that no matter how much pressure we exert, Beijing will not allow the yuan to fluctuate, and any attempt we might make would be futile or even counterproductive. It is okay that some experts believe it is impossible to get China to move on this issue; I can accept that. But keep in mind that many experts on Capitol Hill would say it is impossible to get Financial Services and Energy and Commerce to appear on the same dais together and here we are.

I hope that our Subcommittees from three exclusive House Committees coming together today will send a powerful message to the administration that Congress is serious about the problem of currency undervaluation in Asia and that we intend to put turf battles aside and focus on resolving this matter of utmost importance to our economy and the well-being of our workforce. Even more, I hope this hearing will send a strong message to U.S. manufacturers and American workers. We hear you and we are serious about tackling this problem.

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

Chairman LEVIN. I think I will call next on the Ranking Member, Dr. Paul, and then the Chairman of the Committee has joined us.

So, if I might, Dr. Paul, you wanted to say a few words, and then Barney.

Mr. PAUL. Thank you, Mr. Chairman. I have a brief statement, but I would ask unanimous consent my complete statement be placed in the record.

Chairman LEVIN. So, ordered.

Mr. PAUL. Mr. Chairman, the imbalances in international trade and, in particular, trade between China and the United States, have prompted many to demand the realignment of the Chinese

yuan and the American dollar. Since we are running a huge trade deficit with China, the call now is for a stronger yuan and a weaker dollar. This trade imbalance problem will not be solved so easily.

If a stronger yuan is implemented, increased exports to China from the U.S. may or may not resolve. The weaker dollar may lead to higher U.S. prices and crowd out hoped-for benefits of a realignment of the two currencies.

One thing certain is that the immediate impact would be higher prices for consumer goods for middle class Americans. In many ways, a weaker dollar would act as an import tax, just as if it were a tariff. Both are considered protectionist in nature.

The fact that the Chinese keep their currency artificially weak is a benefit to American consumers, and long-term is inflationary for the Chinese. This deep and legitimate concern for the trade imbalance between China and the United States will fall short if the issue of fluctuating world fiat currencies is not addressed.

The fact that the U.S. dollar is the principal reserve currency of the world gives us a benefit that others do not enjoy. It allows us to export paper dollars and import goods manufactured in countries with cheap labor. It also allows us to finance the welfare, warfare state with cheap loans from China and Japan. It is a good deal for us but, according to economic law, must come to an end and the end will be messy for the U.S. consumer and world trade.

The current system can only last as long as the trust in the dollar is maintained and foreigners are willing to accept them as if they had real value. Ironically, the most serious problem we face is a sharply weakening dollar in danger of collapse. Yet many are now asking for a policy dealing with the Chinese that would accelerate the dollar's decline. At the same time, we're told that we maintain a strong dollar policy.

Financing deficits with monetary inflation is in itself a weak dollar policy in the long term. Trust in our currency due to our economic and military strength artificially props up the dollar on international exchange markets. Since these benefits come not from production or sound monetary policies, they only contribute to the instability and imbalances of international trade. Neither tariffs nor forced devaluations can solve the problem.

Our current account deficit and huge foreign indebtedness is a reflection of the world monetary system of fiat money. The longer the trade imbalances last, the more difficult the adjustment will be. The market will eventually force these adjustments to come. Eventually, it will be necessary to consider worldwide commodity-based money to solve the trade imbalances that concern so many here in the Congress.

I yield back.

[The prepared statement of Mr. Paul follows: PENDING]

Chairman LEVIN. Thank you. Chairman Barney Frank.

Chairman FRANK. Thank you, Mr. Chairman. I assume people have taken account of the fact that Subcommittees from three of the major Committees in this Congress have assembled. That is the first time in my memory this has happened. If my memory doesn't impress, the dean of the House seated to my left has a memory even greater and I think it is probably the same for him.

I hope people will take from this the grave significance of this issue. I say that because I read the testimony and there are people of goodwill who disagree with the approach we are taking. I want to make it very clear to people that if you disagree with this approach, and I am very supportive, I want to say, of what the Chairman of the Subcommittee on Trade has outlined, I think he has been consistently one of the most articulate and thoughtful exponents of what American international economic policy ought to be, and if people had listened to him, we would be a lot better off.

But for those of you who disagree, I think you want to come up with an alternative. People have talked about the dangers in this approach. That is a legitimate argument. But in the absence of an alternative, that is what is going to happen.

The fact is that the economic position of the average American worker has been eroding. It is one thing to see your position erode when conditions are bad. It is much worse when you are being told how there is great growth and great prosperity but you are not profiting from it.

We had a period that now looks like it was a brief period, when real wages had started to go up and now they are starting to go back down again. You know, we continue to have a situation, and I read it in the financial pages even of so-called liberal newspapers, there is a good news bad news story. The good news is that profits are up. The bad news is that wages are up.

As long as that is the mindset of the people who run the financial operation, you are going to have these kinds of responses.

Now, I think what we have here is temperate and reasonable. If you disagree, then come up with an alternative. I will give an example. Dr. Roach, whose commentary on the economy has seemed to be very good and has helped, I think, try to alert the business community of some of the imbalances that we are talking about, and Dr. Roach says in his testimony, and I hope I am not giving away the ending unfairly, that he finds better than this approach the recent decision by the USTR to go after China for violations of intellectual property.

You know, if they had done that 10 years ago, maybe things would be different today. This is a good example. But the fact is that there was no serious effort by the U.S. Trade Representative to vindicate the interests of American intellectual property until we in Congress thought of these complaints.

If people are going to ignore problems and ignore the economic deterioration of the average worker until we get involved, and then it is not, it seems to me, reasonable to sit back and criticize, only criticize. People have a right to criticize. But simply to criticize our response to a problem that other people have long ignored just isn't going to work. As I say again, I think the Chairman has taken a very reasonable approach.

But this is not going away. If this is not the approach, then there better be some other one. If you think if you can talk the American worker out of her dissatisfaction with an economy in which there is growth and she gets very little of it, you are wrong. We are going to have to act.

So, I appreciate the fact that we have had this three-pronged hearing. The Committee on Ways and Means, the Committee on

Energy and Commerce, the Committee on Financial Services represent among us the economic jurisdiction of this Congress in the legislative context. What you see here is symptomatic of a determination on the part of those of us who are in the majority in Congress today to change the situation in which growth in the economy as a whole and an increase in the well-being of the average worker have become disconnected. We believe this is one way to deal with that.

Those of you who don't think this is the way to deal with it, in your own interests, ought to come up with another.

Thank you very much.

[The prepared statement of Mr. Frank follows: PENDING]

Chairman LEVIN. Thank you very much.

You mentioned the third Committee, of great importance. Let me suggest, Chairman Rush, if it is agreeable to you, I think I will call on Chairman Dingell, and then you will take over for your 5 minutes and then Mr. Stearns. Okay?

Chairman Dingell.

Chairman DINGELL. Mr. Chairman, I want to thank you for your leadership in this matter, and also our good friends and colleagues, Chairman Rangel and Frank. Also Subcommittee chairmen Rush and Gutierrez. Of course, I can't say enough about my good friend and colleague from the Commerce Committee here.

I also want to thank our distinguished witnesses for their testimony and willingness to participate, particularly my old friend Secretary Evans, who is down there, and Mr. Mohatarem.

Currency manipulation stifles the intention of free trade and must be dealt with decisively. For too long, the Department of the Treasury has been reticent to cite countries such as Japan, China and Korea for currency manipulation, in spite of clear evidence that they have used such policies to gain an unfair trade advantage against the United States. These countries and others must not be allowed to continue in this illegal trade-distorting practice.

Since 1994, the Treasury Department has not cited a single country for currency manipulation. Japan, however, was estimated in 2006 alone to have a current account surplus of 167 billion and a bilateral trade surplus with the United States that exceeded $88 billion.

Strong evidence exists that Japan has manipulated its currency in order to facilitate an export-led growth strategy to the detriment of our people and the United States economy. Although Japan ceased direct currency interventions in 2004, its government has engaged in verbal interventions in order to keep the value of the yen artificially low. Additionally, it has encouraged banks and pension funds to buy great numbers of U.S. Treasury bonds. This, in combination with historically low Japanese interest rates and other practices artificially decreases the yen's value.

By maintaining a current account surplus and bilateral trade surplus with the United States, and also manipulating its currency for the purpose of gaining an unfair trade advantage vis-à-vis the United States, Japan fulfills the three necessary and sufficient criteria for currency manipulation as outlined in the 1988 Omnibus Trade and Competitiveness Act. Nowhere in the United States Jap-

anese trade are the effects of a weak yen more pronounced than in the automobile industry.

The weak yen provides Japanese auto makers, who now enjoy a 35 percent market share in the United States, with record profits. Indeed, the manipulated yen/dollar exchange rate results in what amounts to a $2,400 price advantage to Japanese auto makers on a $20,000 vehicle.

Some, I think those who think about it, would term this an export subsidy. In light of this, it should come as no surprise that Toyota's 2006 third quarter profits were bolstered by $250 million as a result of yen/dollar exchange rates.

As I represent a part of Michigan that has seen tens of thousands of auto manufacturing jobs disappear in the last decade, this trend is most troubling to me and the people I serve. I am further concerned by the Department of the Treasury's continuing reluctance to cite Japan as a currency manipulator, despite the fact that Japan seems to have fulfilled all of the necessary criteria outlined in the law. Thus, I am forced to conclude that it is incumbent upon this Congress to pass legislation that would require the administration to monitor and to address unfair foreign currency practices more adequately, so as to allow for more effective adjustments in international balances of trade.

I hope that our panelists will speak to my concerns and suggest solutions to amend current law pertaining to currency manipulation in order to give our nation the tools it needs to combat this clearly trade distorting practice.

I would like to conclude by observing, Mr. Chairman, that the fact that three major Committees of this Congress, all having jurisdiction over matters related to the hearing today are conducting these hearings with the vigor in which they are conducting them should serve as a warning to all that the Congress is losing patience with the Administration on this important matter.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Dingell follows: PENDING]

Chairman LEVIN. Thank you, Mr. Dingell.

Chairman Rush.

Chairman RUSH. Thank you, Mr. Chairman. I would like to thank my colleagues for agreeing to hold this historic trinitarian Subcommittee hearing as well as I would like to also thank our witnesses today for their participation in these hearings.

My special thanks also to Mr. Bill Hickey of Lapham-Hickey Steel Corporation. While his company's Chicago facility is not in my district, I would like to join with my colleague, Congressman Gutierrez from the Chicago City Council to extend a warm welcome to him as two Chicagoans to another.

Several of our major trading partners, China, Japan and Korea included, have long intervened in currency markets in order to drive down the value of their respective currencies, much to the detriment of the American economy and job market. This practice which has for years continued unimpeded by action on the part of this administration, must be curtailed so that the U.S. may preserve its manufacturing job base and trade with its partners on a level field of play.

It is imperative that this Congress voice its most stringent opposition to this practice, which will force unsustainable economic development for some and unfair trade imbalances for others. Moreover, my colleagues and I must work together in order to provide this nation with more adequate and precise instruments with which to address and catalog the effects of currency manipulation.

As my Chairman, my colleague and my friend Chairman Dingell has stated, the Treasury Department has neglected to cite any foreign country for currency manipulation since 1994. In two of our major trading partners, China and Japan, we observe their accumulation of massive current account and bilateral trade surpluses.

In addition, these countries have ostensibly engaged in currency manipulation in order to achieve export led economic growth. These three indices constitute the necessary and sufficient conditions for which the Treasury Department may classify a country as a currency manipulator.

Given this, I am deeply troubled by the Treasury Department's reluctance to reach what would appear to be a common sense assessment of the illegal currency practices of two of our largest trading partners.

In a 2005 report entitled Treasury Assessments Have Not Found Currency Manipulation, but concerns about exchange rates continue, the GAO concluded that while the Treasury Department has general complied with the reporting requirements for its exchange rate reports, its discussion of U.S. economic impacts has become less specific over time.

Indeed, in its response to that report, the Treasury Department stated that it does not consider the impact of the exchange rate on the economy. In light of increased imports from both China and Japan which could partially be attributed to the interventionist currency policies as well as the decline in our own export industry, it seems irresponsible to me on the part of the Treasury Department to ignore the effects of foreign exchange rates on the U.S. economy.

I appreciate the calls by many economic and policy analysts that currency policy be conducted under the framework of a broader, multilateral process. But in an absence of any meaningful action by either the IMF, which itself has no enforcement mechanism for currency disputes, or the WTO, it is my conclusion that this Congress must pass legislation that will further empower the United States to counter the pernicious and trade-distorting effects of currency manipulation by other countries.

Let me close by noting that this is not an abstract problem that resides in the world financial markets. Currency manipulation has a very real and devastating effect on average Americans looking for decent jobs.

I represent the South Side of Chicago and neighborhoods like the Inglewood community were once thriving middle class neighborhoods. However, as the manufacturing base collapsed, when the steel mill jobs disappeared, prosperity vanished from Inglewood and other communities on the South Side of Chicago. Without jobs, without income, without economic stability it is impossible to build and sustain thriving, healthy communities. Thus, when currency manipulation undermines America's ability to compete overseas, it

is also undermining our ability to provide well-paying jobs here at home. This is a matter to be taken seriously.

I look forward to the testimony of all of our witnesses and hope that they will shed greater light on the steps that the Congress must take in order to provide our Nation with stronger and more effective tools to address currency manipulation. Thank you, and I yield back.

[The prepared statement of Mr. Rush follows: PENDING]

Chairman LEVIN. Thank you, Mr. Chairman. The distinguished Ranking Member of the full Committee, Ranking Member Barton.

Mr. BARTON. Thank you, Mr. Chairman. I am going to put my written statement in the record.

We appreciate this hearing. We have heard of the Trilateral Commission. We now have the trilateral Committee hearing. So, I look forward to it.

I want to welcome my good friend, Don Evans. It's good to see another Texan here. We appreciate the Committee on Ways and Means and the Financial Services Committee letting the bedraggled Energy and Commerce Committee participate.

With that, Mr. Chairman, I yield back.

[The prepared statement of Mr. Barton follows: PENDING]

Chairman LEVIN. Thank you.

Ranking Member Cliff Stearns.

Mr. STEARNS. Thank you, Mr. Chairman. Let me echo my colleagues. What a great day it is to have the three distinguished Committees meeting and discussing on this important issue.

The Subcommittee on Commerce, Trade and Consumer Protection that I chaired in the last Congress has examined a number of trade issues of importance while I was Chairman. We have examined free trade agreements, the impact of different standards and harmonization efforts on U.S. competitiveness and more discrete issues such as counterfeiting and the protection of intellectual property rights.

My colleagues, many of the trade issues we monitor focus on China and its obligation to fulfill its commitment as a member of the World Trade Organization. These include the administration's ongoing efforts to address shortfalls in the enforcement of intellectual property right violations.

There is good reason that China has been occupying so much concern and discussion among business, workers and policymakers. Congress rightfully wants to ensure that our trading partners operate under fair and equitable rules that do not disadvantage American trade.

With the extraordinary growth in China's economy, we have watched our balance of trade with them become an expanding deficit, notwithstanding the fact that China is now our fourth largest export market for such manufactured goods such as aerospace and health care equipment. Our exports to them have grown 350 percent in the last decade. Our trade deficit, obviously, continues to grow larger and larger.

There is a mutual attractiveness to bilateral trade that benefits both countries and our respective desires to economic prosperity. We all agree with that. We have a growing economy with 1.3 billion people in need of goods and services essential to their infra-

structure. We have the wealthiest nation of consumers that is a natural market for some of their exports. Both conditions should provide the foundation for mutually beneficial trade.

Unfortunately, China's seemingly endless supply of inexperienced labor has severe consequences to our country and the competitiveness of some of our industries. This has not gone unnoticed, especially by anyone employed in any one of these respective industries.

The result of this imbalance in wage rates and national wealth has contributed in large part to a net trade deficit with China that reached $232 billion last year. Such imbalances cannot persist and be healthy for both countries and the global finance system in the long run.

My colleagues, what causes more concern is a notion that this imbalance is also facilitated by China's desire to keep its currency pegged to the dollar. Such actions are perceived by many as manipulation that keeps the yuan undervalued. Most experts, including the administration recognize China's currency is undervalued significantly, despite China's commitment to pursue a floating rate that is freely traded.

Since 2005, when China moved away from a fixed exchange rate and moved to a, quote, managed float system, their currency has appreciated approximately 7 percent. This is an improvement. We should recognize it. But it falls far short of where experts actually believe it should be. The narrow trading range to which China limits its currency effectively leaves it fixed to the dollar, for all intents and purposes.

We know that an undervalued currency makes their exports cheaper and more affordable to us, whereas our exports are more expensive and less affordable. This has largely been good for our consumers but bad for many of our exporters and our domestic industries affected by cheaper imports.

Over time, this situation normally corrects and the global financial system reevaluates the currencies and the exchange rate at the same time. That has not happened in the case of China. Instead, we continue to see an exchange rate relatively unchanged as China adjusts its purchases of dollar denominated assets.

The question for policymakers is, where do we go from here? This is not an easy question that can be solved with one quick solution. China by most accounts cannot switch to a purely floating currency overnight. Their financial system is not quite ready. But that does not obviate the need to make continued progress expeditiously.

My fear, my colleagues, that absent evidence of real progress by China and the administration, the U.S. will grow increasingly impatient as our companies and workers are disadvantaged. Policymakers will have few options, few options remaining, and will naturally explore more immediate changes if we do not see the improvement soon.

So, with that, Mr. Chairman, I welcome the witnesses and appreciate their forbearance here as we go through the normal procedures here to let people have their opening statements. I believe the administration and Secretary in particular has embarked on a course to try and show China that the merits of a market-based economy and to start to reflect reality in the economic situation.

With that, Mr. Chairman, I yield back.

[The prepared statement of Mr. Stearns follows: PENDING]

Chairman LEVIN. Thank you very much.

All right, here we go. Here we go. This is an extraordinary meeting, I think, affecting an extraordinary problem, a crucial problem. So, we have assembled on a bipartisan basis an extraordinary panel. You all don't agree. That will make it all the more interesting.

There is a red light. I've tried to abide it. As you think about your remarks, see if you can condense them into 5 minutes so that we can have a really good back and forth.

I am going to introduce all of you at one time so you can then go on. I really hope that we can get into this.

First will be former Secretary of Commerce, Don Evans, a long-time friend of ours, the chief executive officer, Financial Services Forum.

Next, Mr. Brian O'Shaughnessy, president and CEO, Revere Copper Products. We know that company well.

Steve Roach, who is managing director and global economist for Morgan Stanley, who has been with us before.

Another person of longstanding authority, Dr. Fred Bergsten, who is the director of the Peterson Institute for International Economics.

Another veteran of these wars, Mustafa Mohatarem, who is chief economist for GM.

Also another person who has testified here many times and we very much welcome her, Thea Lee, who is policy director of the AFL–CIO.

Then Mr. Hickey, who is with the steel corporation in Chicago.

So, let's go at it. Secretary Evans, we will start with you and go right down the line.

Welcome to all of you and thank you for coming.

STATEMENT OF DONALD L. EVANS, CEO, FINANCIAL SERVICES FORUM

Mr. EVANS. Thank you, Mr. Chairman. I am honored to be a part of this extraordinary hearing, as you say, to all the distinguished leaders of this nation that are here, the distinguished Members of this Congress, it is good to see all of you again. I thank you for your continued service.

I think fondly about my years here serving in government and being able to work with distinguished public service Members like Chairman Frank. Mr. Chairman, I look forward to coming to your hearing again in June when we are going to also discuss this very important issue. Chairman Dingell and Chairman Levin and Ranking Member Barton and my friend Tom Reynolds, there are just so many of you that I have worked with over the years. So I am honored to be a part of this. Chairman Tanner, also, good to see you, sir. I enjoyed so much working with you through the years.

We all do agree in one very important thing, that we are all trying to do what is in the very best interests of today's workers and tomorrow's workers. So, that is one thing that we can begin this hearing in saying that we all agree on. I have a brief opening comment, Mr. Chairman.

Ensuring that our major trading partners' currencies are valued according to market forces has major implications for the U.S. economy and American workers, as does broader financial sector reform in China. I applaud Chairman Frank for scheduling a hearing in June on this critically important topic.

I am here as chief executive officer of the Financial Services Forum, an association comprising the chief executive officers of 20 of the largest and most diversified financial institutions with business operations in the United States. The forum's members share Congress's commitment to maintain a strong U.S. economy, enhancing savings and opening world markets to American made products as the most effective means of addressing America's trade deficit. Also important is for the currencies of our major trading partners to be determined by the markets.

As the Members of these Committees know very well, two of our most important trading partners are Japan and China. In both relationships, imports into the United States have for years surpassed our exports. There is no question that the Japanese yen is currently trading at very low levels, recently dropping to multimonth lows against the dollar and an all-time low against the euro. Indeed, Bank of Japan data indicate that the yen is at its weakest level in real trade weighted terms in more than 20 years, circumstances that clearly benefit Japanese exporters.

While problematic for U.S. businesses competing with Japanese producers, there is no evidence that the yen's current trading levels are the result of currency manipulation. Indeed, as the Treasury Department reported in December, Japanese authorities have not intervened in foreign exchange markets in more than 3 years. Rather, the low relative value of the yen reflects economic fundamentals. Namely, a fragile Japanese economy still recovering from a decade of stagnation and deflation during the 1990s and low interest rates designed to nurture, encourage and extend the recovery.

More importantly, we clearly cannot credibly argue to China that it should stop intervening in foreign exchange markets, buying up billions of dollars to maintain the desired value of the yuan, while at the same time urging Japan to sell its currency reserves to drive up the value of the yen.

Dissatisfaction with the value of the yen as determined by world markets would only signal that U.S. currency demands are unreasonable, ad hoc, self-motivated and impossible to satisfy. Undermining the credibility and legitimacy of our continuing efforts to encourage a market-determined yuan.

Turning to China, for years the United States has worked with China toward achieving a yuan whose value is determined by market forces. Indeed, shortly after taking office, the Bush administration committed to helping China develop the capital market knowhow and expertise necessary to end the yuan's peg to the dollar.

In July of 2005, those efforts bore fruit, as China revalued its currency upward by 2 percent and eliminated the peg to the dollar. Since mid-2006, the pace of appreciation has accelerated to about 5.4 percent a month on an annualized basis. In total, the yuan has appreciated by about 6.5 percent and it has been estimated that by 2011, the yuan will have appreciated by a substantial 25 percent.

The United States should continue to press China to accelerate progress in that direction.

But even as we do, we should not allow the currency issue to overshadow the broader potential of the U.S.-China economic relationship. Of far greater significance to the policy goals of maintaining strong U.S. economic growth and job creation in this country is expanding access to China for American businesses and helping to activate China's 1.3 billion potential consumers, a fifth of the world's population. A simple example shows why.

Last year, the United States exported to Japan goods and services worth $60 billion, approximately the same amount exported to China, which was $55 billion. But China's population of 1.3 billion is 10 times Japan's population of 127 million. If China's citizens were to eventually consume American-made goods and services at the same rate that Japan's citizens did last year, the United States would export more than $600 billion worth of goods and services to China, 11 times what America exported to China last year, an amount equivalent to 5 percent of America's GDP, and more than twice what we imported from China last year.

Chairman LEVIN. The light is on. I was saying, it's hard to tap the gavel on a former Secretary. But——

Mr. EVANS. Quite all right.

Chairman LEVIN [continuing]. But try to wrap up because I hope everybody else will try to keep more or less within the 5 minutes so we have the fullest opportunity for back and forth. So, that was just a very light tap.

Mr. EVANS. Thank you very much, Mr. Chairman——

Chairman LEVIN. Keep going.

Mr. EVANS [continuing]. I will—well, the fastest way for China to develop the modern financial system, which is what they need to do, is by opening its financial sector to greater participation by foreign financial services firms. By providing the financial products and services that China's citizens and businesses need to save, invest, ensure against risk, raise standards of living and consume at higher levels, foreign financial institutions including U.S. providers would help create what every U.S. manufacturer and service company wants, unleash the Asian tiger hungry for U.S. products.

Thank you very much for the opportunity to appear in front of this extraordinary meeting, Mr. Chairman.

[The prepared statement of Mr. Evans follows:]

Statement of the Honorable Donald L. Evans
Chief Executive Officer
The Financial Services Forum

Testimony Before a Joint Hearing of
The Committee on Financial Services Subcommittee on Domestic and International Monetary Policy, Trade, and Technology
The Committee on Ways and Means Subcommittee on Trade
and
The Committee on Energy and Commerce Subcommittee on Commerce, Trade, and Consumer Protection

May 9, 2007

Introduction

Chairman Gutierrez and Ranking Member Paul, Chairman Levin and Ranking Member Herger, Chairman Rush and Ranking Member Stearns, thank you for the opportunity to participate in this important hearing.

I am here as Chief Executive Officer of the Financial Services Forum. The Forum is an association comprising the chief executive officers of 20 of the largest and most diversified financial institutions with business operations in the United States. The Forum works to promote policies that enhance savings and investment and that ensure an open, competitive, and sound global financial services marketplace. As a group, the Forum's member institutions employ more than 1.5 million people and hold combined assets of more than $12 trillion.

The Forum's members share Congress' commitment to maintaining a strong U.S. economy, enhancing savings, and opening world markets to American-made products as the most effective means of reducing America's trade deficit. Also important is for the currencies of our major trading partners to be determined by the markets.

The Importance of Market-Determined Exchange Rates

An exchange rate is just a price, the price of one currency in terms of another. As with any other commodity in a free market, the price of a currency should be determined by the interplay of supply and demand based on economic fundamentals. By reflecting investors' interest in holding assets denominated in one currency over assets denominated in another, market-determined currencies – just like standard prices in any economy – help direct scarce resources to their most productive uses. Market-determined currencies also have the benefit of serving as a correction mechanism for the global economy – as a falling currency helps stimulate demand for the products of a slumping economy, and a rising currency helps cool demand for the products of a booming economy.

As the members of these Committees know very well, two of our most important trading partners are Japan and China. As a portion of America's overall trade with the world, China is our second largest trading partner, accounting for 12 percent of total U.S. trade, while Japan is our fourth largest, accounting for about 7 percent.

In both relationships, imports into the United States have for years surpassed our exports. Last year, America's trade deficit with China rose 15 percent to $233 billion – or 28 percent of our overall trade deficit. Meanwhile, America's trade deficit with Japan rose 7 percent last year to $88.4 billion – or 11 percent of our overall trade deficit. Taken together, the deficits with China and Japan account for about 40 percent of America's overall trade deficit.

For years, the United States has worked with China toward achieving a yuan whose value is determined by market forces. Indeed, shortly after taking office, the Bush Administration committed to helping China develop the capital markets know-how and expertise necessary to end the yuan's peg to the dollar, providing massive technical assistance. And those efforts have born fruit. In July of 2005, China revalued its currency upward by 2 percent. Since mid-2006, the pace of appreciation has accelerated, averaging about 4.9 percent a month at an annualized rate, and quickening to around 5.4 percent in the first few months of 2007, as China has become more confident about the resilience of its economy. In total, the yuan has appreciated by 6.5 percent since July of 2005, and it has been estimated that by 2011 the yuan will have appreciated by a substantial 25 percent.[1] A market-determined yuan is important – for China, the United States, and the rest of the world – and the United States should continue to press China to accelerate progress. I'll have more to say about China in a moment.

Japan and the Yen

There is no question that the Japanese yen is currently trading at very low levels, recently dropping to multi-month lows against the dollar and an all-time low against the Euro. Indeed, Bank of Japan data indicate that the yen is at its weakest level in real trade-weighted terms in more than 20 years – circumstances that clearly benefit Japanese exporters.

While problematic for businesses competing with Japanese producers, there is no evidence that the yen's current trading levels are the result of currency manipulation. Indeed, as the Treasury Department reported in December, Japanese authorities have not intervened in foreign exchange markets in more than three years. Rather, the low relative value of the yen reflects economic fundamentals – namely, a fragile Japanese economy still recovering from a decade of stagnation and deflation during the 1990s, and low interest rates designed to nurture, encourage, and extend the early recovery. On April 27th, the Bank of Japan announced it would keep its short-term interest rate target at 0.5 percent, well below the U.S. fed funds rate of 5.25 percent and the Euro zone's 3.75 percent. Given such differentials and their implications for higher returns on dollar- and Euro-denominated assets, it's not at all surprising that the yen is trading at current levels.

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[1] See China's Currency: Underappreciated Facts," Economist Intelligence Unit, April 10, 2007.

More importantly, we clearly cannot credibly argue to China that it should stop intervening in foreign exchange markets – buying up billions of dollars to maintain the desired value of the yuan – while at the same time urging Japan to sell its currency reserves to drive up the relative value of the yen, as some have recently suggested. Dissatisfaction with the value of the yen as determined by world markets would only signal that U.S. currency demands are unreasonable, ad hoc, self-motivated, and impossible to satisfy – undermining the credibility and legitimacy of our continuing efforts to encourage a market-determined yuan.

Incidentally, it's worth noting that the U.S. dollar itself is currently trading near record lows against the Euro and at levels against the British pound not seen in nearly a quarter century.

China and the Yuan

Turning to China, in recent years the discussion in Washington regarding the U.S.-China economic relationship has focused in large part on China's currency policy. Many policymakers assert that an undervalued yuan makes cheap Chinese exports even cheaper, giving Chinese producers an unfair advantage over American companies and contributing to the U.S. trade deficit with China.

As I stated a few moments ago, a market-determined yuan is important – for the United States and for China. Foreign exchange market intervention by the People's Bank of China – buying dollars with yuan – has boosted liquidity in China's economy, thwarting government efforts to scale back excessive bank lending and fixed investment. Speculative money flowing into China in anticipation of a revaluation is also undermining government objectives. Finally, allowing the yuan to more fully float according to market forces would free the PBOC to pursue monetary policies that advance China's macroeconomic goals. For these reasons – as well as the priority of a more fair and transparent trade relationship – U.S. policymakers should continue to press China to accelerate progress toward a market-determined yuan.

Chinese authorities have repeatedly argued – reasoning generally acknowledged by most foreign analysts, including Treasury Secretary Paulson – that an immediate shift to a market-determined yuan is not possible given the underdeveloped state of China's capital markets. More specifically, China's banks, securities firms, and other businesses currently lack the expertise to develop and trade derivatives and other structured instruments used to hedge the risk associated with greater currency volatility. This reality is one of many reasons why financial sector modernization in China – accelerated by great foreign participation – is so important. Sophisticated derivative products and hedging techniques provided by foreign financial services firms would enable China to move more quickly toward a free-floating yuan whose value is determined by market forces based on economic fundamentals.

But even as we continue to press China to accelerate progress on the yuan, we should not allow the currency issue to overshadow the broader potential of the U.S.-China economic relationship. Indeed, the short term effect of a significant appreciation in the yuan would likely be to make the trade deficit *worse*. Because a higher-valued yuan would mean higher prices for imported Chinese goods, and because the process of finding cheaper alternatives to more expensive Chinese goods takes time, the trade deficit would likely get worse before getting better – a phenomenon economists call the J-curve effect.

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Of far greater significance to the policy goals of maintaining strong U.S. economic growth and job creation is expanding access to China for American businesses and helping to activate China's 1.3 billion potential consumers – a fifth of the world's population. A simple example demonstrates the enormous potential of greater spending by Chinese consumers:

Last year, the United States exported to Japan goods and services worth $60 billion – approximately the same amount exported to China ($55 billion). But China's population of 1.3 billion is ten times Japan's population of 127 million. If U.S. exports are expressed in relation to population, the U.S. sold the equivalent of $472 worth of goods and services to every citizen of Japan last year, but only about $40 worth of goods and services to every Chinese citizen.

If China's citizens were to eventually consume American-made goods and services at the same rate that Japan's citizens did last year, the United States would export more than $600 billion worth of goods and services to China, 11 times what America exported to China last year, an amount equivalent to 5 percent of America's GDP, and more than twice what we imported from China last year – replacing the trade deficit with a significant surplus.

But in order to mobilize its 1.3 billion consumers, China needs a more open, competitive, and effective financial system. Chinese households historically save as much as half of their income, as compared to single-digit savings rates in the United States and Europe. This pronounced propensity to save is related to the fact that most Chinese depend on their families and private savings to pay for retirement, healthcare, and the economic consequences of accidents or disasters. Activating the Chinese consumer requires the availability of financial products and services – personal loans, credit cards, mortgages, pensions, insurance and retirement products – that will reduce the need for such "precautionary" savings and facilitate consumption.

The fastest way for China to develop the modern financial system it needs to achieve more sustainable economic growth, allow for a more flexible currency, and increase consumer consumption is to import it – that is, by opening its financial sector to greater participation by foreign financial services firms. Foreign institutions bring world-class expertise and best practices with regard to products and services, technology, credit analysis, risk management, internal controls, and corporate governance. In addition, the forces of competition brought by foreign institutions would accelerate the development of modern financial techniques and methodologies by China's financial institutions.

By providing the financial products and services that China's citizens and businesses need to save, invest, insure against risk, raise standards of living, and consume at higher levels, foreign financial institutions – including U.S. providers – would help create what every U.S. manufacturer and service provider wants – an unleashed Asian tiger hungry for U.S. products.

Thank you very much for the opportunity to appear at this unique joint hearing.

Chairman LEVIN. Thank you, sir.

Mr. O'Shaughnessy.

STATEMENT OF M. BRIAN O'SHAUGHNESSY, PRESIDENT AND CEO, REVERE COPPER PRODUCTS, INC., ROME, NEW YORK

Mr. O'SHAUGHNESSY. Good morning, Chairman Levin, Gutierrez, Rush, Frank and Ranking Members Herger, Paul and Stearns. Indeed, all Members, thank you for this opportunity to testify——

Chairman LEVIN. The rest of you can leave off the thank yous. There are too many of us.

Mr. O'SHAUGHNESSY. Okay. Can I start my time over?

Chairman LEVIN. Start all over.

Mr. O'SHAUGHNESSY. As to China currency issues, on behalf of the China Currency Coalition, the witness guidelines for potential conflict of interest require that government contracts be disclosed. You should be aware that U.S. Secretary of War Henry Knox rode to Boston and offered Paul Revere a $10,000 U.S. Government loan to build a copper rolling mill to sheathe the USS *Constitution* with copper made in the U.S.A..

So, my company was founded by Paul Revere in 1801, perhaps the oldest manufacturing company in the U.S.A.. Today, our mill in Rome, New York, produces copper and brass sheet, strip and coil for U.S. manufacturing companies.

Since 2000, about 30 percent of these customers have shut down or moved offshore. Just look at an item made of copper or brass in a big box store and you will see that the product is now made in China. That's because the cost of manufacturing in China is cheaper, you believe. Once you look at the facts, however, you will see a different picture.

Say the production cost of a brass doorknob in China is 100 yuan. If the exchange rate for converting yuan to dollars is controlled by the government of China at eight yuan to one dollar, then the production cost is equivalent to $12.50. But if the exchange rate was market driven, it would be about five yuan to a dollar and the production cost in China would be equivalent to $20. So, a factory that produces brass doorknobs for $18 in the U.S. is going to shut down.

The manipulation of its currency reduces the competitiveness of every other product, good and service in the world compared to its production in China. Such protectionism is reaping huge rewards as China's export-based economy is growing three times faster than the rest of the world. Meanwhile, factory jobs are disappearing in the U.S. and the world. Even manufacturing plants in Mexico are moving to China.

Multinationals that benefit from Chinese protectionism really don't want it to stop and often accuse those that do of protectionism. The irony is that domestic manufacturing companies are the victims of protectionism, not the benefactors. China managed its currency to be undervalued about 40 percent and since then allowed it to appreciate only 3.5 percent a year, while the underlying rate of appreciation was 5 percent.

China's strategy is to delay as long as it can and make corrections as small as it can. The market driven exchange rate simply put all nations back at the starting gate for the race to determine who will win the battle to competitively produce goods and services assuming all other things are equal. Of course, all other things are not equal. Because of this, our Nation's inability to compete with China and the rest of the world means that our currency will continue to depreciate and the standard of living of all Americans will decline and our Nation will grow weaker.

This is because all other major trading nations use revenues generated by value added tax, VATs, to reduce the tax and health care burden on their production of goods and services. The most ambitious are developing energy policies which give them a competitive edge.

The loss of manufacturing jobs to date in the U.S.A. is only the tip of the iceberg. Future losses will go far beyond this and extend to food and service industries.

What should be done to counter this protective behavior by other nations? First, the U.S. cannot continue to negotiate FTAs as long as the other country is free to manipulate its currency and VATs to offset any tariff reduction.

Second, Congress should pass the Ryan-Hunter bill. If this is not successful, then the U.S.A. must take stronger measures, even if it means stepping outside WTO rules.

Third, the U.S.A. must reform its tax and health care systems and institute VATs on a scale that gives production of goods and services in the U.S.A. a competitive advantage.

Fourth, the U.S. needs to ensure that its businesses have access to substantial, low-cost, clean energy so that they are able to compete on the world stage and keep the environment clean. My written testimony points to nuclear.

When Paul Revere tried to rouse the countryside with his wakeup call, what did the people do? We all need to wake up and listen, but we must be careful who we listen to. Honorable Members of Congress, Revere does not take disclosure laws lightly. In the interest of full disclosure, we believe all witnesses, consultants should answer, does your company have or is it considering investing in or financing facilities in China or Japan? Does your company sell to or import components or products from there?

Thank you for your attention. Wake up, America. Visit RevereCopper.com and learn more of these views.

[The prepared statement of Mr. O'Shaughnessy follows:]

Written Testimony

of M. Brian O'Shaughnessy, Chairman, CEO & President, Revere Copper Products, Inc.
One Revere Park
Rome, NY 13440

Phone: 800 448-1776 ext. 2332 or 315 338-2332
Fax: 315 338-2193

a **Witness**

on behalf of Revere *and the* China Currency Coalition

before the Ways and Means Subcommittee on Trade; *the* Financial Services Subcommittee on Domestic and International Monetary Policy, Trade, and Technology; *and the* Energy and Commerce Subcommittee on Commerce, Trade and Consumer Protection.

on Currency Manipulation and its effects on U.S. business and workers.

May 9, 2007

International Trade: Myth vs. Reality

Three million manufacturing jobs have been lost in the USA since the year 2000. Some attribute it to increased productivity - but previous recoveries typically resulted in a loss of about one million jobs in spite of productivity increases. Some think it is our country's responsibility to support fledgling economies because we are the strongest, most powerful nation in the world. Some say we need to set a good example and others will follow. Make no mistake about it, protectionism should not be the end game but it seems to be an acceptable practice when used by everyone but the USA.

No matter how we try to rationalize it, millions of manufacturing jobs are going overseas.

My company is Revere Copper Products. We were founded in 1801 by Paul Revere and believe we are the oldest manufacturing company in the USA. We have two plants. Our large mill is in Rome, New York and produces copper and brass sheet, strip and coil. Many of its customers are manufacturing companies located throughout the USA.

Since 2000, about 30% of these customers have shut down or moved offshore. You can see why if you simply go to any big box store and look at any item made of copper or brass. Turn it over and you will likely see that the product is now made in China. That's because the cost of manufacturing in China is so much cheaper, you believe. At least, that is what you have been told...

Once you start looking at the facts, however, you will see a very different picture.

Let's say the production cost of a brass doorknob in China is 100 yuan. If the exchange rate for converting yuan to dollars is controlled by the government of China at 8 yuan to $1, then the production cost is equivalent to $12.50. But if the exchange rate was allowed to be determined by market forces, it would be about 5 yuan to $1 and the production cost in China would be equivalent to $20. So a company that produces that doorknob for $18 in the USA is going to lose market share and be shut down.

In other words, China manipulates its currency so that it subsidizes the cost of manufacturing in China.

The current and the former US administration have refused to take any concrete action against such manipulation by China and have chosen instead to jawbone. The problem with this strategy is that currency manipulation by China is serving its best interests.

The manipulation of its currency reduces the competitiveness of every other product, good and service in the world when compared to its production in China.

This form of protectionism by China is reaping huge rewards as its export-based economy is growing 3 or 4 times faster than the rest of the world with factories being built at a pace beyond the imagination of anyone just a few years ago. Meanwhile, factory jobs are disappearing in the USA and the world. Even manufacturing plants in Mexico are moving to China.

But this is more than an economic battle.

Did you catch the statement by Congressman Tim Ryan of Ohio concerning the paper ("Unrestricted Warfare") written by two Chinese military strategists? They suggested that military supremacy be achieved by undermining the manufacturing base of the United States by maintaining China's currency at artificially low levels to gain an economic advantage for Chinese manufacturing and destroying the manufacturing base of the United States. Seems to be working, doesn't it?

Personally, I admire the Chinese culture and believe that China does not need such a disruptive currency policy to compete in the world given its many other advantages. The Chinese economic policy is export driven by taxing its citizens through currency manipulation which takes away their disposable income. A market driven currency exchange rate policy would drive China's economy toward domestic consumption and a better life for its citizens.

But make no mistake about it, China is waging a mercantile war on the world and the world is sleeping.

Why is the world sleeping? First, we must look at the role of a significant number, but not all, multinationals. Remember in the 1980s when Japan was such a fierce competitor in so many US markets. The reaction by our largest corporations was loud and largely one voice calling for tariffs and restraints. Contrast that with today as many of the largest US corporations are so much more international and especially with their investments in China. Many that do not have direct investments in China buy substantial numbers of components from China's factories. Many have set their strategic plans to produce components or products in China.

It may surprise you to learn that I don't have a problem with any company that sets up a plant offshore or imports components or products. But if manufacturing in America must compete with the protectionist policies of any foreign government, that is not fair. And if meaningful corrective action by the US government is thwarted by US manufacturing and financial service companies who gain from such protectionism, that is wrong.

This country is more than multinationals and financial service companies.

CEOs of multinational companies are put in a very difficult position by national trade policies. *They have to choose between their company and their country.* Let me explain. Earlier I mentioned that China practices a policy of managing its currency at artificially low levels to gain a competitive advantage for any export products or services produced in China….by as much as 40%! Now, you must realize a simple truth, a multinational that manufactures in China and benefits significantly from this advantage doesn't want this to change.

It is not my intention to vilify multinationals or the capable CEOs who run them. These executives are charged with representing the best interests of their shareholders. Also, many of these CEOs of "American" companies are not US citizens nor are many of their shareholders. For example, the Chairman of Coca-Cola is Irish and its President is Turkish!

It is important to appreciate that it is in our nation's best interest to have the corporate headquarters of a multinational or traditional US based company located in the USA even if it has no remaining production facilities here. That is not so that they can be taxed and regulated and driven away but so that the high skilled, corporate level jobs are here not there…

So when issues such as patriotism are raised in this paper, it is really an appeal to US political leadership not that of multinational corporations.

Companies that manufacture in the USA and must compete with either multinationals or companies that outsource components from abroad believe currency manipulation is unfair and must be stopped. They see other US based manufacturing plants shutting down and are concerned that will be their fate. These domestic manufacturing companies want the US government to take effective action to right this wrong and the sooner, the better.

At a 2006 meeting of an international economic policy committee of an association of manufacturing companies, one manufacturing company said that it buys components from China and does not want the current situation to change. Now there's a breath of honesty. Maybe not patriotic but at least he's honest.

Patriotic…why bring that word into the mix? Well, you see the strength of manufacturing is an inherent strength of our country. Some economists believe our country is in a transition from a manufacturing economy to a service economy just as it transitioned from an agricultural economy to a manufacturing economy years ago. But maybe the manufacturing economy was simply layered on top of our agricultural economy just as the service economy is layered on the manufacturing economy. And it is certainly hard to argue against the proposition that a weak manufacturing sector threatens our national security.

Even so, some economists cite data that the manufacturing sector is doing just fine as it is producing more than ever before. Such data is misleading and you should consider the source. For example, statistics on US produced products include Dell computers which are merely assembled in the USA from components produced abroad. We could argue endlessly about this but the facts are the facts and the fact is we have become a nation with a colossal trade deficit. In 2005, for the first time in over a hundred years, our nation imported more food products than it exported and our trade deficit in manufactured goods continues to soar. Indeed, our nation's trade deficit is growing by $2 billion a day! (More about this later…)

Sounds like our nation needs some help.

Or at least some good advice….and that leads me to integrity. You see when a CEO attempts to push an agenda that supports Chinese protectionism rather than an agenda that goes against that protectionism, maybe that CEO should declare that he or she is conflicted on this issue and should be recused from any forum such as this hearing. Many of these CEOs have plants in the USA which would benefit from freer trade but they support their growing investments in plants in China and component imports from China by choosing their company's best short term interests over that of their own domestic plants and their country.

That's because they have to but you don't!

Supposedly, the issue before us today is how to stop China from managing its currency so as to give its production of goods and services an unfair competitive advantage. Or, is it? If you recall, earlier I mentioned the multinational delegate, the honest one…he said he was against a proposal that would raise his prices on the components he buys from China. I believe the real issue is, "Should the USA support measures that will not work so multinationals can support them or should the USA support measures that will work to cause China to change its policy of managing its currency?"

Those multinationals who gain from currency manipulation have endless arguments for stretching out the process like…. "We don't want to start a trade war now, do we?" *But we are already in a trade war*, aren't we? Of course we are and we are losing. *We are pacifists in this war*. How about this one by the same group of multinationals… "Your policies are protectionist!" Yes, they actually say that, can you imagine? Often the accuser benefits from China's export subsidies which are clearly prohibited by the WTO as protectionist. According to a story in *USA Today* on May 3, 2007, Ralph Gomory, president of the Alfred P. Sloan Foundation and a former top executive at IBM, attacks a growing divergence between multinationals and US best interests.

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The irony is that domestic manufacturing companies are the victims of protectionism not the benefactors.

Another argument we hear is, "What about their fragile banking system?" This one has been around for years and of course, it is impossible to amend an economic strategy let alone a banking system that depends on subsidization to such an extent without removing the subsidy, isn't it? Besides, their banks are owned by the same government that is holding almost a trillion US dollars. Maybe their banks are not quite as insolvent as you have been lead to believe…

China set up a system to manage the movement of its currency toward market levels and then used it to move its currency at rates about 3.5 % per year compared to estimates of an underlying rate of appreciation of 5% of its currency, thereby exacerbating the problem.

So, China is going to delay as long as it can and make corrections in as small increments as it can get away with given its support.

Part of that support comes from US trade policy which pleases the multinationals that are in alignment with the policy of China. Never, but, if ever, slowly…. There is no easy solution to this Chinese puzzle. Even I have supported the verbal approach…for years. Our nation could simply slap a tariff on all imports from Chinese and other nations that manage their currency but I think we must take measured concrete steps that increase in severity before such a step.

China is not the only country that manipulates its currency to gain a competitive advantage. Several other Asian nations also manipulate their currency for the same reasons and partly as a defensive mechanism so their producers of goods and services can compete with goods and services originating from China.

It is important to understand that the end of currency manipulation will not end the depreciation of the US dollar against other currencies including China's yuan.

For this reason, it is difficult and perhaps impossible to develop a coherent trade policy to deal with China without considering the tax policies of our own country. China uses a Value Added Tax (VAT) to protect its domestic production of goods and services and uses its revenues to fund government programs such as national health care. VATs are a tax but they are also a form of tariffs which are largely exempt from World Trade Organization (WTO) rules. The WTO was established to advance world trade. It has developed ground rules for international commerce and mediates trade disputes. Of course, China also employs a VAT tax but unlike everyone else, the VAT is applied in a discriminatory manner which is in direct violation of WTO rules.

Market determined exchange rates simply put all nations back at the starting gate for the race to determine who will win the battle to produce competitive goods and services *assuming all other things are equal.* Of course, all other things are *not* equal and because of this our nation's inability to compete with China and the rest of the world means that our currency will continue to depreciate and the standard of living of all Americans will decline and our nation will grow weaker.

This is because other trading nations use revenues generated by Value Added Taxes (VATs) to reduce the tax and health care burden on their production of goods and services and the most ambitious nations are developing energy policies which give them a competitive edge.

Here is a real world example of how VATs are used by other governments to protect their industry. Revere has had an industrial plate mill in New Bedford, Massachusetts for 145 years. The plate is used in heat exchangers and in unique applications for US national defense. It is considered the best quality plate in the world. Its major competitors are located in Germany but they could be located in China and the principles and the result would be the same. These competitors are able to undercut Revere's prices thanks to a VAT that the German government applies to all goods and services sold in Germany, domestic or imported.

When New Bedford ships its plate to Germany, that plate must pay the 19% German VAT tax. If the German mills ship plate to the USA, the 19% VAT tax does not apply. Revenues from VATs allow the German Government to help fund national health care costs and reduce corporate taxes. This means that Revere's German competitors pay far less in taxes and medical costs for their employees. Medical costs alone amount to about $10,000 per employee for Revere. Ironically and tragically, the New Bedford workers must bear the burden of helping to pay for the health care of the German workers they compete with through the payment of German VATs on any Revere products shipped to Germany. Of course, the German government doesn't reduce taxes for the New Bedford plant nor does it provide any health care for the New Bedford workers.

Naturally, Revere hardly ships any product to Germany while its German competitors just love the US market.

Meanwhile, the American worker is expected to respond to these pressures by increasing productivity and reducing waste. The people at Revere's New Bedford plant did that at an astonishing pace, averaging productivity improvement at the rate of 10 percent a year for the last six years. During this period the workers and management of this mill did everything that was asked of them and more.

Yet, even that wasn't enough—on March 5, 2007, Revere announced the closure of its New Bedford mill and the loss of 87 good paying jobs.

In recent years, the USA has been negotiating Free Trade Agreements (FTAs) in an effort to get other countries to lower tariffs. This has led to the North American Free Agreement (NAFTA) in which the US, Canada and Mexico reduced outright tariffs. Around the time of the negotiations, however, Canada instituted VAT taxes while Mexico increased its VAT rates. VATs are tariffs but are excluded from NAFTA and other FTAs

How can the USA continue to negotiate Free Trade Agreements while other nations are free to offset their tariff reductions through employing VATs and other forms of border adjustable taxes and manipulate their currency?

VATs protect the domestic production of goods and services in any country that has them. The lack of a VAT in the USA allows European nations to gain market share from the USA partially offsetting the impact of China's manipulation of its currency on the production of goods and services in Europe. That's one reason why Europe is less vocal about China's mercantile war. The lack of VATs in the USA also largely explains why the USA has a trading deficit with virtually every other trading nation in every class of goods.

VATs have been adopted by all of the world's major trading nations, excluding the USA and some oil producing Middle Eastern nations.

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Another nail in the coffin of US manufacturing would be if the USA were to sign the Kyoto Treaty. The Kyoto Treaty exempts China, India, Brazil and other developing nations from its standards. But the carbon emissions per $1,000 of GNP in China are seven times that of the USA while India emits three times as much. The Kyoto Treaty and other measures such as Regional/National Greenhouse Gas Initiatives drive manufacturing from developed countries with more strict standards to countries with much worse practices.

These treaties and regulations have the unintended consequence of increasing carbon emissions and global warming as factories are shutdown in the USA and Europe and production increases in China.

During the days of substantial aid programs by the USA to developing nations, the primary consideration was to build an infrastructure. That included large scale projects to supply low cost, economic energy. Of course, what is true for developing nations is also true for developed nations that must compete in a global economy….the provision of low cost, competitive power is essential to success.

The gigantic footprint of windmills, solar energy, bio-fuels, and hydropower are so vast and the costs so uneconomic that no nation that is serious about engaging in the global competition for skilled jobs is embarking on these power programs to the extent of the USA. Any energy source that must be mandated, subsidized and surcharged to such an extent cannot be economic, can it?

China is planning 40 new nuclear power plants; Japan is building 10 more while France relies on nuclear for 80% of its electricity. Why? Nuclear power is clean and low cost if sitting and environmental concerns are managed. Nuclear waste is dangerous but can be contained in areas much smaller than most people realize. Thirty years of nuclear waste from a 1,000 MW plant would fit in an area the size of a high school gym. If other countries can do it, why can't the USA?

The loss of manufacturing jobs to date in the USA is only the tip of the iceberg. The impact of currency manipulation, VATs and environmental/energy costs are not limited to manufactured goods. Any goods and services that compete in global markets, either directly or as part of a supply chain, are exposed to these protectionist forces. Future losses will go far beyond the continued loss of manufacturing jobs and extend to the agriculture, food processing and service industries. Indeed, Alan Blinder, former Federal Reserve Vice Chairman, was quoted in the Wall Street Journal on March 28th saying that, "…as many as 40 million American jobs (are) at risk of being shipped out of the country in the next decade or two."

Policy makers and citizens must realize the urgency of the matter. The USA must see itself as a competing nation…competing in a global market for good paying jobs. But it's not only about jobs. It is also about national security and our entire economy. Factories producing goods and services necessary for US national defense are moving offshore. The US trade deficit is growing $2 billion a day. China and Japan have *each* accumulated about US$1 trillion in reserves. The accumulation of US currency by China and other Asian nations is a *growing* bubble.

So, the looming question is, "What should be done to counter this offensive and protective behavior by other nations?"

First, the USA cannot continue to negotiate FTAs as long as the other country is free to manipulate its currency and VATs to offset any tariff reduction.

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Second, the manipulation of its currency by China or any nation is unacceptable. The first step should be to pass the Ryan/Hunter bill that would define currency manipulation as an illegal subsidy and allow the application of Countervailing Duties (CVDs) to offset the impact of the currency manipulation. The Ryan/Hunter bill is designed to be compliant with the rules of the WTO. That being said, if the WTO refuses for any reason to sanction the use of CVDs to offset currency manipulation, we must assume that the system that governs world trade is broken and must be fixed. Immediately! If the use of CVDs to offset currency manipulation does not lead China to stop manipulating its currency, then the USA must take stronger measures, even if it means stepping outside WTO rules.

Third, the USA must reform its tax and health care systems and institute VATs on a scale that gives production of goods and services in the USA a competitive advantage.

A smart competitor never looks at where a competitor is and tries to match that position. *A smart competitor might try to match where a competitor is going to be at a certain time. But the most intelligent competitor attempts to gain a competitive advantage by providing a product beyond where the competition is going to line up in the race.*

In order to achieve this objective, the USA must eliminate all national taxes, both corporate and personal, including income, dividend, capital gain, estate, FICA and unemployment taxes as well as lifting the burden of health care costs off employers who provide jobs. A new national VAT system can replace these revenues. The regressive nature of a VAT system would be offset by the provision of a national health care system. Also, adverse impacts on charitable and lending institutions need to be offset by matching charitable grants and providing housing subsidies which could further offset the regressive VAT system and make it fair. The new system should be designed to be revenue neutral for all classes.

A national health care system similar to that employed by Great Britain has features that would appeal to all Americans. It provides universal health care for all but allows any citizen to opt out to private care as long as they are willing to pay the cost. I am not aware of any nation that is considering dropping its health care system to adopt the system used in the USA which eats up twice as much GNP per capita and burdens the domestic production of goods and services.

Fourth, the USA needs to ensure that its citizens and businesses have access to substantial, additional low cost, clean energy so that they are able to compete on the world stage *and* keep the environment clean. The USA should use a system similar to the one used by the Base Realignment and Closure (BRAC) Commission to determine the location of surviving military bases to site nuclear power stations throughout the USA. Competing nations all over the world are building terminals and pipelines to receive natural gas to supply their manufacturing and economic base. So must the USA. We simply must not allow the events of 9/11 to destroy our nation's ability to compete by stifling the expansion of natural gas terminals and pipelines.

When Paul Revere tried to rouse the countryside with his wake up call, what did the people do? They certainly didn't go back to sleep. We all need to wake up and listen. But we must be careful who we listen to...

Wake up, America!

Visit: reverecopper.com and learn more

Schlage Lock

Kwikset Locks

Price Pfister

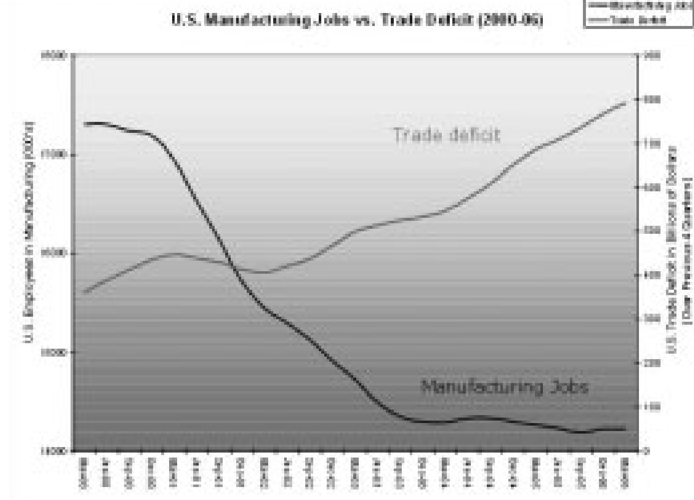
Carrier

Oneida Silversmith

Intri-Plex

Leviton Mfg

Notes: Since 2000, about 30% of the manufacturing plants that Revere shipped to have shutdown and/or moved offshore.



Notes: We do know that 3 million manufacturing jobs have been lost since 2000. Previous recoveries averaged about 1 million job losses.

Some Countries Using VAT Tax to Support Factory, Farm & Service Jobs

Australia	Finland	Japan	Russia
Austria	France	Korea	Singapore
Belgium	Germany	Luxembourg	Slovak Republic
Brazil	Greece	Mexico	Spain
Belgium	Hungary	Netherlands	Sweden
Canada	Iceland	New Zealand	Switzerland
China	India	Norway	Thailand
Czech Republic	Ireland	Poland	Turkey
Denmark	Italy	Portugal	United Kingdom

Notes: 139 countries have a border adjustable tax which discriminates in favor of domestic production of goods & services. One province in India boasts of a VAT tax over 50% in promoting itself as a prime location.

Countries Not

USA

Notes: **The US currently has a trade deficit with almost EVERY trade competitor in almost EVERY CLASS of goods. Some Middle East oil producing nations have no VAT taxes but they have few, if any, other taxes.**

CHINA CURRENCY COALITION

The China Currency Coalition is a group of U.S. industrial, service, agricultural, and labor organizations that seek immediate elimination of the Chinese currency's undervaluation, which is estimated at 40 percent or more.
Members include:

- The IUC AFL-CIO
- American Iron and Steel Institute
- Chicagoland Circuit Association
- The Committee on Pipe and Tube Imports
- The Copper & Brass Fabricators Council, Inc.
- EXEL Industrial
- Forging Industry Association
- Graphics Communications International Union (GCIU)
- The Industrial Union Council (composed of Bakery, Confectionary, Tobacco Workers and Grain Millers International Union (BCTGM))
- International Union of Electrical Workers/Communication Workers of America (IUE/CWA)
- International Association of Machinists (IAM)
- International Brotherhood of Boilermakers (IBB)
- International Brotherhood of Electrical Workers (IBEW)
- International Brotherhood of Teamsters (IBT)
- IPC - Association Connecting Electronics Industries
- Paper Allied-Industrial Chemical & Energy Workers International Union (PACE)
- Manufacturers for Fair Trade
- Metal Treating Institute
- Metals Service Center Institute
- National Council of Textile Organizations
- National Tooling and Machining Association
- Nucor Corporation
- Precision Machined Products Association
- Precision Metalforming Association
- Rescue American Jobs
- Sheet Metal Workers International Association
- Society of the Plastics Industry
- Specialty Steel Industry of North America
- Spring Manufacturers Institute
- Steel Dynamics
- Steel Manufacturers Association
- Tooling & Manufacturing Association
- U.S. Business and Industry Council
- United Automobile Workers (UAW)
- United Food and Commercial Workers (UFCW)
- United Mine Workers of America (UMWA)
- United States Business & Industry Council
- United States Printed Circuit Alliance
- United Steelworkers of America (USWA)
- Union of Needletrades Industrial and Textile Employees (UNITE)
- Vanadium Producers & Reclaimers Association
- Wood Machinery Manufacturers of America

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Chairman LEVIN. Thank you very much.
Dr. Roach.

STATEMENT OF STEPHEN S. ROACH, MANAGING DIRECTOR AND CHIEF GLOBAL ECONOMIST, MORGAN STANLEY, NEW YORK, NEW YORK

Mr. ROACH. Thank you, Mr. Chairman. I will dispense with the thank yous. But by my calculation, that would take up most of my 5 minutes. But I do appreciate both the honor and the privilege to participate in these historic hearings.

I sincerely worry that you and the Congress are moving into very dangerous territory as you contemplate trade legislation aimed directly at China. I fear this approach could backfire and unleash forces that would have an adverse impact on the U.S. economy and on middle class American workers.

Let me just highlight five potential risks to the U.S. economy that are contained and detailed in my prepared statement. Number one, sanctions on China could raise the cost of imports and that would be the functional equivalent of a tax on American consumers.

Number two, sanctions on China would raise the cost of foreign components and inputs for U.S. multinationals that could lead to higher inflation and would be a tax on corporate America.

Number three, sanctions on China could lead to a sharply weaker dollar, as we would be hitting a major buyer of dollar denominated assets in international capital markets.

Number four, because of dollar weakness, sanctions on China could lead to sharply higher real long-term interest rates in the United States.

Number five, because of all of the above, trade sanctions on China could tip an already weakened U.S. economy into recession.

I would also underscore three key risks to the global economy. Number one, a large move in the Chinese currency, which is what you are seeking, could do damage to an embryonic Chinese financial system, which would be a major setback for reform in China.

Number two, actions against China would hit the rest of Asia. Very important, because China is less of a factory than you think and more of an assembler, with direct and important ties to other major Asian economies, including Japan, Korea and Taiwan.

Number three, sanctions on China which would impact the rest of Asia would push this very important region away from the U.S. sphere of influence in terms of economic integration, financial integration and geopolitical integration. These are all, in my view, clear and very important risks of making what I fear could be a major policy blunder of monumental proportions.

I want to stress that I think that your approach is also flawed not just because of the risks I have highlighted, but also because it rests on faulty macroeconomic analysis. You in the Congress, I think, should be less concerned about last year's $232 billion bilateral trade deficit with China and more concerned about America's $836 billion multilateral trade deficit with the entire world in 2006. At the core of this problem, and Mr. Paul has certainly underscored this in his opening statement, is America's unprecedented shortfall of domestic saving. America's net national savings rate, the combined saving of households, businesses and the government sector adjusted for depreciation averaged only 1 percent over the past

three years. This is the lowest in our history. It is the lowest in the history of any leading nation in the modern day world economy.

So, lacking in domestic saving, the U.S. must import surplus savings from abroad in order to grow and run massive current account and multilateral trade deficits to attract the foreign capital. This is much more a U.S. savings problem than a China problem. Why this does not get more into the debate in the Congress concerns me very much.

If you close down trade with China, the impacts I believe would be like a water balloon. The deficit would go somewhere else, unless America saves more. That somewhere else most likely will be a higher cost producer which, again, would impose the functional equivalent of a tax hike on the American middle class.

The bottom line, as I see it, you're treading on very dangerous territory here and the macro analysis that underpins this approach has highly risky implications. I think we need to be very careful what we wish for.

Thank you very much.

[The prepared statement of Mr. Roach follows:]

Prepared Statement of Stephen S. Roach, Ph.D., Managing Director and Chief Global Economist, Morgan Stanley, New York, New York

Congress is now moving into a critical phase in the ongoing deliberations over America's international trade policies. These tripartite hearings are a clear indication of the deep concerns that are shaping your efforts. Such angst is understandable. In a broad sense, this is a debate about America's commitment to globalization—the overarching force that is reshaping the U.S. and the global economy. In a narrow sense, the focus is unmistakably on China—the world's most extraordinary development story and yet the largest slice of America's gaping trade deficit. Much is at stake as you grapple with these weighty issues. You cannot afford to get it wrong.

But I worry that may be the case. There can be no mistaking the momentum in Congress to tighten the noose on China. My own experience underscores this point: This is the third time I have testified on U.S.–China trade policy in the past three months. You have framed the debate as a legislative response to America's outsize bilateral trade deficit with China. This point of view is seriously flawed—underscoring the risk of a policy blunder of monumental proportions. By going after China, you in the Congress are playing with fire.

Playing with Fire

For starters, the legislative "remedies" currently under discussion are based on faulty macroeconomic analysis. China bashing doesn't address the real problem that Congress believes is bearing down on American workers—a massive trade deficit that hit a record $836 billion in 2006. Since the Chinese bilateral deficit of $232 billion amounted to the largest slice of America's overall multilateral trade gap—28% for all of 2006 and fully 34% in the final period of the year—Congress has concluded that China is the major culprit behind the trade-related squeeze on middle-class U.S. workers.

That deduction overlooks one critical point: The United States runs trade deficits not because it is victimized by unfair competition from China or anyone else but because it suffers from a chronic shortfall of domestic saving. That's right, lacking in saving—as evidenced by a net national saving rate that plunged to a record low of 1% of national income over the 2004–06 period—the U.S. has no choice other than to import surplus saving from abroad if it wants to keep growing. That means running current account and trade deficits in order to attract the foreign capital. China turns out to be the biggest piece in this equation not because it is unfairly undercutting American-made products but because it offers a menu of products that satisfies the tastes and preferences of a chronically saving-short U.S. economy. China bashers continually overlook the macro context of America's bilateral trade deficits at great peril.

Consider the consequences if a bipartisan coalition in Congress gets its way and U.S. trade with China is significantly curtailed: The immediate impact would be a

tax on U.S. multinationals like Wal-Mart, which sourced some $18 billion of goods from China in 2006. That would either squeeze profit margins or, if passed through to retail prices, raise the cost of living for American consumers. Over time, if the sanctions were onerous enough, the impact would be to divert U.S. trade away from China. But here's where the problem gets especially thorny: Unless America increases its domestic saving, sanctions on Chinese products will do nothing to alleviate the overall trade deficit. The outcome would fit the "water balloon analogy" to a tee—squeezing the Chinese piece would simply redirect the deficit elsewhere. And most likely that would reallocate saving-short America's multilateral trade deficit away from low-cost Chinese producers toward higher-cost foreign sourcing. That would be the functional equivalent of a tax increase on American consumers.

Unfortunately, by going after China, Congress is also biting the hand that feeds it. China is one of America's most important external lenders. To a large extent this is an outgrowth of the same currency policy that has U.S. politicians so up in arms—a "managed peg" that has allowed the renminbi to increase by only about 7% versus the dollar since July 2005. To keep the RMB in this range, China must recycle a disproportionate share of its massive build-up of foreign exchange reserves into dollar-denominated assets. As of February 2007, China held $416 billion of U.S. Treasuries—second only to Japan and up nearly $100 billion from the level a year earlier. And there is good reason to believe that the Chinese hold another $300–400 billion in other dollar-based assets, such as agencies and corporate bonds. By continuing to allocate at least 60% of its ongoing reserve accumulation into dollar-denominated assets, China remains an important source of demand for American securities—thereby helping to keep U.S. interest rates lower than might otherwise be the case. In effect, Chinese currency policy is subsidizing the interest rate underpinnings of America's asset economy—long the driver of the wealth effects that support the income-short U.S. consumer.

Congressional pressure on China could put its bid for dollar-denominated assets at risk for two reasons: On the one hand, if China accedes to U.S. pressure and allows the RMB to appreciate a good deal more against the dollar, there would be less of a need to recycle FX reserve accumulation into dollar-based assets. Absent such buying, interest rates could rise for a saving-short U.S. economy that still needs massive capital inflows. On the other hand, if Washington enacts onerous trade sanctions on China, the Chinese might understandably have less of an appetite to maintain their overweight in dollar-based assets. In fact, there is a good chance that the Chinese government would simply instruct its reserve managers to diversify incremental reserve accumulation out of dollars. In that case, the dollar could plunge and longer-term U.S. real interest rates could rise sharply—a crisis-like scenario that could tip an already weakened U.S. economy quickly into recession. Either way, by imposing sanctions on one of its major foreign lenders, Congress could be putting a saving-short U.S. economy in a very precarious situation.

Trade sanctions might also subject China to intense internal pressure that extends beyond the impact on its exporters. Despite its rapid growth and increasingly important role as one of America's major suppliers of goods and financial capital, China is still a very undeveloped economy. That's especially the case with respect to its financial system, dominated by four large banks that are only just starting to go public. Banks and China's other international borrowers need to be able to hedge their currency exposure—especially in the face of the large exchange-rate fluctuations that Washington lawmakers are seeking. Lacking in well-developed capital markets, such hedging strategies are very difficult to implement in China. A large RMB revaluation could, as a consequence, deal a lethal blow to China's embryonic financial system.

There is also the distinct possibility that Washington-led China bashing could inflict major collateral damage on the rest of Asia. Contrary to popular folklore, China has not become the world's factory. Instead, it is functioning much more as the final destination of a huge pan-Asian supply chain—directly involving intermediate inputs and supplies from the region's other major economies like Korea, Taiwan, and Japan. China is, in fact, the largest export market for the first two of these externally-led economies and is rapidly closing in on the U.S. as Japan's largest export market.

Academic studies emphasize the pan-Asian linkages to the Chinese export machine. Professor Lawrence Lau of Stanford and the Chinese University of Hong Kong has estimated that domestic PRC-based content accounts for only about 20%

of the total value of Chinese exports to the U.S.[1] More recent research by economists at the central bank of Finland underscores how shifts in the RMB would reverberate throughout a vertically integrated pan-Asian production platform.[2] Congress is operating under the false presumption that trade sanctions would be a surgical strike solely on China. That is unlikely to be the case. Instead, there would undoubtedly be major cross-border spillovers that could quickly put pressure on the rest of a China-centric Asian supply chain.

There is a final misperception about the oft-feared Chinese exporter. It turns out that China has become an important efficiency solution for many of the world's multinational corporations. China's so-called foreign-invested enterprises—basically, Chinese subsidiaries of multinationals—have accounted for more than 60% of the explosive growth of overall Chinese exports over the past decade. That raises serious questions about the real identity of the all-powerful Chinese exporter. It may be less of a case of the indigenous Chinese company and more likely an outgrowth of conscious decisions being taken by Western companies. That poses the critical question: Who is the new China—is it them or us?

With all due respect, I worry that you in the Congress are seeing the China problem from a very narrow perspective. At the root of this approach are understandable concerns about increasingly acute pressures bearing down on American middle-class workers. But the link between this painful problem and China is based on flawed macro analysis—mistakenly focusing on a large bilateral piece of a major multilateral trade imbalance of a saving-short U.S. economy. As is often the case, one error can beget another, and the real risk is that Washington-led China bashing could trigger a host of unintended consequences—not only taxing American consumers and U.S. multinational corporations but also triggering currency and real interest rate pressures that could tip the U.S. economy into recession. But the biggest tragedy of all could come from a United States that squanders an historic chance to engage China as a strategic partner in an increasingly globalized world. If Washington pushes China away, I fear the rest of an increasingly China-centric Asia won't be too far behind.

Protectionism and Inflation

At the same time, I also fear that disinflation could be at risk as Congress rushes headlong down the path of protectionism. The cross-border arbitrage of costs and pricing—one of the unmistakable hallmarks of globalization—could well turn unfavorable if China bashers get their way. This could be a recipe for the dreaded stagflation scenario—a perfectly awful outcome for financial markets and the functional equivalent of yet another tax hike on an already beleaguered American middle class.

The U.S. economy has benefited greatly from an outbreak of "imported disinflation" over the past decade. Researchers from the IMF have estimated that the so-called import-price effect has lowered the U.S. CPI inflation rate by an average of about one percentage point per year since 1997.[3] Such an externally-driven reduction in domestic U.S. inflation is basically an outgrowth of rising import penetration from the low-cost developing world. U.S. import penetration—purchases of foreign-made products as a share of domestic goods consumption—has risen from 22% in the early 1990s to about 38% today. At the same time, Morgan Stanley calculations suggest that developing economies have accounted for 58% of the surge in total U.S. imports over the past decade. China and Mexico have led the way—making up nearly 60% of the cumulative increase of imports to the U.S. from developing economies since 1995.

Nor have currency swings or business cycles altered the disinflationary forces of globalization. Over the past 12 years, prices of non-petroleum imports into the U.S. have been basically unchanged, punctuated by brief cyclical breakouts that never exceeded 4% that were, in turn, followed by periodic declines of approximately equal magnitude. This compares with a cumulative increase in the so-called core CPI of 31% over the 1995 to 2007 interval. Even during periods of modest cyclical acceleration in import prices, spillovers from foreign to domestic inflation have been limited. That's due in large part to the still-wide disparity between price levels of foreign and domestically-produced goods—a disparity which has continued to open up in recent years. According to the U.S. Bureau of Labor Statistics, prices of non-agricultural U.S. exports, a good proxy for inflation of internationally-competitive

[1] See Lawrence Lau's 2003 paper, "Is China Playing by the Rules?" presented as testimony in September 2003 before the U.S.–China Economic and Security Review Commission.

[2] See Alicia Garcia-Herrero and Tuuli Koivu, "Can the Chinese trade surplus be reduced through exchange rate policy?" Bank of Finland, BOFIT discussion paper #6, 2007.

[3] See "How Has Globalization Affected Inflation?" Chapter III in the IMF's *World Economic Outlook*, April 2006.

goods produced within the United States, have recorded a cumulative increase of about 10% since early 1995. While that's hardly a major surge, it nevertheless stands in contrast with the stability of nonpetroleum import prices noted above. That only adds to the compelling arithmetic of imported disinflation the U.S.

I suspect there is an equally important productivity angle to this as well. Globalization and the record expansion of world trade it has engendered have played a new and important role in the execution of global efficiency solutions by U.S. businesses. This arises from increasingly powerful synergies of cross-border supply chains available to U.S. multinational corporations, as well as from the arbitrage between relatively antiquated high-cost facilities at home with newer vintages of low-cost production platforms abroad.[4] Similarly, there is compelling evidence of innovation-driven productivity spillovers from inward foreign direct investment.[5] To the extent that "imported productivity" growth dampens overall cost pressures in the domestic economy, globalization has created yet another powerful headwind holding back U.S. inflation.

As a result of these trends, the sourcing of domestic consumption in the United States has shifted away from high-cost goods made at home to cheaper and increasingly high-quality products produced by low-cost developing economies. In one sense, these impacts are temporary—they reflect globalization-driven impacts on the U.S. economy that have taken it from one state of "openness" to another. Consequently, as import penetration eventually levels out, the impacts of imported disinflation could ebb. At the same time, should forces come into play that arrest globalization—namely an outbreak of trade protectionism—there could well be a reversal of the external pressures of disinflation, thereby boosting overall inflation.

Unfortunately, that is precisely the risk today. As you in Washington now move to contemplate policies that could lead to trade frictions and protectionism, America's global sources of disinflation would be very much at risk. Tariffs and non-tariff duties are the functional equivalent of a tax on low-cost imports. Depending on pricing leverage, such taxes could be directly passed through to American consumers. At a minimum, they would boost cost pressures on U.S. multinationals, with the potential to interrupt the shifting of high-cost domestic production to cheaper offshore locations. Moreover, such frictions might also diminish the productivity dividend offered by global supply chains. This latter possibility could well be reinforced by ongoing efforts of the U.S. Congress to tighten up the so-called CFIUS (Committee on Foreign Investment in the United States) approval process for foreign direct investment into the United States—a development that has gathered considerable momentum in the aftermath of the aborted 2006 acquisition of U.S. port facilities by Dubai Ports World.

Nor is the cyclical timing of all these developments exactly ideal. The imposition of trade and investment barriers could lead to the return of the closed-economy inflation dynamic at just the time when slack has diminished in America's labor and product markets. And, of course, the dreaded dollar-crisis scenario—hardly a trivial consideration in a protectionist climate—could lead to a much sharper spike in import prices than has been evident in a long time. All in all, such an unfortunate confluence of circumstances could exacerbate domestically driven inflationary pressures at precisely the wrong point in the business cycle—in sharp contrast to a globalization that has acted increasingly to offset such cyclical pressures over the past 15 years.

There is great irony to Congressional attempts to "fix" globalization: The odds are that the most extensive damage will be inflicted on the very constituency in the U.S. economy that the politicians are trying to assist—America's middle-class. One of the most important lessons of the 1970s is that inflation is the cruelest tax of all. And yet that lesson now seems all but lost on Capitol Hill today. There is no refuting the reality of pressures already bearing down on American labor. In the current economic upturn, Morgan Stanley calculations suggest that the cumulative gains in private sector worker compensation remain about $430 billion (in real terms) below the trajectory of the typical expansion. Moreover, according to the U.S. Bureau of Labor Statistics, the median wage—inflation-adjusted weekly pay for the worker in the middle of the wage distribution—has risen a cumulative total of just 0.9% over the seven years ending in the first quarter of 2007; that's an especially disturbing development in a period of accelerating productivity growth—very much at odds with the long-standing conclusions of economic theory and experience. As an outgrowth of

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[4] See Federal Reserve Vice Chairman Donald L. Kohn, "**The Effects of Globalization on Inflation and Their Implications for Monetary Policy," June 2006.**

[5] See Jonathan Haskel, Sonia Pereira, and Matthew Slaughter, "Does Inward Foreign Direct Investment Boost the Productivity of Domestic Firms?" CEPR Discussion Paper No. 3384, May 2002. Available at SSRN: http://ssrn.com/abstract=317681.

these developments, the labor share of America's national income has fallen sharply in recent years and remains near its post-1970 low of 56%. Sadly, Congress now appears to be contemplating a response to these pressures that would impose the functional equivalent of an inflation tax on U.S. workers at precisely the time when they can least afford it.

America's beleaguered middle class deserves better. Due to under-investment in education and human capital over the past 25 years, American labor is lacking in many of the skills required to face the new competitive challenges of an IT-enabled globalization that is bearing down on white- and blue-collar workers, alike.[6] Moreover, by failing to save and to embrace pro-saving policies, the U.S. has set itself up for chronic current-account and trade deficits. This is a lethal political and economic combination that has injected a new sense of urgency into the globalization debate. And Washington politicians, rather than taking a hard look in the mirror, have embarked on a dangerous course of "scapegoatism"—blaming China for all that ails the American worker. That has taken the Congress to the brink of moving beyond the rhetorical bluster of the past few years and enacting legislation that would impose severe trade sanctions on China.

In looking back over the past quarter century, few accomplishments in the economics sphere match the successes of the battle against inflation. Globalization and trade liberalization have become important in insuring the post-inflation peace. Yes, for many, this has been a mixed blessing. There is no question that workers in the developed world have borne a disproportionate share of the cross-border arbitrage that lies at the heart of globalization. At the same time, I have little doubt that the ensuing disinflation has been key in fostering improvements in purchasing power that boost living standards of the same hard-pressed workers. Protectionism raises the risk of squandering this critically important disinflationary dividend—thereby eroding inflation-adjusted purchasing power. That is the very last thing America's middle class needs.

Losing Asia?

There are also important geopolitical consequences of the recent shift in U.S. trade policies. The more America resists the rise of Asia—precisely the risk in light of mounting protectionist pressures in Washington—the greater the chances the region will go its own way. Signs of such a development are already apparent—especially in the form of a new rapprochement between Asia's two economic powerhouses, Japan and China. That raises the worrisome possibility of disengagement between the U.S. and the world's most rapidly growing region. If that turns out to be the case, America will have squandered one of the greatest opportunities of globalization.

The emergence of a China-centric Asian supply chain has been a major feature of the region's recovery from the wrenching financial crisis of 1997–98. Up until recently, Japan has been on the outside looking in. That is now changing. Japan's overall trade volume with China has doubled during the last five years, with shipments from the PRC and Hong Kong, combined, having surged from 5% of total Japanese imports in the early 1990s to close to 21% today.

These trends may well be an important precursor of a new stage of pan-Asian economic integration—growing linkages between China and Japan. Collectively, these two nations—the world's second and fourth largest economies—account for 82% of pan-Asian GDP as measured by the IMF's purchasing-power-parity metrics. If they come together, the implications for Asia—as well as for the rest of the world—would be enormous.

The possibility of such a new thrust to pan-Asian economic integration is more than just idle curiosity. China's Premier Wen Jiabao just completed the first mission of a senior Chinese official to Tokyo in over six years. That followed shortly on the heels of last October's trip to China by Prime Minister Shinzo Abe—the first foreign excursion of the then newly elected head of the Japanese government. Both leaders appear to be putting great personal stake in forging a new future for one of history's more volatile relationships. Premier Wen's speech to the Diet—the first time a Chinese leader has ever addressed the Japanese legislature—put the economic relationship between the two nations in an important context: By stressing complementarity and interdependence, Wen spoke of a China that appears willing to embrace Japan as a strategic economic partner rather than as an adversary.

Japan has certainly come a long way in the past five years in rethinking its approach toward China. As recently as 2002, leading Japanese government officials were still casting China in the role of a major source of Asian instability—accusing

[6] See Stephen S. Roach, "Unprepared for Globalization," Morgan Stanley *Investment Perspectives*, February 3, 2007.

the PRC of not only exporting deflation but also being responsible for a "hollowing out" of Corporate Japan.[7] The Koizumi government subsequently turned that attitude around—pushing proactive strategies of corporate restructuring that welcomed offshore efficiency solutions for high-cost Japanese manufacturers. China is now a prime beneficiary of this approach, as Japanese multinationals turn aggressive in pursuing offshore options. Japan's foreign direct investment into China hit U.S.$6.5 billion in 2005—greater than China-bound flows from all of Europe ($5.6 billion) and more than double those of the United States ($3.1 billion).

The significance of further momentum to economic cooperation between Japan and China cannot be minimized. These two economies—one a surplus-labor behemoth and the other a labor-short island—are a formidable combination. As China now faces the imperatives of migrating from a long-standing fixation on the quantity of growth to a newfound focus on the quality of growth, what better partner could it ask for than Japan to provide technological assistance for energy conservation and pollution abatement? And as a rapidly aging, high-cost Japanese economy faces increasingly intensive competitive pressures, who better could it turn to than China to offer offshore options with both the scale and the quality control its production model needs? China needs Japan just as much as Japan needs China—precisely the complementarity that Wen Jiabao alluded to in his recent address to the Japanese Diet. Yet that same complementarity raises important questions for the rest of the world—especially for a U.S. economy that may find itself increasingly marginalized by a new strain of pan-Asian integration.

Globalization at Risk

By embracing protectionist remedies and going after China, Congress is reacting to symptoms of much deeper problems—especially skillset disadvantages of American workers and an extraordinary shortfall of domestic saving. Absolutely nothing is gained on either front by blaming China for problems such as these that originate at home. To the contrary, much could be lost—in the U.S., the global economy, and world financial markets—if Congress makes a major blunder on U.S. trade policy. Wrong-footed macro analysis is a clear risk in this regard—especially holding a bilateral deficit with China accountable for what is truly a multilateral manifestation of America's chronic saving problem. At the same time, unwinding the disinflationary benefits of globalization would borrow a painfully familiar page from the stagflationary script of the 1970s. And the consequences of pushing Asia away from the U.S. sphere of influence cannot be minimized. All in all, the outcome of a protectionist tilt to U.S.–China trade policy could be treacherous—both for financial markets and the U.S. economy.

None of this is to say that there shouldn't be active and direct negotiations with the Chinese on more legitimate conflicts over trade policy—especially those issues that bear directly on broad constituencies of the U.S. workforce. The area of intellectual property rights is especially important in that regard, particularly since it directly affects the core competencies of America's vast legions of knowledge workers—the professionals, managers, executives, sales workers, and office support staffs who, by our calculations, collectively account for 61% of total U.S. employment. The U.S. Trade Representative's recent decision to initiate IPR complaints against China with the WTO is a far more appropriate course of action than misdirected congressional scapegoating over the currency and bilateral trade deficit issues. Unfortunately, you in Washington are having a hard time making this critical distinction.

Globalization isn't easy. It puts pressure on developing and developed countries, alike. As the world's leading economic power, it falls to the United States to assume the special role as a steward of globalization. China bashing is tantamount to an abdication of that responsibility. It is not in America's best interest, and it could quickly take the world down a very slippery slope. Globalization, itself, may have an exceedingly difficult time recovering. You in the Congress must heed these risks—before it is too late.

Chairman LEVIN. Thank you.

Dr. Bergsten.

[7] See Haruhiko Kuroda and Masahiro Kawai, "Time for a Switch to Global Reflation," a December 12, 2002 op-ed piece in the *Financial Times*. Note: Kuroda was then Japan's Vice Minister for International Affairs at the Ministry of Finance and Kawai was his deputy.

STATEMENT OF C. FRED BERGSTEN, DIRECTOR, PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS

Mr. BERGSTEN. Mr. Chairman, my congratulations on the hearings. I am delighted to be invited.

I am clearly in the camp that agrees there is a very large problem here, and it requires new policy steps. Steve Roach has quite rightly pointed to some risks of action. The risks of inaction are much greater. If we fail to address the panoply of issues surrounding our international imbalances, we are imperiling our own economy, and our ability to maintain an open trade policy, and therefore we need to act decisively, forcefully and much more aggressively than we have to date.

The U.S. global current account deficit is twice as great as it ever was before and continues to rise. To finance its deficit and its own capital outflows, the U.S. economy needs $8 billion of foreign capital every working day, or else exchange rates will crash, interest rates will soar, inflation will rise and the economy would be at real peril. We are running an economy based on credit card finance, which as long as it continues is great, but it is inherently unsustainable over any prolonged period of time, and puts the nation at huge jeopardy and therefore requires action.

Steve Roach is right. The central part of the corrective action rests on us. We are the deficit country. We need to take action. We need to raise our National saving rate and the best way to do that is for Congress to move the budget back into the modest surpluses that we were running six or seven years ago. That would increase the national saving rate three or 4 percentage points, reduce our need to attract so much foreign capital, reduce our excess spending over domestic output and begin to correct the problem. So, we need to act first.

However, you can correct deficits only if you can correct the counterpart surpluses. It takes two to tango. You can't get a deficit down unless the counterpart surpluses come down. The problem we're facing today is that one important group of surplus actors, namely the Asian countries led by China and Japan but going beyond them, have blocked any correction from the surplus country side.

It is sometimes ignored that there has been a lot of correction. The dollar exchange rate has come down by an average of 15 to 20 percent, depending on which index you use, over the last 5 years. This decline has been wholly against the currencies of Europe, Canada, and Australia. Their currencies have gone up 30 to 40 percent and they've been hurting to some extent as a result.

But the Asians have blocked any meaningful participation in the adjustment process.

China and Japan are the two big players but they're different. China has overtly blocked any rise in the value of its currency, which needs to go up 30 or 40 percent like the euro and other European currencies. The Chinese have blocked it by overt, blatant, massive prolonged intervention in the currency market. There is no way one can deny that. Indeed, in the first quarter of this year, the amount of their currency intervention doubled to almost $50 billion per month. It is clearly manipulation by any standard and needs to be called that and acted upon.

Japan is different. It has not intervened for over 3 years. It is not manipulating, as Secretary Evans said. However, by any standard, its currency is also substantially undervalued because of low interest rates, huge outflow of capital, the so-called carry trade. The fact that it's not manipulating does not take it off the hook for needing to participate in the adjustment process and accept a substantial rise in the value of its currency.

If China and Japan permit their currencies to go up, it will pull the rest of the Asian currencies up. The effect would be a substantial adjustment of our own imbalance.

Our estimate is that if all Asian currencies go up even 20 percent, it takes $150 billion to $200 billion per year off the U.S. current account deficit. That, I would submit, is getting us at least half of the correction we need. We should push for that as quickly as we can.

I offer a five-point proposal for changing policy. First, Treasury needs to tell the Chinese that if they don't stop intervening so massively, if they don't let the currency go up at least 10 percent a year, then they are going to be labeled as a manipulator in the next Treasury report. I would say it to them privately. I would give them warning. I would give them an opportunity to act on their own so as not to appear to be under foreign pressure. If they don't do it, we should then clearly label them.

Second, the administration, in addition to telling the Chinese, should tell the G7 and the IMF that it is about to label China as a manipulator absent action. That's an effort to get support from the rest of the world to multilateralize the process, which is of course the preferred way to go about it.

Third, the administration should add a trade dimension to the strategy by again telling the Chinese and then acting in the absence of action on their part that we will bring a WTO case against the Chinese currency practices as either an export subsidy or a frustration of trade liberalization outcome under Article XV. These are plausible, legitimate cases to bring through the multilateral process.

Fourth, if the preferred multilateral approach fails, we have to go at it bilaterally. The problem is that serious. With Japan, it's actually easy; we can buy yen in the currency markets. Indeed, if we told the Japanese we were going to do it, I suspect they would intervene directly, and get an appreciation of the yen. Most people in Japan would accept at least 10 percent or more. That's fairly easy.

China is harder, because it's currency is inconvertible. We would have to find market proxies. But again, Treasury intervention directly in the currency markets could work.

Finally, the administration should tell the Chinese that if all of the above fails, it will simply have to stop protecting them against the Congress and work with the Congress to put into place responsible new legislation that would impose effective sanctions against continued currency violation in a way that is compatible with the global multilateral trading system.

A couple of the bills that are now in the hopper try to do that. They can be improved and fine tuned. But I think that objective can be achieved. If at the end of the road that is the only course

available, I think you should take it. The risk of inaction is much greater than the risk of taking decisive progressive action.

Thank you.

[The prepared statement of Mr. Bergsten follows:]

Prepared Statement of C. Fred Bergsten[1], Ph.D., Director, Peterson Institute for International Economics

The U.S. global merchandise trade and current account deficits rose to $857 billion in 2006. This amounted to 6.5 per cent of our GDP, twice the previous record of the middle 1980s.[2] The deficits have risen by an annual average of $100 billion over the past four years.

These global imbalances are unsustainable for both international financial and U.S. domestic political reasons. On the international side, the United States must now attract about $8 billion of capital from the rest of the world every working day to finance our current account deficit and our own foreign investment outflows. Even a modest reduction of this inflow, let alone its cessation or a sell-off from the $14 trillion of dollar claims on the United States now held around the world, could initiate a precipitous decline in the dollar. Especially under the present circumstances of nearly full employment and full capacity utilization in the United States, this could in turn sharply increase U.S. inflation and interest rates, severely affecting the equity and housing markets and potentially triggering a recession. *The global imbalances probably represent the single largest current threat to the continued growth and stability of the U.S. and world economies*.

The domestic political unsustainability derives from the historical reality that substantial dollar overvaluation, and the large and rising trade deficits that it produces, are the most accurate leading indicators of resistance to open trade policies in the United States. Such overvaluation and deficits alter the domestic politics of U.S. trade policy, adding to the number of industries seeking relief from imports and dampening the ability of exporters to mount effective countervailing pressures. Acute pressures of this type, threatening the basic thrust of U.S. trade policy and thus the openness of the global trading system, prompted drastic policy reversals by the Reagan Administration, to drive the dollar down by more than 30 percent via the Plaza Agreement in the middle 1980s, and by the Nixon Administration, to impose an import surcharge and take the dollar off gold to achieve a cumulative devaluation of more than 20 percent in the early 1970s.

The escalation of trade pressures against China at present, despite the strength of the U.S. economy and the low level of unemployment, is the latest evidence of this relationship between currency values and trade policies. With deep-seated anxieties over globalization already prevalent in our body politic, and the failure of the Doha Round to maintain the momentum of trade liberalization around the world, *continued failure to correct the currency misalignments could have a devastating impact on the global trading system.*

The Role of China[3]

China's global current account surplus soared to about $250 billion in 2006, about 9 per cent of its GDP. Its trade surplus has doubled again in the first quarter of 2007. *China has become by far the largest surplus country in the world*, recently passing Japan and far ahead of all others. Its foreign exchange reserves have also passed Japan's to become the largest in the world and now substantially exceed $1 trillion, an enormous waste of resources for a country where most of the huge population remains very poor.

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[1] Dr. Bergsten has been Director of the Peterson Institute for International Economics since its creation in 1981. He was previously Assistant Secretary of the Treasury for International Affairs (1977–81) and Assistant for International Economic Affairs to the National Security Council (1969–71). The latest of his 37 books is as co-author of *China: The Balance Sheet: What the World Needs to Know Now About the Emerging Superpower,* prepared jointly by the Center for Strategic and International Studies and the Institute for International Economics and published by Public Affairs Press in March 2006.

[2] I note with immodesty but pride that, based on the work of my colleague Catherine L. Mann, I predicted precisely such an outcome for 2006 in the third paragraph of my testimony before the Senate Committee on Banking, Housing and Urban Affairs on May 1, 2002.

[3] A superb and comprehensive analysis of this issue can be found in Morris Goldstein, "A (Lack of) Progress Report on China's Exchange Rate Policies," in *The China Balance Sheet in 2007 and Beyond*, Washington: Center for Strategic and International Studies and Peterson Institute for International Economics, May 2007.

A substantial increase in the value of the Chinese currency is an essential component of reducing the imbalances. A recent joint study of the imbalances by leading think tanks in Asia and Europe, along with our Peterson Institute for International Economics, concludes that the RMB needs to appreciate by at least 35 per cent against the dollar.[4]

However, *China has blocked any significant rise in the RMB by intervening massively in the foreign exchange markets, buying $15–20 billion per month for several years to hold its currency down*. The level of Chinese intervention has almost doubled in the first quarter of this year, to about $45 billion per month. China has recently let the RMB rise marginally against the dollar but, since it continues to link its exchange rate to the dollar and the dollar has fallen against virtually all other currencies, *the average exchange rate of the RMB is weaker now than in 2001 when China's current account surplus accounted for a modest 1.3 per cent of its GDP. The world's most competitive economy has become even more competitive through a deliberate policy of currency undervaluation.*

About one quarter of all of China's economic growth in the past two years has stemmed from the continued sharp increase in its trade surplus. *China is thus overtly exporting unemployment to other countries and apparently sees its currency undervaluation as an off-budget export and job subsidy that, at least to date, has avoided effective international sanction*.

By keeping its own currency undervalued, China has also deterred a number of other Asian countries from letting their currencies rise very much against the dollar for fear of losing competitive position against China. Hence *China's currency policy has taken much of Asia out of the international adjustment process*. This is critical because Asia accounts for about half the global surpluses that are the counterparts of the U.S. current account deficit, has accumulated the great bulk of the increase in global reserves in recent years, and is essential to the needed correction of the exchange rate of the dollar because it makes up about 40 per cent of the dollar's trade-weighted index. The most obvious Asian candidates for sizable currency appreciation in addition to China are Japan, Taiwan, Singapore and Malaysia.

The Role of Japan

Japan is the world's second largest surplus country, with a current account imbalance of $167 billion in 2006, and holder of foreign exchange reserves. Japan must play an important role in correction of the global imbalances.

There are two important differences between Japan and China on these issues. On the one hand, Japan is by far the world's largest creditor country as a result of the cumulation of huge surpluses that it has run for most of the past thirty years. Its surpluses have been much more persistent than those of China, which have mushroomed to substantial magnitude only over the past decade.

On the other hand, Japan has not intervened in the currency markets for over three years. It too intervened heavily back in 2003–early 2004, even more than China during some periods, to keep the yen from rising. However, it has not done so since that time. The yen remains weak primarily because of Japan's very low interest rates, which have approximated zero for over five years, which induces investors from around the world to borrow yen and invest them in higher-yielding assets in other countries (the "carry trade"). Hence Japan cannot be accused of "manipulation" at this time.

The same new international study referenced above, however, concluded that the yen was also substantially undervalued. The group's judgment was that it needed to rise by about 25 per cent against the dollar, to around 90:1 from its current level of close to 120:1, as part of a new global equilibrium.[5]

The Policy Implications

It is essential to reduce the U.S. external deficit, and the counterpart surpluses especially in China and Japan, by substantial amounts in as orderly a manner as possible. The goal of U.S. adjustment should be to cut our global current account

[4] Alan Ahearne, William R. Cline, Kyung Tae Lee, Yung Chul Park, Jean Pisani-Ferry and John Williamson, *Global Imbalances: Time for Action*, Washington: Peterson Institute for International Economics, March 2007.

[5] It should be noted that the suggested increases in the value of the RMB and yen against the dollar would represent much smaller rises in the trade-weighted average exchange rates of those currencies, which should make them much more acceptable to the countries involved. If all major currencies rise against the dollar, as they must to achieve a substantial reduction in the U.S. external deficit and as the rest of the truly floating currencies (euro, pound, Swiss franc, Canadian dollar, etc.) have already done, then the average rise for each of them is of course much less. The real increase in the RMB and yen, for example, would be only about half their rise against the dollar.

deficit to 3–3½ percent of GDP, about half its present level, at which point the ratio of U.S. foreign debt to GDP would eventually stabilize and should be sustainable. China's goal, already accepted in principle by its political leadership but without much policy follow-up, should be to totally eliminate its global current account surplus and stop the buildup of foreign exchange reserves. Japan should pare its surplus to perhaps 1 per cent of its GDP.

The United States should take the lead in addressing the imbalances by developing a credible program to convert its present, and especially foreseeable, budget deficits into modest surpluses like those that were achieved in 1998–2001. Such a shift, of perhaps 3–4 percent of our GDP, would reduce the excess of our domestic spending relative to domestic output and thus cut demand for imports. It would pare the shortfall of our domestic savings relative to domestic investment and thus reduce our need for foreign capital inflows, which push the dollar to levels that are overvalued in trade terms. Fiscal tightening is the only available policy instrument that will produce such adjustments. Hence I strongly recommend that the new Congress take effective and immediate steps in that direction.[6]

China needs to adopt policies to promote an opposite adjustment, reducing its uniquely high national saving rate by increasing domestic consumption. China can do so most easily through higher government spending on health care, pensions and education. Such new government programs are needed for purely internal reasons anyway because of the political unrest in China that has resulted from the demise of state-owned enterprises that provided these benefits in previous times. They would reduce the precautionary motive for household saving in China and boost private as well as government demand, contributing importantly to the needed international adjustment. A number of important Chinese domestic goals, such as increasing employment and reducing energy consumption, also call for such shifts in the composition of China's growth strategy.[7]

Large changes in exchange rates will also have to be a major component of this adjustment process. *The dollar will need to fall, hopefully in a gradual and orderly manner over the next two or three years, by a trade-weighted average of about 20 per cent. A change in China's currency policy, in both the short and longer runs, must be a major component of this adjustment and is in fact by far the single most important issue in U.S.–China economic relations.* The short-term success of the new Strategic Economic Dialogue must be judged largely by whether it achieves effective resolution of this problem.[8]

An increase of at least 15 percent in the average value of the RMB against all other currencies, which would imply an appreciation of about 35 percent against the dollar, and sizable appreciations against the dollar of other key Asian currencies, will be required to achieve an orderly correction of the global imbalances.[9] Such a change could be phased in over several years to ease the transitional impact on China. It could be accomplished either by a series of step-level revaluations, like the 2.1 percent change of July 2005 against the dollar but of much larger magnitudes and with a substantial initial "down payment" of at least 10–15 percent, or by a much more rapid upward managed float of the RMB than is underway at present. Such an increase in the RMB and other Asian currencies against the dollar would reduce the U.S. global current account deficit by about $150 billion per year, more than one third of the total adjustment that is required.[10]

Over the longer run, China should adopt a more flexible exchange rate that will respond primarily to market forces. These forces would clearly have pushed the RMB to much higher levels by now in the absence of China's official intervention. There is some justification, however, for China's fears that an abrupt move to a free-

[6] See my testimonies on that topic to the House Budget Committee on January 23 and the Senate Budget Committee on February 1. I suggest there that the external imbalances are in fact the most likely source of a crisis that could force the United States at some point into precipitous and thus unpalatable budget adjustments if preemptive action is not taken.

[7] See Chapter 2 of *China: The Balance Sheet* and Nicholas Lardy, "China: Toward a Consumption-Driven Growth Path," Washington: Institute for International Economics, October 2006.

[8] The Strategic Economic Dialogue also has the long-term potential to foster a more constructive relationship between the two countries that will inevitably lead the world economy over the coming years and perhaps decades. It thus begins to implement the "G–2" concept proposed in my "A New Foreign Economic Policy for the United States" in C. Fred Bergsten and the Institute for International Economics, *The United States and the World Economy: Foreign Economic Policy for the Next Decade,* Washington: Institute for International Economics, 2005, pp. 53–4.

[9] See William R. Cline, *The United States as a Debtor Nation*, Washington: Institute for International Economics, 2005, especially Table 6.2 on page 242.

[10] I have studiously refrained from mentioning the very large Chinese bilateral trade surplus with the United States, which should not be a primary focus of policy because of the multilateral nature of international trade and payments. At present, however, the bilateral imbalance is a fairly accurate reflection of the global imbalances and thus is more relevant than usual.

ly floating exchange rate now, particularly if accompanied by abolition of its controls on financial outflows, could trigger capital flight and jeopardize its economy in view of the fragility of its banking system. Full-scale reform of China's exchange rate system will have to await completion of the reform of its banking system, which will take at least several more years. Hence the adoption of a flexible exchange rate regime in China, which is essential to avoid re-creation of the present imbalances in the future, can be only a second stage in the resolution of the currency problem and the immediate need is for a substantial increase in the price of the RMB (especially against the dollar).[11]

A New U.S. Currency Strategy

It is obvious that China is extremely reluctant to make the needed changes in its currency policy. It is equally obvious that U.S. efforts on the issue over the past four years, whether the earlier "quiet diplomacy" of the Administration or the threats of Congressional action or the new Strategic Economic Dialogue, have borne little fruit to date. *A new U.S. policy is clearly needed.*

One cardinal requirement is for the Administration and Congress to adopt a unified, or at least consistent, position. To date, there has been something of "good cop (Administration)—"bad cop" (Congress, e.g., the threat of the Schumer-Graham import surcharge legislation) bifurcation between the two branches. China has exploited these differences, essentially counting on the Administration to protect it from the Congress—a bet that, to date, has paid off.

I would therefore suggest a new five-part strategy for U.S. policy on the currency issue.

First, *it is clear that China has aggressively blocked appreciation of the RMB through its massive intervention in the currency markets and that the Treasury Department has severely jeopardized its credibility on the issue by failing to carry out the requirements of current law to label China a "currency manipulator*." The Treasury report of May 2005 indicated that ". . . if current trends continue *without substantial alteration* (italics added), China's policies will likely meet the statute's technical requirements for designation." The report of May 2006 sharply criticized China for its currency policies, clearly suggesting that there has been no "substantial alteration" in those practices, but inexplicably failed to draw the obvious conclusion of its own analysis.[12] The latest report, submitted in December 2006, was much milder. *Treasury has thus been reducing its criticism of China's currency practices even as the RMB has become increasingly undervalued and China's external surpluses have soared*.

The Treasury policy needs to be changed sharply and quickly. *The Administration should notify the Chinese that, if China fails to make a significant "down payment" appreciation of at least 10 percent prior to the release of Treasury's next semi-annual report, it will be labeled a "manipulator.* " This would trigger an explicit U.S. negotiation with China on the currency issue.

Second, *the Administration should notify its G–7 partners and the IMF that it plans to make such a designation, in the absence of major preventive action by China, with the goal of galvanizing a multilateral effort on the issue* and reducing its confrontational bilateral character. *The objective of that international effort, hopefully spearheaded by the IMF, could be a "Plaza II" or "Asian Plaza"* agreement that would work out the needed appreciation of the major Asian currencies through which the impact on the individual countries involved (including China) would be tempered because they would not be moving very much vis-à-vis each other.[13] The Europeans have an especially large incentive to join the United States in such an initiative because their own currencies will rise much more sharply when the dollar experiences its next large decline if China and the other Asians continue to block their own adjustment (and perhaps to head off the incipient United States-China "G–2" implied by the Strategic Economic Dialogue).

Third, *the Administration* (with as many other countries as it can mobilize) *should also take a new multilateral initiative on the trade side by filing a WTO case against China's currency intervention as a "frustration of trade commitments" or as an export subsidy*. As Chairman Ben Bernanke indicated in his highly publicized speech in

[11] This two-step approach was initially proposed by my colleagues Morris Goldstein and Nicholas Lardy, *Two-Stage Currency Reform for China, Financial Times*, September 12, 2003.

[12] Treasury and the IMF have justified their inaction on the grounds that there is insufficient evidence that China is manipulating its exchange rate with the "intent" of frustrating effective current account adjustment. This is of course ludicrous because it is highly unlikely that China (or any country) would *admit* such a motive and it is impossible to discern any other purpose for the policy.

[13] See William R. Cline's "The Case for a New Plaza Agreement," Washington: Institute for International Economics, December 2005.

Beijing last December, in connection with the first Strategic Economic Dialogue, China's exchange rate intervention clearly represents an effective subsidy (to exports, as well as an import barrier) in economic terms. It should be addressed as such.[14]

Fourth, if the multilateral efforts fail, the United States will have to address the China currency issue unilaterally. *Treasury can pursue the most effective unilateral approach by entering the currency markets itself.* It is impossible to buy RMB directly, because of its continued inconvertibility, so Treasury would have to select the best available proxies in the financial markets. The message of U.S. policy intent would be clear, however, and at a minimum there would be a further sharp increase in speculative inflows into the RMB that would make it even more difficult for the Chinese authorities to resist their inflationary consequences and thus the resultant pressures to let the exchange rate appreciate.

Direct intervention could be much more effective in promoting the needed appreciation of the yen, since that currency is traded freely in global markets. Japan could of course undertake such intervention itself by selling (probably modest amounts of) dollars from its huge foreign exchange reserves.[15]

The United States has conducted such currency intervention on many occasions in the past, most dramatically via the Plaza Agreement in 1985 and most recently when it bought yen to counter the excessive weakness of that currency in 1998 (when it approached 150:1)—a similar step to what could be undertaken now, with the yen as weak (adjusted for inflation differentials since 1998) as it was then. All those actions have been taken with the agreement of the counterpart currency country, however, and usually in cooperation with that country. This would be the essence of the proposed "Plaza II" or "Asian Plaza" agreement, as suggested above, and the multilateral approach would be preferable now as always and should be pursued vigorously by the Administration. Failing such agreement, however, the unilateral option is available and might have to be adopted.

Fifth, *the Administration should quietly notify the Chinese that it will be unable to continue opposing responsible Congressional initiatives to address the issue if they fail to act responsibly on their own. Congress should then proceed, hopefully in cooperation with the Administration, to craft legislation that would effectively sanction the Chinese (and perhaps some other Asians) for their failure to observe their international currency obligations*—making sure that any proposed trade policy remedies are compatible with the multilateral rules of the World Trade Organization.

Such unilateral steps by the United States, although decidedly inferior to the multilateral alternatives proposed above, could hardly be labeled as "protectionist" since they are designed to counter a massive distortion in the market (China's intervention) and indeed promote a market-oriented outcome. Nor could they be viewed as excessively intrusive in China's internal affairs, since they would be no more aggressive than current U.S. efforts on intellectual property rights and other trade policy issues (including the filing of subsidy and other cases on such issues with the WTO). Such steps should therefore be considered seriously if China continues to refuse to contribute constructively to the needed global adjustments.

Chairman LEVIN. Dr. Mohatarem.

STATEMENT OF MUSTAFA MOHATAREM, CHIEF ECONOMIST, GENERAL MOTORS CORP., DETROIT, MICHIGAN

Mr. MOHATAREM. Thank you, Chairman, and Members of these Subcommittees for holding these hearings to bring much needed attention to an issue that is causing serious and lasting damage to American business and workers.

Today, the yen is trading around 120 yen to the dollar, and experts around the world believe that a more appropriate value would be in the 90 to 95 range.

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[14] These ideas are analyzed in Gary Clyde Hufbauer, Yee Wong and Ketki Sheth, *U.S.–China Trade Disputes: Rising Tide, Rising Stakes,* Washington: Institute for International Economics, August 2006, pp. 16–26.

[15] Another option is for China to pursue the desired diversification of its dollar reserves by selling some of them for yen. See my "The Yen Beckons China's Dollars," *Financial Times*, March 12, 2007.

Over the past several years, the government of Japan has engaged in at least four strategies to keep the yen weak and thus to provide an enormous subsidy to Japan's vehicle and auto parts exporters.

First, in the period immediately following 9/11, Japan engaged in massive intervention in the currency markets, to the tune of almost $500 billion over a three-year period. This intervention was followed by jawboning a constant warning to currency traders that the yen would not be allowed to appreciate. To back the jawboning up, it was prominently announced that the Japanese legislature had approved close to a trillion dollars for additional intervention, should that prove necessary.

Now, when a country has spent $500 billion and announces that it has another trillion dollars to invest, that sends a message to markets that the yen will not be allowed to appreciate. That creates a one-way street. Given the difference in interest rates between Japan and the rest of the world, where Japanese interest rates at that point were close to zero, that Japanese investors were free to invest abroad, the so-called currency trade, and I should say Japanese and foreign investors. Essentially, the government of Japan has created a one-way market for the yen. It can only go down not up.

These policies provide substantial subsidies for each and every one of the 2.2 million vehicles that the Japanese export to the U.S. We estimate these subsidies range from $2,000 on a subcompact car to $14,000 on a full-size utility. Translated, when you look at the millions of units the Japanese export to the U.S., that's about a $13-and-a-half billion subsidy for Japanese auto manufacturers.

This subsidy has been a major factor in the success of Japanese auto companies in the U.S. and it has contributed significantly to the loss of hundreds of thousands of U.S. jobs in the auto and supplier industries. It is a major source of the nation's nearly $90 billion deficit with Japan and it has contributed to severe economic decline in my home state of Michigan and in many other communities in America.

Increasing vehicle and component imports from Japan have forced U.S. auto companies and parts to suppliers to shut our plants in the U.S. and to reduce employment by hundreds of thousands. Ironically, and this is during a period of fairly strong vehicle demand in the U.S. Ironically, when demand for vehicles in Japan is declining, Japanese manufacturers are adding production capacity, they are reactivating assembly lines, adding workers in Japan, and postponing planned factory closures as they move to export an ever greater number of vehicles.

It is time for our government to demand that Japan allow the yen to appreciate. Every major commentator, including our own Federal Reserve bank, the European central bank, and even the U.S. Treasury now acknowledge that Bank of Japan has intervened in foreign currency markets and that this intervention has harmed American manufacturers and American workers.

Congress has the right to insist that the U.S. Treasury Department stop avoiding its responsibility to report when countries are manipulating their currencies to gain a trade advantage against U.S. producers and U.S. workers. It has the right to insist that the

U.S. join European countries who are deeply concerned about an undervalued yen and raise this issue at the next G7 meeting.

Before concluding my remarks, let me briefly mention China's currency policies. China's economic growth over the last 30 years has been not short of miraculous. Many American companies, including General Motors, have benefited from this growth, as have U.S. employees who build vehicles, components and machinery for export to China. Indeed, China is now our second largest vehicle market, with GM's sales in China approaching the one million mark.

The economic stability provided by the fixed exchange rate between the RMB and the dollar was a key contributor to this growth. But you can have too much of a good thing.

Rapid productivity growth in China has resulted in an undervaluation of the RMB relative to the dollar. The People's Bank of China is now required to purchase increasing amounts of dollars to keep the RMB from appreciating more rapidly. These purchases are now only costly to China, they risk stoking inflation and substantially distorting investment decisions in China.

China recognizes these changed circumstances and is allowing the RMB to appreciate at a much faster rate than the yen, I might add. While the RMB clearly needs to appreciate further, it is appropriate to ensure that too rapid appreciation does not create economic instability. That would not be in China's interests or in the interests of the United States. Thank you for your time and attention. We appreciate your consideration.

[The prepared statement of Mr. Mohatarem follows:]

"Currency Manipulation and its Effects on American Businesses and Workers"

House Committee on Financial Services, Subcommittee on Domestic and International Monetary Policy, Trade and Technology; Committee on Ways and Means, Subcommittee on Trade; and Committee on Energy and Commerce, Subcommittee on Commerce, Trade and Consumer Protection

Testimony
By

G. Mustafa Mohatarem,Ph.D.
Chief Economist
General Motors Corporation

May 9, 2007

Thank you, Chairmen and members of the Subcommittees for this opportunity to explore the issue of "currency manipulation and its effects on American businesses and workers." Thank you for holding hearings to shed light on an issue that is critical to every American business and worker.

My name is Mustafa Mohatarem. I am the Chief Economist of General Motors Corporation. I am responsible for economics and trade policy.

I want to focus my remarks today on how the Government of Japan deliberately fosters a weak yen to promote its exports and offer a windfall to its manufacturers, much to the detriment of American businesses and workers and in dramatic contrast to the significant appreciation of the Euro, the Canadian and South Korean currencies over the past year.

By nearly every expert account, the Japanese yen is severely undervalued in comparison to the U.S. dollar and other world currencies. This misalignment provides billions of dollars in annual subsidies for Japanese auto exports and for the production of Japanese vehicles made in the United States with parts imported from Japan. It has contributed to the loss of hundreds of thousands of jobs in the auto and supplier industries in the United States; it is a major source of the nation's nearly $90 billion U.S. trade deficit with Japan; and has contributed to the severe economic decline in my home state of Michigan and in many communities in America. It is time for the U.S. government to demand that Japan allow the yen to appreciate. If freely traded, many experts believe the yen would approach 90 to the dollar instead of today's 120 to the dollar.

U.S. automakers are fully confident that our vehicles can compete successfully with other manufacturers in any market in the world, including the United States. We welcome competition from Japanese companies and other international competitors. We believe that competition in a free and undistorted environment is good for consumers, good for innovation, and good for creating ever safer and more energy efficient vehicles. We are also proud of the enormous strides we have made and continue to make with our UAW and IUE colleagues towards these ends.

Working with our unions, suppliers and distributors, General Motors has made substantial cuts in structural costs, including the costs associated with pensions and health care. We've made tremendous improvements in the productivity of our workforce and the quality of our products. We continue to work with the federal government on ways to improve the quality and efficiency of the nation's health care system and to promote increases in the energy efficiency of our vehicles and factories. But we are also affected by policies of foreign governments that are beyond the control or influence of what any particular company can do. It is those policies that I wish to address today.

GM, Ford and DaimlerChrysler have invested a combined $10 billion per year in the United States in each of the last four years, and purchase 80 percent of all U.S-produced automotive parts and components. U.S. auto manufacturers are at the heart of the U.S. manufacturing economy, directly employing some 340,000 U.S. workers and supporting nearly 6.5 million jobs throughout the U.S. economy. This compares to roughly 75,000 workers the Japanese producers directly employ in this country.

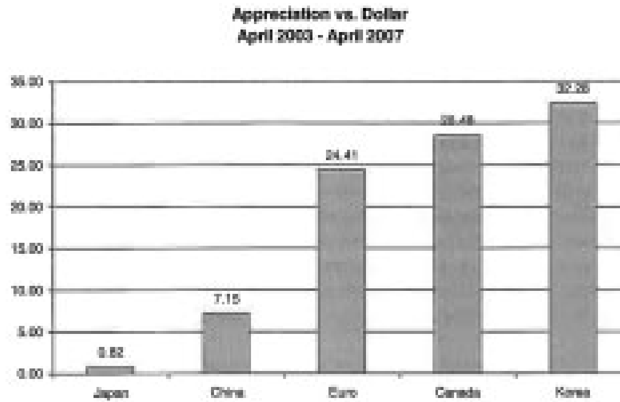
Over the past several years, the Government of Japan has engaged in at least four strategies to keep the yen weak and thus provide an enormous subsidy to Japan's vehicle and autoparts exporters. These approaches include: maintaining huge exchange reserves as a signal to the markets; implementing massive interventions in currency markets, especially from 2002-2004; signals of possible interventions to the currency markets through statements from Japan's officials (so-called "jawboning"); and purchases of dollar-denominated securities by quasi-public entities and private investors spurred on by Japan's yen policy.

Since 2001 the Bank of Japan has accumulated an additional $500 billion in foreign exchange reserves through currency interventions in order to keep the yen weak against the dollar and other major world currencies. While Japan stopped its massive direct interventions in 2004, Japan's Finance Ministry officials subsequently engaged in official jaw-boning to keep the yen down. In addition, there have been significant additional purchases of dollar-denominated securities by quasi-public Japanese entities and by private investors, both of which are encouraged by Japanese government policies. The Bank of Japan continues to maintain a level of foreign currency reserves -- $875 billion in total of which 80% is in U.S. dollars -- that is well above any level needed to insure against precautionary risks or other concerns. These reserves and the threat of further dollar purchases have helped to support the so-called carry trade in which investors borrow funds in low-interest yen in order to invest in higher interest-bearing U.S. securities.

Prior to these massive interventions, the yen was valued at close to parity with the dollar at a level of approximately 95-100 yen to the dollar. We agree with the assessment of most economists today that the yen is undervalued by at least 25 – 30 percent against the dollar. To quote Johns Hopkins Professor Steven Hanke,

> Amid the credit-boom phase of the present business cycle, the Japanese yen has been weak across the board, and is 25% undervalued against the dollar. One reason for this is that the Japanese government engaged in massive intervention to push down the value of the yen in late 2003 and early 2004. Investors thought that the government was committed to a weak yen policy. That, and the fact that interest rates in Japan are some of the lowest in the world, meant that investors thought they had a free lunch in the form of the carry trade – borrowing in low-rate yen, investing the proceeds at higher rates in other currencies. The yen carry trade has become wildly popular, accounting for perhaps $1 trillion of yen-denominated borrowings . . . ["Prepare for a Storm," *Forbes Asia*, April 23, 2007]

As the U.S. trade deficit has grown, most of the world's currencies have adjusted in the expected way: they have strengthened against the dollar. However, the world's freely traded currencies have been disproportionately carrying the burden of these adjustments. The currencies of many of our major trading partners have appreciated sharply against the dollar. Over the past four years and as shown in the chart below, the Euro has risen by 24%, the Canadian dollar by 28%, and the Korean Won by 32%. But, because of persistent Japanese government direct and indirect interventions, the yen has increased by less than one percent. Over that same period, even the Chinese Renminbi has risen by 7% or nearly nine times the increase for the yen.



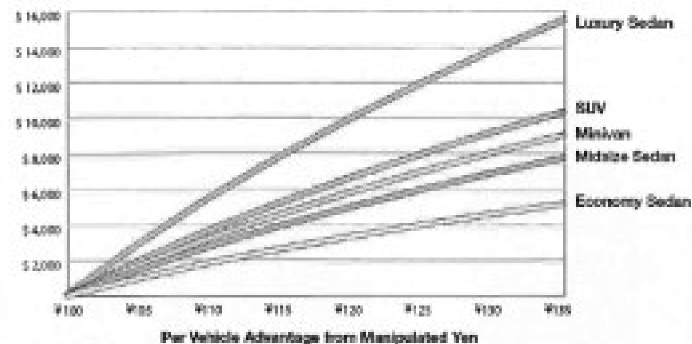
Source: General Motors Economics Staff

What is particularly disturbing in this story is that to achieve a weak and undervalued yen the U.S. government quietly endorsed Japan's efforts to keep the yen weak. In a recent book entitled "Global Financial Warriors: The Untold Story of International Finance in the Post-9/11 World," John B. Taylor, former Treasury Under Secretary for International Affairs, documents the U.S. Treasury Department's support for and acquiescence in the Japanese government's massive and historic manipulation of the Japanese yen from 2002 to March 2004. Mr. Taylor recognizes that this policy, which included frequent verbal interventions, or jawboning, as well as massive quantitative interventions in order to keep the dollar from falling to its equilibrium value, succeeded at the expense of the U.S. manufacturing sector and its employees.

Excerpts from John Taylor's book:

- "An increase in the price of the dollar makes U.S. exports less attractive, and thereby makes U.S. exporting firms and their employees very unhappy." (page 282)
- "Our policy toward exchange rate intervention in Japan was part of our effort to be supportive of quantitative easing. By not registering our strong objections to the intervention, effectively allowing it to happen, we made it easier for the Japanese to pump up their money supply." (page 286)
- "I did not object, as Treasury might have in the past [when told by the Japanese government that its currency intervention was going to increase], but I repeated our own views about keeping intervention to a minimum. True to their word intervention did increase; eventually it increased to unprecedented magnitudes, to $320 billion!" (page 288)
- "After a few months into 2003, the unprecedented nature of the intervention was becoming clear to everyone." (page 286)
- Quoting BusinessWeek: "…[Japanese Finance Minister Zembei Mizoguchi] enjoys celebrity status. And with good reason. This financial diplomat – call him Mr. Dollar – is the architect of perhaps the biggest single-handed currency intervention since World War II." (page 290)
- "If the United States thinks that Japan or China should stop intervening, then it must develop a diplomatic strategy to bring this change about." (page 281)

With the yen valued at 120 to the dollar as compared to the 90 yen per dollar that many economists estimate as its "fair market value," the Bank of Japan has provided Japan's automakers with an average subsidy of more than $4,000 on each midsize sedan exported to the United States, as shown in the graph below. This amounts to a subsidy of more than $9 billion on the 2.1 million vehicles exported to the United States in 2006. There's an additional subsidy of roughly $4.5 billion for imported parts used in American-assembled Japanese cars. This amounts to a total of more than $13.5 billion in subsidies to our Japanese competitors. This is above and beyond the normal profit these companies make, and therefore a Japanese government-subsidized windfall.



Source: Automotive Trade Policy Council

Japanese auto producers use these windfall subsidies to support their marketing and incentive campaigns, for their investments in research and development of new products, and for expansion of their operations around the world. The leading Japanese auto companies make almost three quarters of their global profits in the U.S. market. Their own public financial reports credit the weak yen for boosting profit margins. Over the last eighteen- month period the Japanese companies reported that the weakening of the yen contributed $7 billion in additional profits.

Opening Japanese auto manufacturing facilities in the United States has not slowed down the imports of automobiles from Japan. The reverse has happened: Japan exported more than 2.1 million vehicles to the U.S. in 2006, the most since the mid-1980s before they built facilities in the U.S. Last year alone, almost half of all Toyotas sold in the U.S. market were built, not in America, but in Japan.

Japan is facing a major and continuous decline in its own market for vehicles. Yet, even as demand within Japan for new autos is declining, Japanese companies are adding production capacity to Japan-based facilities, reactivating assembly lines, adding workers and postponing planned Japan factory closures as they move to export ever greater numbers of vehicles. All this is the result of a Japanese government policy to subsidize exports as the Japanese auto market shrinks.

Nowhere are the effects of the undervalued yen greater and more devastating than in my industry, which, according to the United States Bureau of Labor Statistics, has lost 300,000 highly productive, good-paying jobs since 2000. Nearly two-thirds of the 2006 U.S. trade deficit with Japan, or $56 billion out of a total of $88 billion, was the result of Japanese auto imports.

The impacts have been especially harmful to states in the industrial heartland. Michigan has lost nearly 120,000 of those auto industry jobs since 2000 and nearly 280,000 jobs in its manufacturing sector. Autos are vital to Michigan and to the industrial heartland because of substantial job multiplier effects: for every job created or destroyed in auto assembly there are anywhere from 3 to 5 jobs created or destroyed upstream in supply all the way up to the mine mouth and downstream through auto and parts distribution.

Some would suggest that these job declines have nothing to do with the yen. That is an incorrect assertion. We have made giant strides in recent years to enhance our competitiveness by working with our suppliers, workers, and distributors and many more improvements are in the works. While we are putting our own house in order, it should also be noted that there are external factors impacting competitiveness that are beyond our control and one of them is the exchange value of the U.S. dollar. To quote the former head of President Clinton's Council of Economic Advisers, Martin Baily, and his Peterson Institute of International Economics colleague, Robert Lawrence,

> The exchange rate of the dollar is the major factor leading to the trade deficit rather than any structural inability of US manufacturing or services to compete in the new global environment. . . . By far the most important reason the trade deficit is so large today is that the dollar is much higher than it was in 1981 or 1991. . . . [Martin Baily and Robert Z. Lawrence, "Can America Still Compete or Does it Need a New Trade Paradigm?" Institute for International Economics, December 2006 at http://www.iie.com/publications/pb/pb06-9.pdf, pages 8 and 9; emphasis added]

There is also a consensus among economists that while there are benefits to our economy from a strong dollar, such as lower overall inflation and reduced interest rates, the overvalued dollar has caused severe economic distortions that have artificially inflated certain goods producing and service sectors and there will be a day of reckoning when interest rates go back up as they must. Recent reports on the decline of housing construction and the concomitant slowing of GDP growth would suggest that this day may have already arrived.

The current Federal Reserve Board Chairman and then-Governor Ben Bernanke cautioned as early as March of 2005 that the trade deficit would be a concern precisely for these reasons. He said and I quote:

> In the United States, for example, the growth in export-oriented sectors such as manufacturing has been restrained by the U.S. trade imbalance . . . while sectors producing nontraded goods and services, such as home construction, have grown rapidly. To repay foreign creditors, as it must someday, the United States will need large and healthy export industries. The relative shrinkage in those industries in the presence of current account deficits--a shrinkage that may well have to be reversed in the future--imposes real costs of adjustment on firms and workers in those industries. ["The Global Savings Glut and the U.S. Current Account Deficit," Remarks of Governor Ben S. Bernanke, Homer Jones Lecture, March April 14, 2005, St. Louis, Missouri, updating a March address on the same topic]

Put another way, those jobs that the undervalued yen has destroyed in Michigan and in the nation's industrial heartland have been the result not of any lack of efficiency or competitiveness. Rather, they are the result of the decision by the government of Japan to push the yen down by twenty percent or more and keep it there. The loss of these jobs is the result of a weak yen and other Asian currencies that cheapen foreign imports at the expense of equally efficient domestic, U.S. producers, their suppliers and employees. When the dollar someday falls to its competitive, undistorted level against the yen many of the jobs that Chairman Bernanke said will be needed to repay our Japanese and other foreign creditors just won't be there. There will be other jobs in a full employment economy – but they will be less productive and less good paying. All of this because of the foreign exchange operations of the Bank of Japan that have pushed down the yen in order to promote the export-competitiveness of their industries.

In contrast to our own government, many countries are deeply concerned about the unfair competitive advantage Japan is offering its vehicle and parts makers by means of a weak yen policy. Germany, France, and other European nations have repeatedly urged that the undervalued yen be addressed by the G-7 nations. Regrettably, Japan, and it appears the US too, have blocked such discussion of the misaligned yen in this setting.

Economists across the globe fear that Japan's vast sums of currency reserves and its dominant role as the go-to point for overseas investors on the hunt for cheap loans – the so-called carry trade – present dangers to the global trading system. Editorial opinion in the major international financial press (including *The Economist and the Financial Times)* has called for urgent attention to today's huge global currency distortions. The International Monetary Fund (IMF) has been charged with providing recommendations for much stronger action to deal with huge currency misalignments this year.

As Treasury Secretary Paulson has noted the yen trades in a global market. There is no good reason for Japan to hold any significant level of foreign currency reserves, let alone the $875 billion (80% in U.S. dollars) it built up in earlier years to keep the yen from appreciating. There can be only one reason to hold such levels of reserves and that is to continue to encourage speculators engaging in the carry trade to borrow in yen – to go short on the yen – while investing in and going long on the dollar.

Should the Government of Japan be allowed to continue to maintain a weak yen policy that gives billions of dollars in windfall subsidies to its auto industry to the detriment of its competitors? We think not.

So, what's to be done? There needs to be a realignment of Asian currencies against the dollar. We strongly believe that Japan's currency policies should be addressed first. Japan is both the largest economy in Asia and the richest. Many Asian economies have emulated Japan's policies. Thus, unless Japan can be persuaded to change its policies, others will remain reluctant to change.

It is time for U.S. policy to place the needs of its own manufacturing sector first. To do so will require the U.S. to demand that Japan allow the yen to regain a market-determined value. Japan must be pressed to bring its currency into alignment and to trim its excessive currency reserves and trade surpluses. To begin this process, the U.S. should insist that the International Monetary Fund publish its estimate of fair market values for major currencies.

Congress should insist that the Treasury Department accept its responsibility to report accurately when countries are manipulating their currencies to gain a trade advantage. The U.S. should join European finance ministers in calling for yen currency misalignment to be put on the table at the next G-7 meeting.

We would hope that by shining a bright light on the yen policy of the Government of Japan, a coordinated international effort would result in a yen that appreciates to the level of perhaps 90 yen to the dollar.

Should none of these actions bear fruit, we would ask Congress to consider legislation that would view currency manipulation of this nature as an unacceptable trade practice enforceable under U.S. trade law.

Thank you for your time and attention. We very much appreciate your ongoing support on this critical issue.

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Chairman LEVIN. Thank you very much.
Thea Lee, welcome.

STATEMENT OF THEA M. LEE, POLICY DIRECTOR, AFL–CIO

Ms. LEE. Thank you very much, Mr. Chairman, Members of all three Subcommittees, for the opportunity to testify today on behalf of the 10 million working men and women of the AFL–CIO. We would like to congratulate and thank all three Subcommittees for your foresight in bringing together the three important Subcommittees with jurisdiction over this issue and for bringing together such a diverse group of perspectives on this important issue today.

As everybody knows, the labor movement has been very involved in the trade debate and we fight hard for rules that we think are going to be fair to working men and women both here in the United States and around the world in the context of bilateral trade agreements and trade negotiations. But it has become increasingly apparent to us over the years that if we put all of our focus on tariff reduction and subsidy discipline but we don't pay any attention to currency movement and manipulation, that we are missing an enormous piece of the picture, that this has a huge economic impact on our members and on the businesses that we work with, and that we can do a lot of work in the trade negotiations to agree on tariff reductions and rules on subsidies, but we have an enormous gaping hole that we have not addressed, and that is the currency manipulation.

It is our view that both our own trade rules and the international institutions have not caught up to the current reality, the post-Bretton Woods world, where we have a mixture of fixed and floating exchange rates and various levels of intervention by different governments.

One of the key points I would like to make today is this is not a self-correcting problem. This is not something that the market can fix, because the market is being thwarted by government actions. The governments that are taking those actions see it as in their interest to intervene in the markets in the way that they are doing so, and that is their privilege, of course. But it is also true that it is our own government's responsibility to take action if those other government actions are hurting our workers and our businesses.

I think one of the things that we have seen from our own government is that there has been an attempt to convince the Chinese government or the Japanese government that it is not in their interests to manipulate their currency.

One of the things about currency manipulation is that it is a two-edged sword. I think we all recognize that, and that is one of the things that you hear from the different members of the panel here, that there is a different view for workers and for multinational businesses, there is a different view for consumers and workers, there is a different view for companies that import and companies that export, companies that outsource.

But that at the end of the day, if we have a market disequilibrium in the exchange rates, the market is sending the wrong signals. The goods that are produced in countries that keep their currency artificially low are too cheap and our goods are too expensive in global markets, and so we put ourselves at an enormous competitive disadvantage before we even get out of the starting gate.

That is where we would like to ask our own government to act much more effectively than they have done to date. It is where I think there is an important role for the U.S. Congress to act, if the administration simply refuses even to recognize that the problem exists. Certainly, as many people have mentioned today, the Treasury Department cannot even take that initial first step of defining the governments of China and Japan as currency manipulators.

I wanted to make clear that this is not an academic exercise for the people that we represent. The difference between currency manipulation and a market equilibrium exchange rate is the difference between having a job and watching the factory close. It's the difference between having health insurance for your kids or not. For our country, it may be the difference between having a healthy middle class or sitting back and watching as the economic divisions tear us apart.

Currency manipulation is, of course, not the only issue in the trading realm. It is one of many issues that we face. Certainly with respect to China, one of many unfair trading practices that American workers and businesses face. We have violations of workers rights, asymmetrical tax policies, illegal subsidies, lax environmental and resource regulation and, of course, in our own country, a dysfunctional health care and pension system that disadvantages our own manufacturers.

But we need to take action on all those fronts. But I think if we leave the currency piece out of it, we are taking an enormous chunk of the economic disadvantage that American producers face and failing to address it.

So, in terms of the action plan, let me just skip to the chase and say that the time for more dialog and bilateral consultation is over. That hasn't worked. We haven't succeeded in convincing those other governments to change their actions. So, we need to start by using the annual Treasury Department report to be honest and to brand countries as manipulators when they have been.

Second, to indicate—for the administration to indicate its willingness to use WTO dispute resolution measures to address currency manipulation as an illegal subsidy. We would like to support and join our other friends and colleagues on the China Currency Coalition in supporting H.R. 782, the Fair Currency Act of 2007, which would clarify the definition of currency manipulation, identify currency manipulation as an illegal subsidy and ensure that countervailing duty laws can be applied to nonmarket economies. This would apply not just to China but to any country that is manipulating its currency. We think that would be a crucial first step in addressing this very important problem that's having such a negative impact on the members and on the businesses that we work with.

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

[The prepared statement of Ms. Lee follows:]

Prepared Statement of Thea M. Lee, Policy Director, American Federation of Labor and Congress of Industrial Organizations

Chairman Levin, Chairman Gutierrez, Chairman Rush, Members and Ranking Members of all three Subcommittees, I am delighted to have the opportunity to tes-

tify today on behalf of the ten million working men and women of the AFL–CIO. My remarks on currency manipulation are also offered on behalf of the China Currency Coalition, of which the AFL–CIO is a founding member.

Currency manipulation is an urgent economic issue for American workers and businesses. We all live and work and compete in the global economy—but in order to succeed in the global economy, we need our own government to ensure that the terms of competition are fair. Defining—and adequately addressing—currency manipulation is an essential element of ensuring fair global competition, but the institutions of the global economy and our own government have so far failed to rise to this challenge.

The AFL–CIO is working closely with our allies in the domestic manufacturing sector, as well as with many American farmers and ranchers, to draw attention to the job, wage, and community impacts of currency misalignments and to urge effective solutions.

Unfortunately, it often appears that this Administration does not share our sense of urgency. We hope that Congress will step into the void left by the Administration's failure to act, and we welcome this hearing as a crucial step in that direction.

The Economic Importance of Addressing Currency Manipulation

The economic impact of currency manipulation is equivalent to a country's raising tariffs on imports or subsidizing its exports. Currency manipulation shifts the relative prices of imports and exports through deliberate government action, creating a competitive advantage for the country that keeps its currency undervalued.

As a nation, we put tremendous energy into negotiating international trade rules to expand reciprocal market access at the World Trade Organization and through bilateral and regional trade agreements. Yet, small tariff changes can—and have been—swamped by unanticipated currency movements that effectively nullify negotiated changes in tariffs and disciplines on export subsidies.

In principle, rules are in place at both the World Trade Organization (WTO) and the International Monetary Fund (IMF) to prevent countries from gaining an unfair competitive advantage through exchange rate action. Yet neither the WTO nor the IMF, nor our own government, appears willing or able to implement these provisions.

Our government needs to realign its priorities and reevaluate its policy tools to recognize and address this problem.

Defining the Problem

This Administration has failed even to correctly identify currency manipulation as a problem and has failed to hold governments accountable for their actions.

In December, the Treasury Department issued its 2006 Report to Congress, in which it found that "no major trading partner of the United States met the technical requirements for designation [as a currency manipulator] under the terms of Section 3004 of the [Omnibus Trade and Competitiveness] Act [of 1988] during the period under consideration." The 2007 Report, which was due on April 15th, has not yet been submitted to Congress.

The relevant portion of the 1988 Act states that: "The Secretary of the Treasury shall analyze on an annual basis the exchange rate policies of foreign countries, in consultation with the International Monetary Fund, and consider whether countries manipulate the rate of exchange between their currency and the United States dollar for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade."

The 2006 Treasury report finds that China's current account surplus rose to "around 8 percent of GDP" in the first half of 2006, up more than fivefold from 2001. It also notes that China's foreign exchange reserves "reached $1 trillion in October," adding around $200 billion in reserves just in the last twelve months.

The Chinese government has intervened massively in foreign exchange markets in order to prevent the RMB from appreciating. According to Fred Bergsten's January 31, 2007 testimony to the Senate Banking Committee, the Chinese government has bought $15–20 billion worth of foreign exchange every month for several years in order to keep the value of its currency down.

The U.S. trade deficit with China hit $232.5 billion in 2006, up about 15 percent since last year. This is 28% of our total goods deficit, but a startling 43% of our non-petroleum goods deficit. The Economic Policy Institute has estimated that the growing bilateral deficit with China has displaced 1.8 million jobs since China

joined the WTO in 2001.[1] Jobs were displaced in every state and the District of Columbia.

Japan has also intervened extensively in currency markets—spending more than $400 billion between 2000 and 2004 to push down the value of the yen against the dollar. In 2006, Japan ran an $88 billion surplus with the United States in 2006—$56 billion of that total accounted for by automobiles and parts. The U.S. Automotive Trade Policy Council estimates that the yen is undervalued by at least 20 to 25 percent against the dollar, giving every imported Japanese car a $4000 cost advantage over U.S.-made cars.

Either there is something wrong with the criteria Treasury is using to determine currency manipulation, or there is something wrong with the Treasury Department's math.

In a recent Policy Memorandum, economists Josh Bivens and Rob Scott of the Economic Policy Institute laid out three clear criteria for determining whether or not a country is manipulating its currency: "First, does it have a high and rising bilateral trade surplus with the United States? Second, is its *global* current account surplus (the broadest measure of its trade and income flows) high and rising? Third, does it possess a high and rising accumulation of international reserves?"[2] Certainly, both China and Japan meet all these criteria.

Table 1 below (reprinted from EPI) compares China's current position to nine past instances when the Treasury Department found that nations were manipulating the value of their currency vis-à-vis the dollar for competitive gain. "On each front," write Bivens and Scott, "the current position of China well exceeds the previous threshold that led to a finding of manipulation."

Many respected academic experts have also weighed in on this issue. The bipartisan, Congressionally appointed U.S.-China Economic and Security Review Commission (USCC), in its 2006 report, found that China's currency manipulation "harms American competitiveness and is also a factor encouraging the relocation of U.S. manufacturing overseas while discouraging investments in U.S. exporting industries." The Commission also found that the currency manipulation "distorts the trading relationship between the United States and China. . . . American small and medium-size enterprises are particularly disadvantaged by having to compete for U.S. market share with Chinese exporters who enjoy the subsidy of an artificially undervalued renminbi."[3]

Table 1. Currency manipulation found nine times in the past

		Trade surplus of U.S. annual rate (US$ billions)	GDP	Trade surplus of U.S. annual rate (% of GDP)	Global Current Account most recent year (US$ billions)	Global Current Account most recent year (% GDP)	Accumulation of reserves: 12-month change (US$ Billions)	Accumulation of reserves: Total reserves (Months of imports)
Taiwan	Oct-88	17.4	97.8	17.8%	18.1	18.5%	31	28.0
	Apr-89	13.8	122.9	11.3%	10.2	8.3%	-	-
	May-92	9.8	179.1	5.5%	12.0	6.7%	14	17.0
	Dec-92	10.5	179.1	5.9%	12.0	6.7%	13	18.0
South Korea	Oct-88	9.4	120.5	7.8%	**10.0**	8.3%	7	-
	Apr-89	9.0	157.1	5.7%	14.3	9.1%	9	**3.0**
	Oct-89	**8.1**	169.0	4.8%	14.2	8.4%	9	-
China	May-92	12.7	368.7	3.4%	12.2	**3.3%**	14	10.0
	Dec-92	16.7	409.1	4.1%	13.5	3.3%	**6**	9.0
Current position of China								
China		203.8	2,259.2	9.0%	160.8	7.1%	207	12.8

Bold indicates lowest level with finding of manipulation.

Historical data source: U.S. Treasury Report to the Congress on International Economic and Exchange Rate Policy.
Current data source: U.S. International Trade Commission and the International Financial Statistics Database of the International Monetary Fund.

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[1] Robert E. Scott, "Costly Trade with China: Millions of U.S. Jobs Displaced with Net Job Loss in Every State," Economic Policy Institute Briefing Paper #188, May 2, 2007.

[2] *L. Josh Bivens* and *Robert E. Scott*, "China Manipulates Its Currency—A Response is Needed." Economic Policy Institute Policy Memorandum #116, September 25, 2006.

[3] U.S.-China Economic and Security Review Commission, "2006 Report to Congress," November 2006, pp. 6, 53. Report is available at: *http://www.uscc.gov/annual*_report/*2006*/*06*_annual_report.php.

Ben Bernanke, Chairman of the Federal Reserve Board, in his prepared remarks to the Chinese Academy of Social Sciences, dated December 15, 2006, wrote that China's undervalued currency provides an "effective subsidy . . . for Chinese firms that focus on exporting rather than producing for the domestic market." He outlined some of the advantages for China of allowing the RMB to appreciate, including encouraging a shift toward domestic consumption and social services, as well as improving long-term financial stability.

China's currency manipulation also impacts other trading partners, who feel pressured to keep their currencies competitive with the RMB in order to avoid a competitive disadvantage in the U.S. market. Bivens and Scott write, "There is a cost to developing nations from the Chinese currency peg. By pursuing mercantilist exchange rate policies, China has robbed market share from smaller developing countries and forced many into managing their own exchange rates with the goal of matching China's competitive position. Many of them would prefer a more flexible currency regime but cannot allow themselves to get priced out of competitiveness in the U.S. market through China's manipulation."[4]

Exactly what would it take for Treasury to find that a country had in fact manipulated its currency, and—perhaps more important—what it would take to move beyond yet another round of endless diplomacy and strategic dialog to concrete action and results?

This is not an academic exercise for the union members we represent. The difference between currency manipulation and a market-equilibrium exchange rate is the difference between having a job and watching your factory shut its gates. It is the difference between having health insurance for your kids—or not. And, for our country, it may be the difference between having a healthy middle class—or sitting back and watching as economic divisions tear us apart.

And, tearing us apart they are. The fact is domestic manufacturers and their workers are forced to compete at an enormous competitive disadvantage from manipulated currency rates—even before taking into account all the other issues we face: violations of workers' rights, asymmetrical tax policies, illegal subsidies, lax environmental and resource regulations, and a dysfunctional health care and pension system that disadvantages our manufacturers.

Failure to Act

In June 2005, then-Secretary Snow testified to the Senate Finance Committee that "if current trends continue without substantial alteration, China's policies will likely meet the technical requirements of the statute for designation. . . . Concerns of competitiveness with China also constrain neighboring economies in their adoption of more flexible exchange policies. China's rigid currency regime has become highly distortionary."

Given the raw economic data on trade imbalances and reserve accumulation, it certainly appears that current trends have not only "continued without substantial alteration," they have accelerated.

Therefore, we were bitterly disappointed that Treasury found no manipulation again this year, and we were underwhelmed by the announcement of the "Strategic Economic Dialogue" (SED) as a response to the "global imbalances" that the report did concede.

On paper, the SED promises a "forum for addressing critical economic issues and planning for long-term cooperation." Issues to be addressed include developing efficient innovative service sectors, health care, cooperation on transparency issues, and a joint economic study on energy and environment, among other things.

This SED offers too little, too late. The proposed forum, dialog, and cooperation are grossly inadequate, given the magnitude of the economic problems we face with respect to China. Beyond its limitations with respect to currency manipulation, the SED does not even begin to address a separate and equally serious economic concern: the egregious and widespread repression of workers' rights in China. The breadth of the SED needs to be expanded, as does its core content.

Neglect of Workers' Rights

We continue to be frustrated that this Administration fails to raise the issue of workers' rights violations with the Chinese government in any effective or high-level forum. None of the highest-level economic dialogs with the Chinese government include workers' rights as part of their public agenda (neither the Joint Commission on Commerce and Trade, nor the SED, address the issue publicly).

[4] *L. Josh Bivens* and *Robert E. Scott*, "China Manipulates Its Currency—A Response is Needed." Economic Policy Institute Policy Memorandum #116, September 25, 2006.

Violation of workers' rights is just as much an economic issue as currency manipulation, violation of intellectual property rights, or illegal subsidies. We estimate that hundreds of thousands of U.S. jobs are lost because the Chinese government brutally suppresses the rights of Chinese workers to form independent unions and bargain collectively for their fair share of the wealth they create.[5]

Promoters of permanent normal trade relations (PNTR) and China's accession to the WTO argued that unfettered trade and investment would be the best way to raise living standards and promote human rights in China.

Unfortunately, the five years since China's accession to the WTO have not borne out this prediction. Instead, increased trade and investment have coincided with continued harsh violations of workers' rights, rising worker unrest, and a "strike hard" campaign against dissent by the Chinese government. Far from "exporting American values" to China, American companies have been complicit in this abuse and have profited from it.

Legal protections for wages, benefits, and hours are routinely violated in the private sector, and shoddy enforcement of health and safety standards costs workers' lives in China's export industries.

Faced with growing worker unrest, the Chinese government continues to choose violence and repression as tools of control, and has made only cosmetic gestures towards legal reform. Proposed reforms to China's trade union law in 2001, while ostensibly designed to protect union organizing in the growing private sector and strengthen workers' rights, maintain the single government-controlled labor organization's strict legal monopoly over all trade union activity in China. Yet American business interests resisted even those modest reforms, weighing in against measures that might strengthen workers' rights at the margin. (See the excellent report by Global Labor Strategies, "Undue Influence: Corporations Gain Ground in Battle Over China's New Labor Law," available at *www.laborstrategies.org*.)

We are baffled and frustrated at our own government's failure to insist that the Chinese government honor its international obligations as a member of the International Labor Organization and the United Nations. The Congress has given the executive branch numerous tools to provide leverage in this area, including Section 301, which explicitly defines egregious violation of workers' rights as an unfair trade practice. Yet the Administration refuses to apply these tools.

Time for Action

In 2004, the AFL–CIO, along with a group representing several dozen U.S. industrial, service, agricultural, and labor organizations, formed the China Currency Coalition. On September 9, 2004, the Coalition filed a Section 301 petition alleging that China's currency manipulation was an unfair trade practice under U.S. trade law.

The petition laid out China's international obligations under World Trade Organization (WTO) and International Monetary Fund (IMF) rules and documented the extent of the manipulation, as well as its impact on American workers and businesses. Finally, the petition asked the Bush Administration to "seek authorization in the WTO through expedited dispute settlement" to offset the subsidy and take measures to offset the disadvantage caused by the currency manipulation for U.S. exports to China.

The Bush Administration summarily rejected the petition within a few hours of its filing—apparently without taking the time to read the several hundred pages of analysis, documentation, statistics, and tables. (I commend the full petition to you: it can be downloaded, along with its supporting materials, at: *http://www.chinacurrencycoalition.org/petition.html*.)

A bipartisan group of 35 U.S. Senators and Representatives refiled the petition on April 20, 2005, only to have it rejected again.

The Bush Administration never challenged the factual findings of the petition, only claimed that dialog and engagement with China would be more effective than accepting the petition.

Then-Treasury Secretary John Snow said in a press conference held earlier in the year: "China acknowledges [that it is best for the global system, for the United States, and for China to move to a flexible exchange regime] and is making progress toward this goal." He boasted of the "extensive" talks under way: "I have held extensive meetings and consultations with the Chinese economic team both here in Washington and in Beijing." And he touted the progress being achieved: "With steady progress clearly being made, the most effective way at this time to achieve the goal of a flexible, market-based exchange rate in China is to maintain the *persistent en-*

[5] See the Section 301 petition filed by the AFL–CIO in June 2006: *http://www.aflcio.org/issues/jobseconomy/globaleconomy/chinapetition.cfm*.

gagement we have established rather than through a trade petition" (emphasis added).

Then-USTR Robert Zoellick promised strategic leverage would be used to pressure China: "America's policy of leveraged engagement gives us constructive new ways to press for real results in China. . . . Under U.S. law, the first two criteria that China must meet to be considered as a 'market economy' are: the extent to which the currency of China is convertible; and the extent to which wage rates in the foreign country are determined by free bargaining between labor and management. . . . *These statutory criteria, together with China's strong interest in being recognized as a market economy under U.S. laws, provide us with significant leverage on labor, currency, subsidy and other issues, and we plan to use it"* (emphasis added).

John B. Taylor, at the time Under Secretary for International Affairs at Treasury, quoted President Bush in a speech on October 21, 2004: "As President Bush recently said, . . . "So I'm saying to places like China, you treat us the way we treat you. You open up your markets just like we open up our markets. And I say that with confidence because we can compete with anybody, any time, anywhere so long as the rules are fair."

So many promises, so few results.

The Bush administration has refused to hold the Chinese government to its international obligations on trade, currency manipulation and human rights, and has denied American businesses import relief they are entitled to under the law. The administration has actively encouraged the Japanese government, as the yen has remained seriously undervalued.

The AFL–CIO believes that the Bush Administration needs to move beyond "bilateral consultation" and continued dialog to address the urgent problems in the U.S.-China and U.S.-Japan trade and economic relationships.

First, the Administration should use the annual Treasury Department exercise to send a clear and consistent message to the governments of both China and Japan that they have been identified as currency manipulators and that concrete actions will follow if needed adjustments are not made in a timely fashion.

Second, the Administration should signal that it will initiate WTO dispute resolution with respect to ongoing currency manipulation.

But Congress cannot wait for this Administration to act.

We urge Congress to give immediate consideration to the Fair Currency Act of 2007, H.R. 782.

This bill clarifies the definition of currency manipulation, identifies currency manipulation as an illegal subsidy, and ensures that countervailing duty laws can be applied to non-market economies. It applies to any country that is manipulating its currency. It is a crucial first step in addressing the urgent economic problems we face today.

I thank the three Subcommittees for the invitation to appear here today, and I look forward to your questions.

Chairman LEVIN. Thank you very much.

Mr. Hickey.

STATEMENT OF WILLIAM HICKEY, LAPHAM-HICKEY STEEL CORPORATION, CHICAGO, ILLINOIS

Mr. HICKEY. I want to thank Congressman Rush for the welcome. It's very nice of you, Congressman.

I am Bill Hickey. I am president of Lapham-Hickey Steel Corporation, which is a steel service center based in Chicago, Illinois, founded in 1926. We have plants in Illinois, Ohio, Wisconsin, Minnesota and Connecticut and we currently have about 450 employees.

I'm also a sitting member of the ITAC–12 which advises the Department of Commerce and the USTR on trade policy.

I am a past chairman of the Metal Service Center Institute, which is a leading member of the Chinese Currency Coalition, which we are representing here today.

My wakeup call to this subject occurred in the summer of 2001 when one of our long-term customers asked for a meeting to talk about their business. He told me that they were no longer going to purchase steel products from our corporation but would purchase the parts they had produced before from China and assemble these parts in their plant. The finished machine parts delivered from China would cost less than the raw steel product that we sold to the customer.

So, our customer reduced their staff of high-skilled and high-income employees and retained a few low-skilled and low-income employees to assemble and ship their product. This visit started my research into how this economic event could take place.

How can China deliver finished machine products into the United States at less than the cost of the raw steel?

This was during this time the industrial economy of the United States was in recession. Tens of thousands of manufacturing jobs were disappearing every month. As these jobs vanished, our trade deficit with China exploded. But the value of the Chinese currency did not move. This is when I realized that what China had done in the mid-1990s was to devalue their currency by more than 50 percent against the U.S. dollar and then freeze the value of the exchange rates by intervening massively in the currency markets.

This guaranteed that Chinese manufacturers could ship massive amounts of products to the United States at the China price. Japan, South Korea also engage in these similar tactics for their manufacturers.

All the economic theory about free and fair trade that you learned goes out the window. As I realized that domestic manufacturing companies cannot compete with Asian governments, I began to witness the structural decline in the U.S. manufacturing sector.

Many of the other speakers today talked about all these macro events. I go to places like Rockville, Illinois. I see Congressman Manzullo is here. Rockford, Illinois, has been destroyed. The manufacturing base in Chicago has been destroyed. It is true in South Bend, it is true across the country.

Accordingly, I turned to public advocacy to get our government to level the playing field with our Asian competitors. I started by congressman at the time, William Lipinski, who was very supportive in our efforts. We engaged the Metal Service Center Institute to use their chapter structure to hold town hall meetings across the country and inform the people of the manufacturing sector of this country that we are not incompetent; we are at a competitive disadvantage that our government allows to continue today.

Along with many of the others in this room, including some members here, I know Mr. Levin, we tried to get this administration to recognize that misaligned RMB was destroying tens of thousands of manufacturing businesses and millions of jobs. Every time this administration was pressed for some action on the currency, those pushing for action were either insulted or ignored.

In early 2005, I had a chance to visit with Representative Tim Ryan of Ohio. We explained the problems of manufacturing companies in his district and we discussed how much of this economic

distress was caused by currency manipulation. A match made in heaven.

Representative Ryan combined with Chairman Duncan Hunter to sponsor House Resolution 1498 in the last Congress. It ended with 178 bipartisan cosponsors but was ignored by this administration.

Now that the control of Congress has changed parties, we have a Treasury Secretary calling for much faster appreciation of the Chinese currency. Now that the control of Congress has changed parties, we have a Department of Commerce that has conceded that nonmarket economies employ massive domestic and export subsidies. Now that the control of Congress has changed parties, we have a USTR that starts trade cases in the WTO against China.

If control of this body had not changed, does anyone in this room believe that the administration would have taken any of these recent actions? This is the case for why we need House Resolution 782. We must get this enacted into law as soon as possible. The bill makes currency misalignment by protected government intervention a subsidy under U.S. countervailing duty law. The Fair Currency Act has five important virtues. For the first time, injured industries and their workers would have an effective remedy under U.S. trade law against undervalued currencies. For the first time, the Treasury Secretary with the leverage of his diplomatic campaign to stimulate U.S. export.

It is consistent with our WTO obligations on subsidy rules. It avoids this fantasy of any reliance on the International Monetary Fund to do anything. This bill addresses the problem of currency manipulation, per se, by any country at a time.

It has been six years since I discovered the China price. Since then, there has been no effective action taken by this government. We as a country need laws that ensure our companies and employees are not going to be destroyed by a policy of neglect by any administration at any time.

Thank you all.

[The prepared statement of Mr. Hickey follows:]

Prepared Statement of William Hickey, President, Lapham-Hickey Steel Corporation, Chicago, IL

I am Bill Hickey, President of Lapham-Hickey Steel Corp. Lapham-Hickey Steel Corp. is a metal service center founded in 1926 with headquarters in Chicago and plants in Illinois, Ohio, Wisconsin, Minnesota and Connecticut. Currently we have approximately 450 employees and customers of all sizes.

I also am a sitting member of the Industry Trade Advisory Committee (ITAC–12) which advises the Department of Commerce and USTR on trade policy. I am a past chairman of the Metals Service Center Institute (MSCI), who is a leader of the China Currency Coalition, whom I represent as well as the employees of our company. The China Currency Coalition mostly consists of supply-chain industries such as primary metals, fabricated metals, plastics, electronics, textiles, small- and medium-sized manufacturers and labor organizations.

I want to thank these three Subcommittees for their unprecedented cooperation and holding this hearing on currency manipulation and its effect on our manufacturing companies and their employees.

My wake-up call on this subject occurred in the summer of 2001 when one of our long-term customers asked for a meeting to talk about their business. He told me they were no longer going to purchase steel products from our company, but would purchase the parts that they had produced from China and assemble these parts in their plant. The finished machined parts delivered from China would cost less than the raw steel product that we sold to the customer.

So our customer reduced their staff of higher skilled and income employees and retained a few lower skilled and income employees to assemble and ship their product.

This visit started my research into how this economic event could take place; how can China deliver finished, machined products to the United States at less than the cost of the raw steel?

My First Experience With "The China Price" and Its Effect On U.S. Manufacturing

During this time the industrial economy in the United States was in recession. Tens of thousands of manufacturing jobs were disappearing each month. As these jobs vanished, our trade deficit with China exploded, but the value of the Chinese currency did not move. This is when I realized that what China had done in the mid-1990s was to devalue their currency by about 50% against the U.S. dollar, and freeze the value at that exchange rate by intervening in the exchange markets. This guaranteed that the Chinese manufacturers could ship massive amounts of products to the United States at "The China Price." Japan, which engaged in similar tactics, was not far behind.

All the economic theory about free and fair trade I had learned was thrown out the window.

As I realized that the domestic manufacturing companies could not compete with Asian governments, I began to witness a structural decline of the U.S. manufacturing sector, and I was not alone.

The decline of manufacturing is not just a series of anecdotes. What I saw was captured by the import penetration rate for tradable manufacturing industries, as reported by the U.S. Census Bureau. In 1997, imports totaled 22.6% of the tradable U.S. industrial market; in 2004, imports totaled 31.8%. That nine percentage point increase amounts to a 41% increase in the U.S. import penetration rate for tradable industries.

Of the 473 manufacturing job classifications under the North American Industrial Classification System (NAICS), 37 sub-industries (8%) increased their market share, with one category suppressed for national intelligence reasons. 85 sub-industries (18%) are deemed untradable by the Commerce Department, which does not provide import and export data. Accordingly, 351 of the 473 industrial sub-classifications (or 74%) lost market share from 1997–2004, explaining the 41% increase in the U.S. import penetration rate.

In the fabricated metals sector, which I am most closely tied to, 30 out of 43 sub-industries were tradable. Only one industry gained U.S. market share, a mere 0.9 percentage point growth. Specifically, imports in "other metal container manufacturing" fell from 13.15% of the market in 1997 to 12.24% in 2004.

Surely, other competitive factors include high corporate tax rates, health and pension benefits, tort costs, natural gas and pollution abatement. The Manufacturers Alliance and the National Association of Manufacturers (NAM) estimate these non-wage structural factors add 31.7 percent in production costs to U.S. manufacturers compared to our major trading partners. We also face strains in our education system and major challenges producing skilled workers.

These issues are all very important to me. However, today I believe the most pressing problems facing all U.S. domestic producers are effectively macroeconomic trade problems. 143 of our trading partners have consumption taxes averaging 17–18 percent, where they tax our exports at the border and do not tax their exports to the United States. As a result, all imports come into this country free of tax while those we offer for export to almost any destination in the world carry the burden of double taxation.

If you add an undervalued currency in China at 40 percent or more, and a significant but slightly smaller regional undervaluation in Japan and the rest of Asia, the trade magnitude effectively doubles the other non-wage structural disadvantages. As a pragmatic businessman, when faced with numerous difficult problems, I feel I must identify the largest source of competitive disadvantage and eliminate it first, otherwise there is not enough time to deal with the full range of competitive problems.

My Advocacy From 2001-Present

Accordingly, I turned to public advocacy to get our Government to level the playing field with our Asian competitors.

In early 2003, I started by visiting my Congressman at the time, Representative William Lipinski, who was very supportive in our efforts and referred me to his friend, Congressman Luis Gutierrez of the Financial Services Committee. We engaged the Metals Service Center Institute (MSCI) to use their chapter structure to

hold town hall meetings across the United States to inform the people in the manufacturing sector that we were not incompetent—we were and still are at a competitive disadvantage that our government allows to continue.

I, along with many others, including many Members of Congress, have tried to get this Administration to recognize that the misaligned Renminbi was destroying thousands of manufacturing businesses and millions of jobs.

Every time this Administration was pressed for some action on the currency, those pushing for action were either insulted or ignored. The action by Congress has been only marginally more responsive.

In the last two Congresses, under the Chairmanship of Representative Bill Thomas, The House Ways & Means Committee refused to even hold a hearing.

On October 1st 2003, Chairman Peter King of New York agreed to hold a hearing with the Financial Services Committee Subcommittee on International Monetary Policy, which many of you participated in. During that hearing, the Undersecretary of Commerce, Grant Aldonas, refused to acknowledge that currency misalignment by China was costing jobs. Treasury Undersecretary John Taylor was asked directly by Congressman Manzullo what plans the administration has to stop overt currency manipulation by Japan. Mr. Taylor failed to disclose he was consenting to what turned out to be massive Japanese intervention in a follied attempt to combat deflation, as revealed in his recent book *Global Financial Warriors*.

In 2004, the China Currency Coalition filed a Section 301 case against China's currency manipulation, which would have required the administration to begin negotiations if accepted. The 200+ page petition was rejected two hours after it was submitted in September 2004.

In 2005 and 2006, the National Association of Manufacturers staff told their members pushing for an association endorsement that the administration opposed the legislative solution.

In early 2005 I had a chance to visit with Representative Tim Ryan of Ohio. He explained the problems of the manufacturing companies in his district and we discussed how much of this economic distress was caused by currency manipulation.

A match made in heaven!

Representative Ryan combined with Chairman Duncan Hunter of the Armed Services Committee to sponsor H.R. 1498 in the last Congress that ended with 178 bipartisan co-sponsors, but was ignored by Chairman Thomas.

Now that the control of Congress has changed parties, we have a Treasury Secretary calling for much faster appreciation by China on their currency. Unfortunately, he still lacks any leverage to accomplish these objectives.

Now that the control of Congress has changed parties, we have a Department of Commerce that has conceded that non-market economies employ massive domestic and export subsidies. Unfortunately, this issue may end up in the U.S. courts without Congressional intent being crystal clear.

Now that the control of Congress has changed parties, we now have a USTR that starts trade cases at the WTO against China. Unfortunately, this is a slow, cumbersome and unpredictable process.

If control of Congress had not changed, does anybody believe that the Administration would have taken these recent actions?

The Case For H.R. 782

This is why we need H.R. 782 enacted into law as soon as possible. This bill makes currency misalignment by protracted government intervention a subsidy under the U.S. countervailing duty law. I have submitted for the record a detailed set of questions and answers prepared by the China Currency Coalition about the legislation.

In summary, The Fair Currency Act of 2007 has five important virtues.

1) For the first time, injured industries and their workers would have an effective remedy under U.S. trade law against undervalued currencies.

2) For the first time, the Treasury Secretary would have leverage for his diplomatic campaign to stimulate U.S. exports.

3) It is consistent with our obligations under the WTO subsidy rules.

4) It avoids any reliance on the International Monetary Fund. IMF Article IV urges all members to avoid using exchange rates to prevent the adjustment of imbalances in trade flows. In practice, it is an outmoded carry-over from the Bretton Woods era, contains no definitive legal obligation and is inherently unenforceable. In fact, IMF Director General Rodrigo de Rato said publicly the IMF should play no role in disputes over currency values. Fundamental reform of the IMF is a worthy long term goal; reliance on a new IMF in the short-run assures an unbearable status quo.

5) This bill addresses the problem of currency manipulation per se by any country at any time. In my remarks, I focus on China and the Renminbi. Let me assure you that this is a much bigger problem. Japan, South Korea, India and others are using mercantilist currency policies to engineer an artificial advantage in both their own and the U.S. market.

The China Currency Coalition has consistently sought an immediate substantial revaluation of the Renminbi to reflect economic realities. We recognize that a more flexible currency regime requires time and institutional reform. Moreover, we note that Japan has a flexible managed float regime that has produced an undervalued Yen. That is not what we want for the Yen, the Renminbi or any currency.

It has been six years since I lost my first customer. Since then, there has been no effective action taken by the government.

We, as a country, need laws that ensure our companies and employees are not going to be destroyed by a policy of neglect by any Administration at any time. In December of last year to China's Academy of Social Sciences, Fed Chairman Ben Bernanke called China's currency policies an "effective subsidy." The momentum continues; in the last two weeks alone, two major publications have vindicated the arguments the United States domestic manufacturing sector has been making for years. Steve Pearlstein of the *Washington Post* stated on April 25th: "Contrary to what you hear from editorial writers and other free-trade ideologues, it is not 'protectionist' for the United States to impose countervailing duties on imports from a country that subsidizes exports and keeps its currency pegged to the dollar."

In the May 14th issue of *Newsweek*, Robert J. Samuelson, writes: "It is not "protectionist" (I am a longstanding free trader) to complain about policies that are predatory; China's are just that."

Thank you.

Chairman LEVIN. Thank you very, very much.

This has been sterling. Now what we are going to do, each of the Committees will call on Members. I think we are first.

I am just going to say something preliminarily and then call on the first person who is here. I think, Mr. Tanner, I will call on you next.

I just wanted to say as I listened to the testimony that I think there is movement here. I think there is a growing awareness that the status quo won't work. There is this shift. If you read, for example, *The Economist*, and I say this to you, Secretary Evans, in response to your—you know, *The Economist* is a very mainline, traditional, conventional, one might call it.

This is a quote: Japan's abnormally low rates could be viewed as a form of intervention to hold down the yen. Since Japan still holds another 900 billion of foreign exchange reserves accumulated a few years ago when it was intervening, it is hard to claim that the currency is truly market determined.

I was just reading a column today by another very traditional economist, Robert Samuelson, talking about China's time bomb and that it is meaning for the world economy and for the American economy. How it is a time bomb and we are just, I think, in danger of more inaction.

So I am not going to use my 5 minutes. I think everybody else who needs to listen to Mr. Hickey and listen to the people that I have talked with from businesses throughout this country who cite the currency valuation problem as destroying their livelihoods, their businesses, that it is a tilted field that they can't play on effectively.

So I do think that there is a shift here. There has been a failure of the administration to recognize it and to recognize the impact on the lives of people.

One of you talked about, I guess it was one of my colleagues, Mr. Herger, about Smoot-Hawley. We are decades away and that isn't the issue. The issue is what do we do about a globalizing economy which is much more complicated but where more players are essentially rigging the terms of competition. Whether our belief is that those who rig only hurt themselves, and that eventually rigging will be undone on its own, or whether there is a need for us to wrestle with the problems of globalization in this country much more effectively.

When it comes to currency, I think the answer has to be that we have been essentially standing by the ropes instead of in there wrestling. It is not easy to wrestle. But we have been more bystanders than we have been activists.

Mr. Tanner, you are next. Then I will turn to Mr. Gutierrez and then Mr. Rush.

Mr. TANNER. Thank you, Mr. Chairman. I will try to be brief as well.

I want to thank all the panelists for being here this morning on this important matter. It is complicated. It is one that is hard to get one's arms around, because of the various nuances, may I say, if you put a peg in here, what happens here and so forth. So I am going to try to limit my question just to one aspect of all of this.

As all of you know, the United States has borrowed over $1.6 trillion in hard money in the last 60 months. What bothers me about that is, more than 75 percent of it has come from overseas sources, which means that out of the tax base that all of us paid April 15th, from the summer of 2002 to this summer, we will have $80 billion unavailable to address the problems in this country because it is going to pay interest. This continued degradation of the tax base, I think, poses a whole other set of problems. But that is, from a business standpoint, how I look at it.

The other thing, the reason I want to ask you what happens, Japan and China own over $1 trillion of our paper. China, particularly, has increased—almost two. China has increased their holdings dramatically in the last five years as many of you know, something over 400 billion.

What happens to the interest rates that we pay as Americans on this foreign held debt when we have a meaningful correction in the valuation of the currency?

Mr. BERGSTEN. I could take a crack at that and Steve, too, could talk about it. On your first point, you are exactly right to worry about that. We published a book about 18 months ago entitled, "The United States as a Debtor Nation." It runs through that analysis in depth.

Mr. STEARNS. I read it.

Mr. BERGSTEN. Well, then you know the answer to your question. But you are absolutely right and that is why I set a goal for U.S. policy, not to eliminate our external deficit but to cut it in half. At that level, about 3 percent of GDP, the ratio of our foreign debt to GDP would at least level off and not get worse. I am looking to cut $400 billion to $500 billion per year off the current imbalance. That is why I say it is going to take a dollar to climb 20 percent because we get about $20 billion to $25 billion of current account improvement per percentage point of dollar decline.

Second, on your point about inflation and interest rates. The rule of thumb that most economists in this business use is that every decline of 10 percent in the exchange rate of the dollar on average will lead to an increase of 1 percent in the inflation rate. If we believe that nominal interest rates pretty much track inflation, then the nominal interest rate would also go up 1 percent. So, if you think the dollar is still overvalued on average by about 20 percent, which is our calculation and what I just reported, unless all the laws of economics are repealed, the dollar will come down by 20 percent over the next few years and everything else equal, that would push inflation and interest rates up by about 2 percentage points. Hopefully this phases in a gradual and orderly way over three or 4 years, and not all of a sudden. The dollar has in fact come down 15 to 20 percent over the last five years. The decline has been gradual and orderly, not a hard landing, but it still will push inflation and interest rates up, it will magnify that cost you mentioned, and it will increase our costs at home.

In essence, we have been getting a subsidy from the rest of the world, keeping our inflation and interest rates down because of all the capital inflow we have gotten to finance the big current account deficits. So, even as job-holders in Revere or in Steel have been hurt, U.S. homeowners have benefitted from this big international imbalance because of the buildup of foreign dollar balances, lower interest rates, et cetera, but that is living on borrowed time. We are going to pay that piper and there is going to be an offsetting increase in inflation and interest rates as the correction takes place and it will certainly add to the problem that you have highlighted.

Mr. ROACH. Can I just add one thing to that, Mr. Chairman? Fred has described sort of the gradual adjustment as it has been occurring. What you asked, Mr. Tanner, is what would happen to the Chinese appetite for dollar-based assets should we take action against them. I think that that would accelerate the process dramatically that Fred just described. If we tax one of our major lenders, they are going to want to buy other assets other than dollar-based assets. They are not going to be as cooperative in the way of providing capital for a savings-short U.S. economy as has been the case. I am not saying that they are going to sell their existing holdings, I am saying something very different. They are accumulating foreign exchange—new foreign exchange reserves to the tune of at least $250 billion per year. Fred indicated in the first quarter of this year their accumulation was well in excess of that. They are currently investing somewhere in the order of about 60 percent, maybe more than that, of this new foreign exchange reserve accumulation in our capital markets and dollar-based assets. They will lower that asset allocation. That will have consequences for the currency and for real interest rates that a weakened U.S. economy will have a hard time taking. This is a big risk and unfortunately this is what we ask for when we do not save and we are so dependent on the kindness of strangers to finance a savings-short U.S. economy.

Chairman LEVIN. All right.

Mr. MOHATAREM. Mr. Levin, can I take a different view on this? I think the assumption is that somehow the U.S. is doing something wrong and that we are at the mercy of Japan and

China. No, as Ben Bernanke, the Fed Chairman has said, there is a glut of savings, that the strategy of export-based growth produces the excess savings which are being invested in the U.S. at very low rates. One of the challenges people face when they say it is a U.S. problem because we have to borrow is why are interest rates so low, in fact why are foreigners earning a much lower rate of return of their investments in the U.S. than Americans earn abroad? The answer is that the driver of the Japanese, Chinese, and other Asian investment in the U.S. is not a desire to earn a higher rate of return, it is to support their exports. So, a change in policy necessarily will mean a change in their export-based growth strategies. It is not necessarily our problem. It will cause some changes in the U.S. but let's face it we are just letting foreign countries distort our economy.

Chairman LEVIN. All right, it is so interesting, it is hard to stop, but the other Committees are going to choose and we are alternating Republicans and Democrats. Chairman Gutierrez, your Committee next and then Rush. The next person on Ways and Means will be Mr. Herger.

Chairman GUTIERREZ. Thank you. It is a great and very interesting discussion. The first thing that comes to mind is the dichotomy between Dr. Roach and Wall Street and Morgan Stanley and Main Street, Hickey and Mr. O'Shaughnessy. You all represent the business community here but some people employ people each and every day and manufacture goods and others finance it, but that kind of dichotomy I have not seen before so it is interesting. I think we are going to have to make a decision of who we are going to listen to: Wall Street or Main Street, those that actually develop jobs and produce jobs for people.

I would like to ask Mr. O'Shaughnessy, in your testimony you state that Congress should pass the Ryan Hunter bill, my friend Mr. Ryan from Ohio is here with us today. Since that was the reason that led me—this hearing is not about any particular bill but since that is particularly what led me to call Mr. Levin and enthusiastically join him, tell me how would you see Congressman Ryan's bill helping your industry? I am going to follow up with Mr. Hickey on the same question?

Mr. O'SHAUGHNESSY. Well, Congressman Ryan's bill has teeth in it. Nothing the administration has done to date has teeth. Many of those who want for China to continue its manipulative practices, its protectionist behavior support all kinds of efforts and bills that have no teeth, that would create new jobs, new Committees. By "new jobs," I mean an assistant secretary of the Treasury for example. Congressman Ryan's bill would allow Revere and our trade associations, the Copper and Brass Fabricator's Council, to file for countervailing duties against Chinese imports of copper and brass products because those copper and brass products are subsidized by currency manipulation. The bill directly links currency and defines currency manipulation as an illegal subsidy. That is why I support him.

Chairman GUTIERREZ. Let me ask Mr. Hickey is there anything you would like to add on the proposal by Mr. Ryan?

Mr. HICKEY. Mr. Gutierrez, I support the Ryan Hunter bill because of the frustration I have in the efforts I have taken. In 2004,

I with Mr. Trumpka, who is another member, one of the heads of the AFL–CIO, filed a 301 against China. Mr. Levin and some congressional Democrats followed that up several months later. Before I got on the plane back to Chicago, the Secretary of Commerce, the Secretary of the Treasury, the Secretary of Labor, and the USTR all denied the petition. That petition was 200 some odd pages long and within an hour they digested it and said it is protectionism. Again, if you cannot talk about the problem, it is protectionism. You look at the 421's, the 421's were specific legislation put into the China ascension to the WTO so that industries that were hurt by China could take a petition to the government. We have had four or five 421's, every one has been denied by the Bush administration and every letter of denial reads the same thing. It basically says this industry would go out of business anyhow if it wasn't the Chinese cutting the price. This is insanity. We have no way of protecting these industries.

Chairman GUTIERREZ. Thank you.

Chairman LEVIN. All right, can I call Mr. Rush?

Chairman GUTIERREZ. Sure.

Chairman RUSH. Thank you, Mr. Chairman. I also agree this has been an extraordinary hearing so far and the testimony has really been quite interesting. I want to again thank the witnesses for their participation. My time is limited so I am going to ask a question, and I would like for responses from each and every one of you. Dr. Mohatarem makes what is an interesting point in his testimony, he mentioned that as the U.S. trade deficit has grown, other freely traded currencies, such as the Euro and the Canadian dollar, have appreciated considerably against the dollar. Why in your opinion has the yen not done so as well? Could each of you except for Dr. Mohatarem respond briefly to this question?

Mr. EVANS. Well, as I said in my testimony, it is my belief that the yen has not appreciated in value because Japan continues to go through this recovery of the debt devastating period of the 1990s, a period when that economy basically just collapsed or had flat growth for over 10 years. As they continue through that recovery, part of it is low interest rates and so you have low interest rates, that tends to leave your currency in a relatively low level. So, I think my point with respect to the yen is it does not appear that Japan has been intervening in the market in any material way in the last three years and so to encourage them to intervene I think would be foolhardy.

Mr. O'SHAUGHNESSY. I think that Japan's policy is much more sophisticated. I think that they are intervening but they are intervening in a way that is not as direct as the Chinese are. I would agree with that portion of the testimony indicated earlier by the General Motors Corporation representative, I will not attempt to pronounce your name, mine O'Shaughnessy is bad enough. But Japan has created a one-way market for the yen and all you have to do is look at the fact that they have $1 trillion U.S. dollars, so they are doing it. Then you just have to figure out how they are doing it, and I think he summed that up pretty well.

Mr. ROACH. I would just agree with Secretary Evans, Japan has gone through a very difficult 15 years, it is apples to oranges in comparing Japan with the state of other developed economies. With

respect to China, keep in mind that 30 years ago, the Chinese economy was on the brink of collapse. Yes, they have used exports as a means to drive their economy. They have used investment as well dramatically. They are now at a critical point—and no one is giving the Chinese any credit in this hearing today whatsoever—a critical point in transitioning to more of a consumer-led economy and that will be a very natural way to deal with their role that they need to play in dealing with these imbalances. So, yes, Europe has borne the brunt of the dollar's decline thus far but I think for good reason.

Mr. BERGSTEN. The answer is two part. In the earlier part of this decade, Japan did intervene massively, more than China, but that process ceased three years ago. There are lots of allegations about indirect and covert and subtle and nuanced intervention now, but I do not find it. I actually discovered their doing that back when I was the under secretary of the Treasury. I caught them intervening, told them to stop it and they did, but I do not think it is happening now. The explanation now is the very low interest rates that discourage the Japanese and others from investing in yen assets. To me, however, as I said in my statement, just because there is no manipulation does not excuse the Japanese. There is clear under-valuation, and that has to be addressed, whether or not there is manipulation, in the interest of a better international balance.

Ms. LEE. I do not have a strong opinion about the mechanism of intervention but I would agree with what both Fred Bergsten and Mustafa Mohatarem said that the yen is under-valued and has an enormous economic impact on American workers, on the auto industry in particular, and so this is an issue that we think is very urgent. I think the mechanisms may be different, very different from how the Chinese government engages in currency manipulation but the outcome is the same and the urgency for effective action by our government is the same.

Mr. HICKEY. Mr. Rush, back in 2003/2004, the Central Bank of Japan went out and made sure that the yen would not go below $1.10. Alan Greenspan of Japan was publicly saying, he said they spent 10 percent of their GDP. That would be like the Federal Reserve in the U.S. going out and buying $1 trillion worth of yen so that the yen would not appreciate against the dollar. Look at Korea, Korea now has more foreign reserves with 40 million people than the EU with 400 million people. The Koreans now have over $350 million in foreign reserves. They are doing the same thing the Japanese did, they are doing the same thing the Chinese do, they all went to the same conferences.

Chairman LEVIN. All right, I think next is Mr. Herger and then Mr. Pal, Dr. Paul, and then Mr. Stearns.

Mr. HERGER. Thank you, Mr. Chairman. Dr. Roach, people are rightfully concerned about the trade imbalance with China. I believe that RMB is under-valued and the administration should continue to press China to appreciate the RMB relative to the dollar, however, I am not convinced that we need to impose across-the-board retaliatory tariffs on all Chinese goods while China makes its way toward a fully convertible currency or apply countervailing duties under the theory that the exchange rate is a subsidy. Instead,

I would like to see the United States work with China to reduce their savings and increase their spending, which would pave the way for more U.S. exports to China. Would not this be a more direct way to address the trade imbalance?

Mr. ROACH. I think the Chinese government in their latest five year plan have put their cards on the table, they know they have to do this, they want to do it. But in a once centrally-planned socialist economy, you do not just push the button on the consumer culture overnight. There is a lot of precautionary saving by Chinese households who are scared about future prospects for jobs and income. They have no national social security, no pension system, no unemployment insurance, no re-training programs. The government is now focusing very much on doing that, it is going to take a lot of time. They can definitely use our help in that regard. I do think that would be a very productive endeavor for us to be much more actively involved in rather than beating them over the head with a club and demanding that they do something solely to help us as a nation who actually spends too much. They could learn some things from us in terms of spending, and we could probably learn some things from them in terms of saving.

Chairman RUSH. Thank you. Secretary Evans, do you have any comment?

Mr. EVANS. Yes, I totally agree—first, let me respond to what Chairman Levin said earlier, I also believe there is movement and I think it is good movement. I think it is headed in the right direction, particularly with respect to China, and I will address that maybe further later. But with respect to your comments, I think putting an emphasis on helping China turn into a consuming economy is critical for them and for us. I think we need to put great emphasis on them opening up their financial services industry to give them the kind of tools and the kind of products that their people need to become consumers, like credit cards for instance. In China, there are one million credit cardholders in China. There are 500,000,000 Chinese that own a cell phone. So, you have got to get some basic fundamental systems in place over there. Dr. Roach talked about some of the other products that they need like pension products and retirement savings products and homeowner mortgage products and auto insurance products. There are all these kinds of products that they need in that economy that we have and take for granted every day in order to give them the security that they must have to begin to be consumers instead of savers. So I think that is one area we should put a lot of emphasis in every way that we can, open up your markets to our financial products so we can help you turn your economy into a consuming economy and turn those 1.3 billion consumers loose and get them to begin to not only consume their own products in their country but products and services from American companies and businesses.

Chairman RUSH. Good point. Anyone else like to comment? Yes?

Mr. O'SHAUGHNESSY. I do not feel that there is anything theoretical about under-valuing currency to subsidize manufacturing, I think that is what nations do in order to gain a competitive edge, to employ their people, to build up that kind of a manufacturing infrastructure, that base, that strength, that national security, that is what you do to do it. In my dealings in international business,

any time I was involved with a customer or a competitor and their nation's currency was valued lower, they were really excited. Manufacturing companies in countries that have that happen get really excited because they know it gives them a competitive edge.

Mr. BERGSTEN. I totally agree with the strategy you were suggesting. I do not think it is either/or vis-à-vis trade measures. I would like to add one point. The strategy you suggest is intimately related to the currency issue. When the currency is as under-valued as it is now, it gives the wrong price signals to the economy. It keeps resources going into investment in heavy industry for export. It discourages domestic consumption because it prices imports way too high. It even discourages the government from moving in the direction that Steve rightly suggested they should do. So, it is not one or the other. What China needs is to alter the composition of its growth strategy away from relying on heavy industry and capital-intensive spending, which is export-oriented, and in the direction of expanding consumer demand, including through government spending for social infrastructure programs. A big change in the exchange rate would be part and parcel of that strategy and would promote it.

Incidentally, that change in strategy would have lots of other advantages for China. It would sharply reduce its growth in energy demand and in environmental pollution, and it would improve the job pay-off from its investment. We document all that in our studies. It is of overwhelming interest to China itself to move in the direction you suggest, and I believe one reason they do not move in that direction is the wrong allocation signals that come from the hugely mispriced currency relationship. We know that from other countries' experience and so you need to put all these together in a cohesive package.

Chairman LEVIN. I think we better go on.

Chairman RUSH. Thank you.

Ms. LEE. Can I just say one quick thing? It is important.

Chairman LEVIN. Okay.

Ms. LEE. It is relevant to this question about if you want China to consume more and the U.S. to consume less, I totally agree with what Fred Bergsten said in terms of the relative price signals that are distorted, but I think the other point is that Chinese workers need to have their basic rights protected, that in order to build a middle class and a stronger democracy in China, the key way to do that is to protect the rights of Chinese workers to stand up for their own rights on the job. They do not have the right today to form an independent union, even to ask for their back wages to be paid or to have Chinese labor laws respected with respect to minimum wage or maximum hours. That is a crucial piece if we are going to build a strong middle class and a consuming middle class in China, it has to be done by empowering Chinese workers to respect their rights.

Thank you.

Chairman LEVIN. Thank you. Dr. Paul?

Mr. PAUL. Thank you, Mr. Chairman. This is a question for Dr. Roach and anybody else who wants to comment. I want to follow-up on your strong emphasis on our lack of savings, and I would suggest that the fact that we tax savings would be a disincentive

to save. I would also suggest that the fact that our dollar is constantly being depreciated, our government tell us it is about 2.5 to 3 percent, a lot of individuals believe we are losing purchasing power much faster, that would be a disincentive to save. We also have a better-to-borrow-than-save psychology because people feel so rich when the Nasdaq is at 5,000 or the housing prices are soaring, they feel rich and why save, we can just borrow at good rates? But I find a difficulty in our economy mainly because of the distortion of the interest rates. I maintain that our interest rates really are not market determined in that they are artificially low. If savings rates are real low, interest rates should go up, but we have the opposite, we have essentially no savings and very, very low interest rates where people want to borrow and they do not want to save and then they are taxed on top of this. I cannot see how we can deal with this problem without dealing with Federal Reserve policy because the Federal Reserve is the one that manipulates the interest rates and deceives the public and the very important information that we need is true interest rates, just like we need true prices in a market economy. Socialism fails because it has no market pricing. I think we have socialism in our monetary policy in that interest rates are distorted and we do the wrong things and it leads to, and has a large contributing factor to these imbalances on our trade. Do you care to comment?

Mr. ROACH. Absolutely, I really think you have your finger on a very important issue but it does not get into this debate because everybody wants to bash China here. The Federal Reserve, under the former Chairman Mr. Greenspan, came up with the brilliant, or maybe not so brilliant idea, that we did not need to save the old-fashioned way out of our paychecks, we could save out of assets. So we have a bunch of asset bubbles in the last seven or eight years, equities, more recently property. If you can save out of these assets, why save out of your paycheck? What supports the asset-based saving model is unusually low real interest rates, that is what people brought to financial markets. I think this is the wrong way to run the world's greatest economy is to encourage individuals in particular to save out of assets through artificially low interest rates. So, I think that is entirely correct.

You tap on to some very important issues though of fundamental tax reform that always get talked about but have become politically very difficult for the Congress to move ahead on. Do we need some type of a consumption tax for a U.S. economy whose consumption share of our GDP today is at a world record high of 71 percent. There has never been an example of a major economy that has consumed more of its national output than we are doing in the United States right now. So, to say that this is an idea of, as Mr. Gutierrez said, of Wall Street versus Main Street misses the basic point. This economy is enjoying a consumption excess, the likes of which we have never had. We do not save. Then we are demanding that others who provide us with the savings play by our rules, something is wrong with this movie.

Mr. O'SHAUGHNESSY. Yes, I am not sure how many people understand the relationship between taxes, international trade, health care, and the impact on domestic manufacturing. We are the only major trading nation in the world that does not employ a VAT

tax. Now when I say "VAT tax," it could be a border-adjustable tax. But we are the only, only one, isn't that amazing? We have a deficit in almost every class of goods with almost every trading nation in the world. If we change to a consumption tax rather than tax saving and investment, we would be much better off and our manufacturing base would be much better off. I also believe that it is our tax structure, so unique in the world, causing us to lose market share to for example European countries or even any other country that causes them to increase market share against us and they are not quite as concerned as they would otherwise be on what is happening with China. They are not a big ally on Chinese currency manipulation. You do not hear the Europeans—you hear them a little bit but like us no strong really actions and that is why, it is because of our tax system and their advantage over our tax system. That has to change.

Mr. MOHATAREM. Mr. Paul?

Mr. PAUL. All right.

Mr. MOHATAREM. Can I add just very quickly I think we are again missing the point here. The current intervention by Japan, China, you name it, an Asian country, essentially provides savings to the U.S. at very low subsidized interest rates. That in turn distorts our economy, it lowers the price of critical goods in the U.S. economy, it increases the price of non-critical goods like housing. So, yes, you are right, they are related. The question is where is the driver, and I would argue the driver is attempts by countries to manipulate their currencies by intervening in currency markets where they proceed to subsequently invest it in very low yielding U.S. assets. It is not surprising when you force down the rate of return in U.S. investments and U.S. savings that people save less. So, the problem really again comes in that governments are trying to manipulate and in a sense distort our economy.

Chairman LEVIN. I just went down the roster of those of who are here now, and I thought we might set a procedure if anybody comes back, they be at the end of the line, okay? So, I thought next we would go Mr. Stearns and then try to alternate Democrats, Republicans, okay? Then next we would go Mr. Pascrell, I hope I have this right, Mr. Castle next, going somewhat by seniority and alternating, and then on the Democratic side, Ms. Moore. Then perhaps we could take Mr. Whitfield and Mr. Brady together, is that okay? Yes?

Chairman RUSH. I have Judge Gonzalez.

Chairman LEVIN. Oh, Judge Gonzalez, okay, I was getting to him. No, no, I was getting to him. Then after that, Mr. Gonzalez and then Mr. Manzullo and then Mr. Matheson and Mr. Roskam. Mr. Lucas, you are going to join us. We will play this by ear somewhat. Can we do that, is that somewhat fair?

Mr. STEARNS. That is good.

Chairman LEVIN. Okay, so, Mr. Stearns, you are next.

Mr. STEARNS. All right, thank you, Mr. Chairman. Mr. Bergsten, you had mentioned five things that we have to do, you mentioned that we need to label them as manipulators, whether it is Japan or China; the second you mentioned get the support of other countries, particularly dealing in Europe; the third thing you mentioned is work up a WTO case against them on their Article

15; fourth, go after bilateral intervention; and, fifth, if nothing else works, then to look at Congress to solve the problem. I guess in that case you were talking about H.R. 782. The question I have for you and also for Mr. Mohatarem, and Mr. Mohatarem mentioned this, I am trying to quantify that if you would, let's assume that we are able to get Japan and China to stop manipulating their currency and let's say it was successful over four or five years, give me the quantitative impact it is going to have in the United States. You tried to mention that, Mr. Mohatarem, when you mentioned that the SUVs or the luxury vehicles would be $14,000 difference between a General Motors and perhaps two different cars. But I will start with you, Mr. Bergsten, assuming everything works out, what would the American economy look like today with Japan and China not manipulating their currencies and if you can do it in a quantitative and maybe if you could do it in a short amount of time?

Mr. BERGSTEN. Just to be clear on the premise, I suggested China should be designated a manipulator.

Mr. STEARNS. Right, right.

Mr. BERGSTEN. I did not say Japan should be designated as a manipulator.

Mr. STEARNS. Yes, your five points were with China.

Mr. BERGSTEN. That is right, though I believe the yen is under-valued and should be addressed separately. We have tried at my institute to do very careful analysis——

Mr. STEARNS. If you could really refer us to a website or a position paper or a white paper, I would just like to see somebody that has done this analysis in which Congress and the Administration and everybody—I want to see what the impact is so when I go back and talk to my constituents I could say this is important to you and talk in quantitative terms.

Mr. BERGSTEN. The website is www.iie.com. We published a new paper on it last week as part of our big China conference. It quantifies exactly what you ask for. The conclusion is roughly as follows: If the Chinese, Japanese, and other Asian currencies, which I think would follow, all went up by a mere 20 percent, this would reduce the U.S. global current account deficit by about $150 billion per year after a 2-year phase-in period.

Mr. STEARNS. You mentioned that but what would that mean to the economy? Everybody understands—everybody says, okay, you have got a trade deficit but no one really knows what that means, how would that affect the economy, the everyday American?

Mr. BERGSTEN. You have to start from the fact——

Mr. STEARNS. So, for $150 billion less trade, what does that mean for the average American?

Mr. BERGSTEN. One hundred and fifty billion less trade deficit.

Mr. STEARNS. Deficit, right.

Mr. BERGSTEN. So, now we have got more exports.

Mr. STEARNS. Right.

Mr. BERGSTEN. Fewer imports.

Mr. STEARNS. Right. Does that mean more jobs to the United States?

Mr. BERGSTEN. Well, I am going to get to that. Remember, the U.S. economy is right now at full employment, a critical starting

point. So, if we were to get a lot more jobs and have a lot lower unemployment rate, we probably would also have higher inflation and higher interest rates, things we would not be so happy about. So, the main conclusion is that we would have a different distribution of jobs in the economy. Export jobs would be promoted, which is a good thing. Export jobs pay 15 to 20 percent on average higher than average manufacturing jobs. Likewise, we would have more import competing jobs because imports would now cost more, and there would be less demand for imports.

Mr. STEARNS. Let's take a family in Michigan, in and around Detroit, what would that mean to Detroit?

Mr. BERGSTEN. I do not have the job composition of Detroit right on my fingertips, but since autos is a big import competing sector, what I am talking about would create more jobs in the U.S. auto industry.

Mr. STEARNS. Okay, I am just trying to understand should we be careful what we ask for here?

Mr. BERGSTEN. Well, let me make one other point. Remember that we get that deduction in the current account deficit by a lower exchange rate for the dollar.

Mr. STEARNS. Right.

Mr. BERGSTEN. As I mentioned in response to the earlier question, that implies, everything else equal, a little higher rate of inflation, a little higher interest rate—there is no free lunch.

Mr. STEARNS. No free lunch.

Mr. BERGSTEN. It is a good thing.

Mr. STEARNS. So, you are saying we would have higher interest rates and higher inflation.

Mr. BERGSTEN. So, you come back to what Dr. Mohatarem just said, we would have more jobs in the tradeable goods sector, more exports, and more import competing jobs. We would have fewer jobs in the non-tradeable sector, like housing, because inflation and interest rates would be a little higher. There would be a change in the composition of employment, which on the whole would be good for the country.

Mr. STEARNS. Mr. Chairman, I would just ask that one of his other panelists give his point of view too if you do not mind.

Chairman LEVIN. Sure.

Mr. STEARNS. Even though my time has gone out.

Mr. MOHATAREM. Very quickly, over the last ten years, as the Japanese have succeeded in depreciating the yen from about 95 it was prevailing and 97 to where it is now imports in Japan have gone up by about one million units. If you reverse the million units and assume that those would be domestically produced if the yen went back to 90, which is where we think they would be, that is roughly a $25 billion swing. Each billion dollars of imports or auto production is roughly 20,000 jobs through the economy. So, take 20,000 by 25 and you are talking about roughly 500,000 jobs, not all of these would be in manufacturing, a lot of these would be in services because we use a lot of services as we produce cars as we ship them to our dealers and as our dealers sell them. So, you are talking about essentially reversing the damage that has been done to the economies in Michigan, Ohio, and other major auto producing states.

Mr. STEARNS. Thank you.

Chairman LEVIN. No, and I appreciate your pursuing it. Mr. Pascrell?

Mr. PASCRELL. Thank you, Mr. Chairman. Mr. Chairman, I think it is a fair conclusion listening to the panelists and listening to the questions from the Committees that the Treasury Department of the United States has repeatedly, I say repeatedly, declined to find that either China or Japan manipulates their rate of exchange for purposes of gaining unfair competitive advantage in international trade. As Ms. Lee pointed out very succinctly, this is not a self-correcting problem. We are not going to get into today the difference of losing manufacturing jobs and gaining service jobs. I certainly do not want to get an advantage in the debate, I am looking for the truth.

Ms. Lee, I have a question for you. Do you believe that H.R. 782, the Fair Currency Act, is WTO legal? and, if so, I want you to explain why.

Ms. LEE. Thank you very much, Mr. Pascrell, for the question. I do absolutely believe in the lawyers that have worked with us in the China Currency Coalition who have issued a lengthy legal opinion as to the WTO legality of H.R. 782. A key point I think is that WTO rules and IMF rules supposedly address currency manipulation and rule it out but the key point is that neither the WTO nor the IMF seem to understand how to define currency manipulation and they seem completely unwilling to take any action. So, the idea of H.R. 782 is simply to clarify the definition and to give the administration new and stronger and better tools and prod the administration to use those tools and to use them in a way which is consistent with our international trading systems. So, I thank you for the question, and I do not know if one of my colleagues wants to add something to that.

Mr. HICKEY. I agree 100 percent with Ms. Lee. I think the time we spent on making sure that it was WTO consistent on this legislation really is proof in the pudding.

Mr. PASCRELL. Mr. Chairman, this is like a tennis match, it is like a tennis match, currency, manipulation of currency, advantage, China; subsidization of trade, advantage China. When do we get an advantage or when do we play on a level field? Mr. Evans, Mr. Secretary, I have a question for you. Even if the Chinese allow the currency to float tomorrow morning, we would still have a balance of trade problem I think. What should America do, what should we do to address some structural problems that exist at our end? I was specifically thinking about the 1 percent of savings of Americans compared to the savings in other countries. One could say, "Thank God, the Chinese save so we can borrow," but the fact of the matter is that is a tremendous disadvantage in our country in terms of the very topics we have been talking about today. What should we do about that structural situation?

Mr. EVANS. You are talking about the structural situation that we are not saving and the rest of the world is?

Mr. PASCRELL. Well, that is a simplification of it, yes.

Mr. EVANS. First of all, I would say—I would point to our economy today is in very good shape.

Mr. PASCRELL. Well, that is your opinion, Mr. Secretary, I want an answer to the question.

Mr. EVANS. In terms of the trade deficit, I would say we need to continue to have focus on opening up markets around the world for the goods and services of American workers. I think there needs to be ongoing emphasis on that. That means more free trade agreements with the rest of the world. I would encourage the passage and the signing of the Free Trade Agreement with Panama and Colombia, and I would continue to push for our trade promotion authority for the President. I think that we must understand how this world has changed and that we are just 5 percent of the people here in America and 95 percent of the people live outside the borders of our country. So it seems to me that where our emphasis should continue to be is on opening up markets around the world, pushing China real hard to open up their markets for the financial service industry, et cetera. Dr. Roach I can see is wanting to respond.

Mr. PASCRELL. Go ahead, Dr. Roach.

Mr. ROACH. Can I just say in answer to your question what must we do to save? Five things, the first three are fix the budget deficit, the second two are——

Mr. PASCRELL. How would you do that, Dr. Roach?

Chairman LEVIN. Wait, Mr. Pascrell, the time is out and a question how do we fix the budget deficit I do not think can be answered in a few seconds.

Mr. PASCRELL. Well, can he finish what he was going to say then?

Chairman LEVIN. Just quickly because we have six or seven others.

Mr. ROACH [continuing]. The second two is tax reform, some type of a consumption tax.

Chairman LEVIN. Okay, Mr. Castle? Thank you so much for your patience and everybody else's but this is I think is a scintillating discussion, I know you will make it more so.

Mr. CASTLE. Thank you, Mr. Chairman. I cannot believe he could not answer the question on how to fix the budget in a few seconds or even minutes for all it matters, I would love to hear that answer. Actually I am going to ask some questions along that line, but I want to go to Dr. Bergsten. I need some help with this perhaps Economics 101, and I am not asking you how to fix the budget although I would love to know how to do that, the deficit issues. We referred to our deficit and all of you basically in your comments referred to the ownership of American debt as being a problem here so I can see that as underlying problem in terms of our deficit. But I would like to know how—to have an economic explanation of the whole interplay of the deficit of the United States of America on this particular trade problem. You mentioned it in your written testimony, I am sorry I was not here for your oral testimony, in discussing it and how we have to address it immediately and that would help greatly with the trade issue. This is the kind of the thing that most of us who run for Congress run on, but I am not sure we totally understand it. I would be interested in connecting all the dots with respect to that if you could help.

Mr. BERGSTEN. We used to hear the term "twin deficits," referring to the budget deficit and the trade deficit. They are not twins. They do not always move precisely together, but a bigger budget deficit clearly promotes a bigger trade deficit for two reasons: When government net spending goes up, unless there is some corresponding increase in domestic output, we import the difference. So, it adds to total domestic spending, unless something on the output side miraculously occurs simultaneously, we are buying more than we produce at home, we import the difference, and the trade deficit goes up.

That is one mechanism. The other mechanism is that when the budget deficit goes up, the government's borrowing from the capital markets puts more pressure on those capital markets, and drives interest rates up. Those interest rates attract foreign investment, which drives up the exchange rate of the dollar. That reduces the price competitiveness of our products and the trade deficit goes up. So, you have got two channels running from higher budget deficit to higher trade deficit and that is a very well-established proposition. There is a learned debate as to what the ratio is, is it 0.5 to one, is it 0.3 to one? I think 0.5 is probably about right. So, roughly for every dollar the budget deficit goes up, you could expect about a 50 cent increase in the external deficit. If we want to get the external deficit down, the best and only way we know to do it, is to get the budget deficit down. I would say convert it to a small surplus, which would mean less pressure on capital markets and on attracting imports to meet our total national spending requirements.

Mr. CASTLE. Let me just sort of ask a follow-up question along the same lines as being educated. China is apparently acquiring a lot of the debt of America, taking our notes, bonds, et cetera. Can you tell us exactly how that affects the value of the currency, the RMB, by the fact that they hold that?

Mr. BERGSTEN. If the Chinese currency were floating in the exchange markets, like the dollar, euro and many other currencies do, then the proceeds of the Chinese trade surplus and of all the foreign investment coming into China would amount to dollar inflow buying Chinese currency and the price of the Chinese currency would go up. The Chinese abort that process by having their central bank buy those dollars at a fixed price so they do not affect the market price of the currency. There is no market price for the currency, which is why it is called a "fixed" exchange rate. It is an anomaly in today's world but they do it. That is the source of this huge buildup in their foreign exchange holdings. When the Central Bank of China buys those dollars for RMB to keep the price of RMB from going up, it has a big buildup of dollars. What do they do with those dollars? They turn around and buy U.S. Treasury bills or agency securities. That money then increases our money supply, which holds down our interest rates, thus supporting our housing. That is the source of the problem.

Mr. ROACH. But there is a corollary to that, Mr. Castle, and that is if the Chinese elect or are forced to raise their currency, that means that they will be buying less in the way of dollar-based assets. The question we must then address is who is going to fund us at current levels of the currency, the dollar and real interest

rates. The odds are that that does imply some fairly sharp adjustments in the prices of our assets.

Mr. BERGSTEN. Let me just respond with one actual——

Mr. HICKEY. Can I just make a comment on what Fred said? For the last 10 years, we have had increasing changes in the government fiscal policy in the United States, we have had surplus and we have had deficits. Every year the deficit with China gets worse, so the theory is great but the theory does not work when the other countries intervene. Last year, the Federal budget deficit went down. We had a 15-percent increase in the trade deficit with China. The Chinese economy grows at 10 percent a year, our trade deficit grows at 15 percent a year. We are now importing what, 8 or 9 percent of Chinese GDP? This is rigged game. Anybody who does not understand this has to have their head examined. Fred has got great theory but the reality is that we have had major changes in Federal surpluses and deficits over the last 10 years and our trade deficit keeps going up.

Chairman LEVIN. Fred, 5 seconds.

Mr. BERGSTEN. The theory is right but he is also right that the distribution of our imbalance goes to those surplus countries. I made the point that the Europeans let their exchange rate go up. As a result, our trade deficit with Europe has gone down, but he is right because the Asians are running the big surpluses. That is why they have got to be the central players in Act Two of the correction of the imbalances.

Mr. CASTLE. Thank you, Mr. Chairman.

Chairman LEVIN. Fred cleared the way for your question.

Ms. MOORE. Absolutely, that was a dynamic exchange, thank you very much. I have listened very carefully to you all, and I realize that I know less than I thought I knew before I got here. I guess I want to start by asking Dr. Bergsten to elaborate on his observation that historically the U.S. dollar has been over-valued. We have talked a lot about the under-valuation of the Asian currency and you seem to suggest that we have contributed a great deal to our trade deficit, our inflation, and our own situation by over-valuing the dollar. In a sort of a devil's advocacy role, I would like to say are we now saying, well, gee, we have gotten ourselves into this situation and so the solution should be now we are going to force others to inflate the value of their currency. Then I might follow-up with a question that perhaps Dr. Roach would like to jump in to try to—I am concerned as a Member—I am here as a Member of the Financial Services Subcommittee on Domestic and International Monetary Policy, and I am curious and suspicious that some of the debtor nations that we have tried to help have in fact seen their economies fail because we have in fact tried to force some conditionality on them and force them into a rapid rise in their currency to meet our expectations and investors' expectations.

Mr. BERGSTEN. U.S. history is actually rather depressing because we do not seem to learn from that history. We have now gone through four major cycles in the last 30 or 40 years, all of which started with low saving and a big increase in consumption—whether it was the Reagan tax cuts in the 1980s or low interest rates now—which has led us to overspend in terms of our domestic production possibilities. Our trade deficits keep going up; and for-

eigners keep building up dollar balances. This happened in the early 1970s, the mid-1980s, it happened in the mid-1990s. At some point about once a decade we suddenly get alarmed and decide we do not like that, and are running too big a risk. So, then we act to drive down the exchange rate of the dollar. President Nixon devalued twice in the early 1970s. Jim Baker did the Plaza Agreement in 1985, drove the dollar down by 50 percent over the next 2 years because he realized that we had to make major changes to avert the risk of a total dollar collapse and I might say a huge outbreak of protectionism here in the Congress. So, we have gone through these cycles where we permit our external balances to grow and then they hit a point where either the foreigners stop financing us or more likely we realize there is too big a risk thereof and decide to drive the dollar down and take corrective actions ourselves. All this has been severely and sharply abetted by a major structural fact, which is now changing and I should emphasize to the Committee that we have been able to do that in part because the dollar has been the world currency for a century. Other countries and private investors around the world have been happy to buy dollar assets because the dollar is the world currency. That fact has certainly made it easier for us to finance these imbalances, lull ourselves to sleep, and let these things build up.

Ms. MOORE. So we have manipulated our currency?

Mr. BERGSTEN. It was not overt manipulation but it was certainly acceptance of an over-valued currency because, as I said before, in the short run it is great to live on your credit card.

Ms. MOORE. So I am running out of time so I want to get to Dr. Roach because here we are, had Japan and China been smart——

Mr. BERGSTEN. Now comes the euro, a currency based on an economy as big or bigger than ours. The U.S. dollar is no longer the sole world currency, and that is going to make it much harder for us to do in the future what we have done in the past.

Ms. MOORE. Thank you.

Mr. ROACH. Just in answer to your question, go back 20 years ago, the same room, the discussions were all about Japan, and we gave Japan very strong advice that it needed to engineer policies that would lead to a sharp appreciation of the yen. The Japanese look back on that as a huge mistake. They had 15 years of rolling recessions and deflation. The Chinese are very mindful of that experience and very wary of taking bad advice from us again. I think that is a very important context to think about. I would also—there is a huge difference with the Chinese and the Japanese, the Chinese have very undeveloped capital markets and I think are much less able to deal with the types of sharp currency adjustments as a result that are being recommended by many of my co-panelists today. So, I think this could prove to be a much more serious and difficult issue for them to adapt to than we are allowing for.

Chairman LEVIN. All right. Here is the roster, Mr. Whitfield and Mr. Brady and Mr. Gonzalez, Mr. Ryan has been here, I think, Mr. Roskam, if it is okay you will go last. So, does that cover everybody? I think so. All right, thank you very much for your patience. Mr. Whitfield and then Mr. Brady?

Mr. WHITFIELD. Thank you, Mr. Chairman. I also want to thank the panel for being with us today and spending this time. There is a tendency in Congress to look for silver bullets, and we always are enthusiastic about legislation that would help protect manufacturing jobs in the U.S. and help us create more jobs and so forth. We have heard some discussion today about Mr. Ryan's bill with Mr. Hunter, and I know, Mr. O'Shaughnessy, you support that and Mr. Hickey and I think Ms. Lee and others. But on a scale of one to 10, how far would Ryan-Hunter go in really addressing this issue that we are dealing with today? Do any of you have any thoughts on that? Yes, Mr. Roach?

Mr. ROACH. I think on a scale of one to ten, I would qualify it as a three and that is because by fixing the Chinese bilateral trade deficit, the question is what about the other $500 billion of trade deficits that America runs with the rest of the world. We cannot delude ourselves into thinking that we can have a bilateral fix from a multi-lateral problem. This is flawed macro-economics.

Mr. WHITFIELD. Okay.

Mr. ROACH. It is a point that I stressed repeatedly in my opening remarks and it is one that just seems to be ringing on deaf ears.

Mr. WHITFIELD. Dr. Bergsten?

Mr. BERGSTEN. No, Steve is right about that but Ryan-Hunter applies to all currencies. A focal point is China but the principles and rules that are put in place, as I read them, would apply to all currencies. Now, if we got the renminbi up substantially, 20 or 30 percent, it would pull the other currencies up through the market repercussion, but the bill would permit going after others, not only for manipulation but for fundamental misalignment, which would then apply to my concept of Japan and some others in the region even though they are not "manipulated." So, I give Ryan-Hunter a higher grade, but I am not sure if it is a five or six. The bill does not solve the whole problem, but it goes a good distance and is a lot better than what we have now.

Mr. WHITFIELD. Okay. Mr. O'Shaughnessy?

Mr. O'SHAUGHNESSY. As to currency manipulation, I would give it about an eight.

Mr. WHITFIELD. Okay.

Mr. O'SHAUGHNESSY. I think that if you understand though that once currencies are all market-oriented, market-changed, then what is going to happen is our currency is still going to depreciate.

Mr. WHITFIELD. Right.

Mr. O'SHAUGHNESSY. That gets to, that is why on a scale of all of the things we need to do, it is just one of three or four things.

Mr. WHITFIELD. Right. Mr. Hickey?

Mr. HICKEY. Mr. Whitfield, this is a nine or a ten compared to what we have today.

Mr. WHITFIELD. Okay.

Mr. HICKEY. We have no effective policy tools today.

Mr. WHITFIELD. Okay. Are trade deficit inherently bad?

Mr. BERGSTEN. Trade deficits, like almost any economic phenomenon, have costs and benefits.

Mr. WHITFIELD. Right.

Mr. BERGSTEN. Trade deficit means we are importing more stuff, which holds prices down; it creates jobs in the importing sectors, retailers, et cetera. To me it is not whether it is a good or bad thing, it is what magnitude is sustainable. On my judgment, about half where we are now. We do not have to get rid of the whole $800 billion deficit, Steve kind of mis-spoke there. I think you have to cut it roughly in half, which would be an optimal level. There is no reason any country should run a zero trade balance.

Mr. WHITFIELD. I notice in Germany, for example, they have a $200 million-plus trade surplus and yet they have an unemployment rate of around 10 percent or so.

Ms. LEE. Yes, if I could also, I think the point is not that a trade deficit in itself is separate from other things in the economy, but I think the point is in the United States what we have done with our trade policy is to put in place a set of policies, including currency tax and trade rules, that actually encourage companies to move jobs offshore. Very few other countries in the world do that. Most countries are trying to figure out how to keep good jobs at home.

Mr. WHITFIELD. Right.

Ms. LEE. We have had a policy which is upside down, and I think one of the key things about the currency issue is what I said earlier, that it is a double-edged sword, that there are beneficiaries to an over-valued dollar.

Mr. WHITFIELD. Right.

Ms. LEE. The beneficiaries to that dollar, to the over-valued dollar, are companies that are producing offshore for selling in the United States that are retailers or importers or outsourcers and for those companies, that can be a very good policy. For those of us here in the United States, American workers, we cannot outsource ourselves, we live here. We need to be able to find good jobs here in the United States. You look at the long downward slide in real wages in this country, the stagnation of wages for the majority of American workers, and I think you have to say that our trade policies have undermined our ability to get good jobs here in the United States.

Mr. WHITFIELD. I see my time has expired.

Chairman LEVIN. Your time is up. Okay, Mr. Brady you join and maybe you would yield a second, you are twins today.

Mr. BRADY. That is the first time I have been called that. Thanks, Chairman, great panel today. A couple of thoughts, first, just for the record, we happen to address some of China's disputes with this filing and wining cases on semiconductors, the settling in our favor of Kraft fiber board. We filed cases against China in auto parts, nine different illegal import and export subsidies and two separate intellectual property cases. We have also done a number of U.S. trade remedy laws, tariffs on steel, bedroom furniture, brake rotors, and textile surges, all as a result of bilateral and other agreements we have had. We can say we are not doing enough and be accurate. It is inaccurate to say we have done nothing on China in trade enforcement issues. There is no question the currency needs to float at market rates, the question is how fast and what real impact it has on us. Like Mr. Whitfield, I do not think this is the magic potion that everyone in Congress makes it

out to be, a good example is Revere Copper. Here is a company, a highly respected, historical company but like others have faced a number of issues, closing plants in Detroit in the 1980s, long before China currency was an issue, having serious labor disputes, including strikes, accusations of bribery at the Hanibel smelter, and accusations of off-shoring and Hb1 abuses. In manufacturing news, Mr. O'Shaughnessy, as he just mentioned a few minutes ago, blames our high tax rate and method of taxation in making him non-competitive on a world-wide basis, and now it is China. I am not criticizing Revere Copper, just the opposite. I think in today's competitive world it is a combination of labor, taxation, health care, and open markets that all make it very difficult to compete in the world market today. It is more complex than people say.

The solutions we are looking at today, Mr. Chairman, I worry tend to focus on punishing one group, U.S. consumers. A higher yuan means higher prices for U.S. consumers. Higher tariffs is higher prices for U.S. consumers. A stronger dollar is higher prices, higher inflation, higher interest rates, all on U.S. consumers. I think we ought to be focusing on solutions that have been proposed today not just in savings, and it was interesting to hear Dr. Bergsten's point about assets-based savings versus capital and cash-based savings—or Dr. Roach's, very interesting. It is an area where Republican and Democrats ought to be working together. But we have not talked much about overall increasing these markets overseas in a significant way. We have seen recently in the last few months the lines cross. The growth in our sales overseas is now growing faster than the growth of what we are buying, not in numbers but the increased percentages, including in China. Our exports and sales to them grew by a third last year. We bought 18 percent more. Those numbers have crossed in the right trend. We ought to be, again Congress, ought to be looking at ways to accelerate that trend of sales of overseas.

We also, and I am curious, Dr. Bergsten, I think you are right about one of the ways we address China's export surges really is to curb their investment in industry and export type industry. Can we not address that not simply through the currency but since they have a banking system with an estimated 40 to 50 percent non-performing loans, much of that capital going to those industry export-oriented enterprises throughout their country, what steps can we take to force them to address their capital system, which is I think contributing just as much as the currency to their export mentality?

Mr. BERGSTEN. Well, I am with you on the analysis, and Secretary Evans stressed that earlier too, but I am not sure we can do much to force them to improve their financial system. They want to do it for their own reasons—and I give Secretary Paulson great credit—I think that has been at the top of his priority list as he worked with the Chinese in the Strategic Economic Dialogue and elsewhere. But again I will come back to the point I made in one of the earlier discussions: huge price distortions in your economy, like a grossly under-valued exchange rate, give all the wrong signals to the banks. The banks in China continue to lend to the inefficient state-owned enterprises which are enjoying a 40 percent export subsidy. Over time these state-owned enterprises are going

to fail, creating more non-performing loans. Under current pricing signals and the current structure of China's growth, it is not irrational for the banks to make loans to these companies. Maybe everything reminds me of the exchange rate, but to the extent we can get them to move that variable, it will help resolve the problem you quite rightly emphasize.

Mr. BRADY. I think perhaps the worry I have is that rather than punish U.S. consumers as the solution for this trade deficit and China's issues, why do we not put the onus back on China and provide a little pain over there because it just seems to me that this is such a complex issue that we ought not to be standing up in townhall meetings bashing China but looking at the very people who will end up paying the price for some of these solutions?

Chairman LEVIN. Let me suggest this, I think that you have opened up a number of issues and others want to participate, so let's leave it at that. We will have that debate about the progress that has been made——

Mr. BRADY. Well, Chairman, one point——

Chairman LEVIN [continuing]. Or lack of it.

Mr. BRADY [continuing]. That echoes you is that I think the solution here is less a sledge hammer and more a surgical knife if we are going to do this right.

Chairman LEVIN. Okay, I think there are differences of opinions as to that description. But I think Mr. Gonzalez was next, Mr. Manzullo, and then Mr. Roskam. Thank you again for your patience.

Mr. GONZALEZ. Thank you, Mr. Chairman. I would request unanimous consent at this time to submit for the record a CRS report that is entitled, "Japan's Currency Intervention Policy Issues, Updated April 12, 2007," from which I will actually be citing.

Chairman LEVIN. Without objection.

[The provided material follows: PENDING]

Mr. GONZALEZ. Thank you very much. The first question would go to, is it Dr. Mohatarem? That is as close as I am going to get. But I know your testimony has focused more on Japan than China and obviously we are consumed with China but nevertheless let me go ahead and cite from the summary of this particular report and see if you agree with this.

"Japan intervened, bought dollars and sold yen extensively to counter the yen's appreciation in 1976, 1978, 1985, 1988, 1992, 1996, and 1998 to 2004. Since March 2004, the Japanese government has not intervened significantly, although some claim that Tokyo continues to talk down the value of the yen. This heavy buying of dollars has resulted in accumulation of official foreign exchange reserves that exceeded a record of $888 billion as of March 2007 by Japan.

The intervention, however, seems to have had little effect. It may only have slowed the rise in value of the yen since the yen rose from 296 yen per dollar in 1996 to 103 yen per dollar at the end of 2004. In the spring of 2006, the exchange value of the yen had depreciated to about 119 yen per dollar. Japan's intervention, therefore, amounted to what is called 'leaning against the wind' or intervening in smooth, short-term trends rather than to reverse the direction of change."

How do you interpret that particular finding in their summary? Again if you could be brief because I am going to have time probably for one more question.

Mr. MOHATAREM. As I mentioned before, when you make it a one-way bet, every time the yen is appreciating, you are going to intervene very heavily, and when the yen weakens for whatever reason, you leave it alone. Currency traders assume that the normal behavior where if you expect the currency to appreciate, you begin to buy that currency, that corrective mechanism will not be allowed to work, you do not have to intervene as much because you have already made your point that you are going to be intervening if it goes in the other direction and by such massive amounts that you are going to be able to overcome any of the market pressure.

The second point I would make is somebody needs to teach CRS economics. They are looking at nominal exchange rates, not real exchange rates, inflation adjusted. Because Japan has had deflation or very low inflation, the real value of the yen has been dropping. In fact, as the Bank of Japan itself notes and as Morgan Stanley's estimates show, the real value of the yen right now is weaker than it has been in 20 years. So, yes, they are correct that if you just looked at the nominal rates, unadjusted for inflation differentials, it looks like the yen has appreciated. But in fact because Japan has had deflation, a rate of inflation, the real value of the yen now is cheaper than it has been in the last 25 years.

Mr. GONZALEZ. I appreciate your view on that particular finding. I also want to point out it is so important to look at the distinct differences of the relationship of the United States economy with Japan as opposed to China in its present situation and then looking forward.

Dr. Roach, quickly, a couple of things that you said that somewhat concern me, Robert Samuelson's article today in the Post, most of you probably already have read it, is discussing the Chinese as an emerging market as someone that could basically represent a huge consumer base for us.

"Even Chinese officials favor higher local demand but either they cannot or will not stimulate it. Personal consumption spending is a meager 38 percent of GDP. That is half of the United States rate of 70 percent. The Chinese say that astonishingly high levels, partly because they are scared of emergencies, the social safety net is skimpy, health insurance is modest, out-of-pocket spending covers half of medical costs reports economist Nicholas Lardy of the Peterson Institute. There is no universal social security and only 17 percent of workers have pensions, a mere 14 percent are covered by unemployment insurance."

I know that you have vast quantity of individuals there with limited capacity and so on, maybe that will offset it somewhat. I am going to ask for your own interpretation of this particular article.

Secondly, though he seemed to indicate that right now what is being set up as far as the United States' foreign investment in business, and by the way, while we wait for that society to catch up, Mr. O'Shaughnessy and Mr. Hickey will be out of business. Number two, he seemed to say that what we are setting up in China is basically assembly but let's take Intel. If Intel sets up shop there, do you not believe that it is much more than just cheap

labor, it is our technology that will be subsumed and assumed by what probably will be our greatest competitor. I guess really what we have in stock is really technology. But are those concerns that we should be addressing presently as China evolves?

Mr. ROACH. You ask an awful lot of very important questions. Let me just answer one of them if I could.

Mr. GONZALEZ. Please.

Mr. ROACH. China, a year ago enacted a new five year plan, very, very focused on dealing with a number of the impediments to a consumer-led society, all of which you address which were written about by Bob Samuelson today. It is not going to happen overnight. They are definitely focused on social security, pensions, unemployment insurance, and worker training to deal with the huge degree of income and job insecurity that is out there. When they get there in the next three to five years, that will be an extremely important opportunity for still competitive U.S. companies to take advantage of what will be the world's greatest consumer market. That is an important point. What is missing here in this discussion is 30 years ago China was on the brink of collapse. They have used deliberately an export-led growth strategy to come back out of that and now they want to migrate to more of a balanced consumer-led growth strategy. What is wrong with that if it improves this economy as being an increasingly solid participant in the broader global economy with opportunities for all of us?

Chairman LEVIN. All right, I think we will have to leave it at that.

Mr. GONZALEZ. Thank you very much, Mr. Chairman.

Chairman LEVIN. Thank you. Mr. Manzullo, you are next.

Mr. MANZULLO. First of all, I am a 100 percent free trader. I have one of the finest free trade voting records in Congress and am in the process of helping re-write the Export Administration Act, yet I am still a cosponsor of Ryan-Hunter. So, being a free trader is not inconsistent with supporting that bill. Second of all, here is a quote of Madam Wu Lee, vice premier, on April 22, 2004 before the U.S.-China Business Council, I was there, "China has a market-based managed unitary floating exchange rate." That is where we start. That is the definition of what to do with their currency, out of their own words.

Second of all, with regard to Dr. Roach, I with all respect, questioning a country's monetary policy is not bashing that country any more than questioning the United States' approach to China and what we think may be a mistake or improper is not bashing the United States. We represent millions of people, thousands in my congressional district who have lost high-paying manufacturing jobs, I do not bash any country, I am in pursuit of truth. Dr. Roach, again, I think that you should remove from your remarks the fact that you accuse us of bashing China, that is not correct. We are just trying to seek the truth and do the best for the people that we represent.

Secretary Evans, page three of your statement, I agree with almost everything in there but when you say that China's economy is so under-developed that its immediate shift in the market because of the lack of derivatives, stock market, et cetera, will really create havoc, I think when you say that you encourage the Chinese

to do absolutely nothing, not you, but the statement encourages them to do nothing and not to grow up. I have met a lot of Chinese and they are graduates of the same colleges you guys went to, they know the system better than we do. In fact, they are investing in our markets and making more money than we are. They understand the system. But at the same time, they cannot say that their economy is under-developed and yet they can develop a sophisticated rocket so precise that it can knock a satellite out of the sky. So we have to realize that we are actually dealing with a very sophisticated country.

Dr. Mohatarem, you work at General Motors and you criticize the Japanese for manipulating the market, yet I saw an official memo from GE—General Motors, to one of your fastener suppliers demanding that a portion of the fasteners from China come from China, which I find interesting because at the same time GM is screaming about Japan and unfairness, in the actual price of your cars, you are forcing American manufactures to outsource from China on fasteners which are not covered by the Fastener Quality Act of which I personally re-wrote in this Congress 14 years ago.

Fred Bergsten, you made a statement with which everybody agrees and that is the currency manipulation has created a false economy and that is what we are dealing with here. It is an economy that is false. That is what Bill Hickey is talking about over there when we work with unfair currency and the same Mr. O'Shaughnessy, when we help file a short supply petition against China for cornering copper scrap. Remember what happened, Bill? The day we filed the petition, they backed off on it. So, I just wanted to bring all this together here because we must start with the assumption of Wu Lee, that we are in a false economy. There are 44,000 U.S. manufacturers manufacturing in China, sending goods back to the United States, do you really think they want to see the RMB at its true value and see the cost of labor go up in China? But what has happened is because the United States had done nothing, essentially we have encouraged the American manufacturers to go overseas to get involved in a false economy and if something happens to make right, to do the right thing, to make sure that the currencies float, to let the market economy itself govern the impact of fairness in currency, we come here now and have all these discussions about the dramatic impact that could have. If anybody wants to respond, that is fine.

Mr. O'SHAUGHNESSY. Yes, I would please, Congressman.

Chairman LEVIN. Very, very briefly if you would.

Mr. O'SHAUGHNESSY. Okay. First of all, I think when Steve Roach talked about China migrating to a consumer economy, the word "migrate" was a very good one, I am thinking in terms of how people migrate over centuries and here is how their migration has gone, when they changed their currency to this market basket, they have migrated at the rate of 3.5 percent a year while the underlying rate of appreciation is probably 5 percent and they have made things worse. To put things in perspective, how important currency is, let's prioritize and quantify, currency to Revere is worth 40 percent of our costs. VAT taxes or a consumption type tax and health care costs are worth 20 percent. So, right there is 60 percent, so clearly currency is number one.

Chairman LEVIN. The bell is ringing. Mr. Roskam, you are going to have your minutes and then it is set up rather well, Mr. Ryan, you are going to have a few minutes to conclude the hearing since your bill has been mentioned [continuing]. Thank you for your patience.

Being a freshman has marvelous attributes, except one.

[Laughter.]

Mr. ROSKAM. Thanks, Mr. Chairman, very much. Thank you all. You know, it is, all kidding aside, it is really helpful to sit and listen to you all. You come to this with good faith and a very high view of the process, and it's really encouraging to someone like me.

In the interest of full disclosure, I represent the West and Northwestern suburbs of Chicago. Within that area, depending on who you're talking to, feels pretty conflicted about this issue. I've got Mr. Hickey's counterparts, who are a little bit further west than him, manufacturers, tool-and-die folks. I've got thousands of Motorola employees, Tel Labs employees and so forth that are involved in very robust trade with China.

So, I find it interesting. Unlike Mr. Manzullo, I don't have a history with any of you, so you're all a clean slate as far as I'm concerned. What I've heard basically today if you distill it down—what I've heard—you may not have said this, but what I heard was sort of two versions of the same theme. One was stay the course, and I understand the rationale behind that. The other is pull the trigger in terms of the Ryan-Hunter bill.

What it strikes me is when you distill this all down, it is what is your tolerance for pain? How much water are you willing to take on? How far will go into the wind in order to get to a point where you're dealing robustly with a billion consumers potentially?

Mr. Evans, I understand the nature of wanting to wait it out in terms of the financial services sector developing so that China has the tools in order to do that. Meanwhile, the Mr. Hickeys of the world are struggling in terms of real lifestyle change possibly, certainly if not for him, then for his children and the workers around him.

I'm wondering, you know, there's value to this conversation because the negotiators then can go back and say, look, you know, these guys in Congress, they're serious. They're not kidding. It does drive the discussion. So, I think that that's helpful in terms of putting pressure on China. But I'm not sure that either of the two alternatives that we've heard today are really the best alternatives; stay the course or pull the trigger.

Is there a third way? Is there a neutral—not a neutral, but is there something that moves the ball? Maybe, Mr. Secretary, you could address that.

Mr. EVANS. Well, look, I just want to be clear. China is not moving fast enough on currency exchange. They need to pick up the pace. Now what—how much pick up the pace, I don't know. I can't define that precisely for you. But I think this is a very important discussion that we're having right here. Because I think it will create the environment for them to pick up the pace.

They'll learn that Congress is serious about this. I encourage all Congress men and women to go over there and spend time in China and get to know the leaders over there and understand

where they're coming from. But it is important for Congress to send signals to them, like it's important—you know, I commend Secretary Paulson, as was said earlier, for the strategic economic dialog that's underway. We've got active dialog with them all the time there, and I guarantee you, every time they're talking, you've got to pick up the pace in moving toward market-based currencies.

But, you know, they do have the problem of developing the markets for futures and forward trading and swaps and derivatives and everything else so that they don't run a risk of their economy having some kind of hard landing or soft landing like so many economists were worried about just four or 5 years ago. Four or 5 years ago when I went over there, economists were saying they're going to have a hard landing or a soft landing. Nobody seemed to know.

But I want to be clear that I'm not to stay the course, you know, everything's okay. I think we need to keep the pressure on them to pick up the pace.

Mr. ROSKAM. Thank you. Yes, sir?

Mr. BERGSTEN. With due respect to Secretary Evans, the weakness of China's financial markets is not a deterrent to the kind of currency adjustment I'm talking about. I am not calling for China to freely float its exchange rate. That is not necessary. They can do one-shot revaluations. They can manage their float upward like they've managed it to stay flat. None of that will worsen their financial markets.

Over time, they need better financial markets to have a truly floating rate. But they do not need that in the short run. In my statement, I tried to offer a middle course between "stay the course" or "pull the trigger." We have multilateral institutions and rules. We have not tried to use them very much. Treasury has gone to the IMF, but not really very hard. We have not brought a case to the WTO—some colleagues on the panel tried to do it, but were rejected by the administration, as was testified.

We could take China to the WTO under existing rules of the game, which, on our analysis, is not a slam-dunk, to use the current terminology, but it would have a significant chance of both bringing some justice to the outcome and putting more multilateral pressure on the Chinese to move their own policies. So, in my preferred solution in my statement, that's what I was offering. If it doesn't work, they have to pull the trigger. But I think we should go those multilateral, middle-course routes first.

Chairman LEVIN. Talking about legislation, I'd like to have Mr. Ryan take a few minutes, and then we're going to adjourn*.

Mr. RYAN. Thank you, Mr. Chairman, thank you for having this hearing, trilateral, and thank you for allowing me to be in this beautiful room. I thought I was important as an appropriator until I got into this room this morning.

I appreciate everyone's testimony and comments, some more than others, of course. Mr. O'Shaughnessy and Mr. Hickey's grade curve, I appreciate much better than Dr. Roach's for the Ryan-Hunter bill.

A couple of points I want to make, just what Mr. Manzullo said. You know, this is not about China bashing. We have constituents in our district who are losing their jobs, and Wheatland Tube,

which is a business in my district, they have tubing coming over from China. The end price for the tube coming over from China is the same cost as the raw materials for Wheatland Tube. So, there's a significant advantage here that we just want to say, level the playing field off.

So, I do have a couple of questions. Dr. Roach, one of the questions I have, if the RMB was valued where it should be, what would that mean for investment in the United States?

Mr. ROACH. I think—first of all, I'm not sure, just clarify. Where do you think it should be?

Mr. RYAN. Well, if it was, you know, valued more than it was today by a percent or two or three——

Mr. ROACH. Well, that's not going to make any difference by 1 or 2 percent. If the RMB were raised by a large magnitude, I think, as I indicated in my statement, that would have very serious implications for the currency and the real interest rates in the U.S. It would weaken the U.S. economy and would have the counterproductive impact of really lowering investment near term.

Over a long period of time, if the dollar were to move lower in a more gradual basis, that could begin to restore some investment back into the United States. That would take a very, very long period of time, along the lines of the migration point that was just made by Mr. O'Shaughnessy.

Mr. RYAN. Ms. Lee?

Ms. LEE. If I could, I mean, I think the point is that the—if the RMB were appreciated by 20 to 40 percent, which is what we would estimate would be needed, it has offsetting impacts, and I think it would be very healthy in terms of the long-term ability, the productivity of the United States economy, the ability to compete.

Right now our trade deficit is undermining our GDP growth. It's cutting away at that, and we are, as everybody has said, we are consuming 6 to 7 percent more than we produce every year, and that's not good for us. We're borrowing from the rest of the world in order to fund consumption that we can't afford.

So, you know, an adjustment of relative prices where we make—we make the price of Chinese goods more expensive, but we also enhance the ability the American companies to produce on American soil, it's the offsetting thing. We heard before talk about, you know, the punishment of consumers. Well, consumers are workers. We see the declining real wage, median real wage in this country.

What we're saying is that even with all the cheap imports, American workers aren't doing well. They're not coming out even. They're not getting their fair share of what's there.

I think it's because of stories like Mr. Hickey's and Mr. O'Shaughnessy's that well-meaning American companies that are doing everything they can to compete on American soil are having the rug pulled out from underneath them by our own government. So I—you have to look at both sides of it, not just at the investor side or the Wall Street side of that equation.

Chairman LEVIN: I think we're going to have to finish because we have votes.

Mr. RYAN. Can I ask just one quick question?

Chairman LEVIN: Quick.

Mr. RYAN. If Secretary Evans and Dr. Roach could answer. I'm sorry. I don't know if you've read the Fair Currency Act or not. Do you believe it to be WTO-compliant? Dr. Roach?

Mr. ROACH. I'm afraid I do not. There is nothing in the WTO as it's written that really deals directly with treating currencies as an unfair subsidy. I think you'd have to go back and have the WTO provisions themselves redrafted to allow for that.

Mr. RYAN. Dr. Bergsten?

Mr. BERGSTEN. No. I don't think that's right. We've looked very carefully at the compatibility of the law and the whole idea. In fact some of my colleagues at the Institute and I wrote the subsidy code when we were at the Treasury 30 years ago. We know it fairly well.

We think the cases that would be brought under Ryan-Hunter would certainly be plausible, arguable cases to bring to the WTO. We're not sure they would win, because the issue is unprecedented. It's never been addressed. You'd have to get an IMF finding that there was currency misalignment or manipulation. Then the WTO would have to apply it to its rules.

You could pursue at least two channels that are certainly plausible and arguable, and on the face of it, there's no incompatibility between the law and the existing rules.

Chairman LEVIN: Good I'm glad you had a chance to ask that question. So, we're going to adjourn to two o'clock. My own feeling about this excellent hearing is, I hope it sends a clear message. I also think this testimony is going to accelerate the consideration of legislation.

Thank you very much. We stand in recess until two o'clock.

[Recess until 2:08 p.m.]

AFTERNOON SESSION

Chairman LEVIN: Thank you very much. I think we'll begin. So, this is the recess edition. We heard this morning from a distinguished panel, and I have a hunch that your staffs gave you some indication of the testimony. I hope so. Indeed, that was the purpose of structuring it this way so that we could have a rather full panoply of opinions, of approaches, of attitudes regarding the currency issues, and for the administration to come to give your perspective and any responses that you have.

We thought it might make most sense to start with the Hon. Mark Sobel, who is the Deputy Assistant Secretary for International Monetary and Financial Policy at Treasury, and then the Hon. Stephen Claeys, who is the Deputy Assistant Secretary for Antidumping and Countervailing Duty Operations, Department of Commerce, and then the Hon. Daniel Brinza, who is Assistant USTR for Monitoring and Enforcement.

That seemed to be the proper approach, because perhaps this is in part a question of the jurisdiction of each of the three of you, but in two of your cases, the testimony doesn't relate very much to the issue of currency that's before us, while the testimony of the Treasury obviously very much refers to it since there's no question about your jurisdiction, although I think there is a relevant role for the other two agencies.

So, in view of that, why don't we start with you, Secretary Sobel, and then we'll go to the next two. Thank you again for coming. It's a mic. You have to push a button.

STATEMENT OF THE HONORABLE MARK SOBEL, DEPUTY ASSISTANT SECRETARY FOR INTERNATIONAL MONETARY AND FINANCIAL POLICY, U.S. DEPARTMENT OF TREASURY

Mr. SOBEL. Thank you, Mr. Chairman. Twice each year, Treasury issues a report to Congress on international economic and exchange rate polices as required by the 1988 Trade Act. This Act requires the Secretary to consider whether countries manipulate the rate of exchange between their currency and the U.S. dollar for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade.

Treasury takes the preparation of this report very seriously. We know that it is read closely by Congress, the financial community, the general public and foreign governments. We make every effort to ensure that we produce a comprehensive report that reflects the realities of today's international monetary and financial systems. Treasury has improved the coverage and analytic rigor of the report in recent years. Reflecting the significant changes in the world economy since 1998, we have strengthened our coverage of global economic development, the evolution of global imbalances and international capital flows. We have discussed the share international strategy for adjustment of external imbalances, and we have begun adding special appendices.

Among the special appendices, one examines the role of various indicators important in addressing currency manipulation questions, provides illustrative scenarios on this question, and notes the wide array of countries that have large external surpluses for differing reasons.

Another focused on methodological issues relating to evaluating whether an exchange rate is misaligned, noting that the range of estimates can vary widely, but certain inferences can be drawn about misalignment, provided the results are taken from a variety of models, and the results are largely similar in magnitude and direction. However, these results must be supplemented with assessments of other reasons why exchange rates might deviate from perceived equilibrium values.

Treasury previously reported to Congress in March 2005 on the inherent difficulties in making designations pursuant to the Act. That report also made clear that in assessing exchange rate manipulation, standard analysis needed to be supplemented with other indicators, and there is no mechanistic of formulaic approach in determining exchange rate manipulation.

The report also noted the role of intent in rendering judgments about designations pursuant to the Act. Intent is an important consideration because it is inherent to the language in the Act that currency manipulation be undertaken for the purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade.

The GAO reviewed the methodology Treasury uses in examining foreign exchange policies in April 2005. The GAO report concluded that Treasury has complied with the requirements in the 1988 Act.

The GAO report made no recommendations but did note that current manipulation is a complex issue that involves both country-specific and broader international economic factors.

Another key element in our strategy is to encourage the IMF, the world's only multilateral international with a mandate for exchange rates, to improve its work on exchange rates surveillance. Treasury strongly supports IMF Managing Director de Rato's efforts to update the IMF's operational rules for surveillance.

Let me turn to China. Although the RMB has appreciated against the U.S. dollar by more than 7 percent since July 2005, China does not have the currency policy we want it to have and that it needs. China's cautious approach to exchange rate reform exacerbates distortions in its domestic economy and impedes the adjustment of international imbalances.

Though China has embraced currency flexibility as a policy goal, the authorities are not moving quickly enough for the United States, for the global community, or for their own good. While we agree on China's broad reform agenda, China's leaders believe there is a risk in moving too quickly. Secretary Paulson has told his Chinese counterparts repeatedly that the greater risk is in China moving too slowly.

Currency movement alone will not significantly reduce China's trade surplus with the U.S., nor eliminate distortions in the Chinese economy. China's trade surpluses are rooted in the structure of the Chinese economy. China needs to rebalance its economy so that household consumption powers growth, rather than exports and excess investment. The Secretary will again reemphasize these messages at the upcoming meeting of the Strategic Economic Dialogue.

Secretary Paulson has laid out several key steps China must take to advance toward the goal of currency flexibility: Widening the band on daily exchange rate movement; reducing intervention; developing its capital market; and setting clear monetary policy targets to avoid inflation and increase confidence in the value of the RMB.

On Japan, the Treasury closely monitors Japan's foreign exchange policy. The value of the yen is determined in open, competitive global markets. Japan has not intervened in the foreign exchange market since March 2004. In real price adjusted terms, the yen is at its lowest value since the early 1980s. This is due to a protracted period of deflation in the Japanese economy that coincided with rising prices in the U.S. and Japan's other trading partners. Japan's deflation reflects the drawn-out difficulties of adjustment to the bursting of the asset price bubble in the 1990s.

Japan's economy is recovering, but the recovery has not been brisk. One of the most important contributions Japan could make to the global economy and to U.S. firms and workers would be to resume sustainable and robust domestic demand growth and exit completely from deflation.

We discuss foreign exchange issues with Japan and the other G7 partners regularly. Japan has joined in repeated G7 statements supporting foreign exchange flexibility.

Thank you, Mr. Chair.

[The prepared statement of Mr. Sobel follows:]

Prepared Statement of The Honorable Mark Sobel, Deputy Assistant Secretary for International Monetary and Financial Policy, U.S. Department of Treasury

Thank you Chairman Levin, Chairman Gutierrez, Chairman Rush, Representative Herger, Representative Paul and Representative Stearns and Members of the Subcommittees, for the opportunity to appear today to discuss this important issue.

Treasury's Assessment of Exchange Rate Policies

As you know, twice a year the Department of the Treasury issues a Report to Congress on International and Exchange Rate Policies. This report, often called the "Foreign Exchange Report," is required by the Omnibus Trade and Competitiveness Act of 1988 (the "Act"). The report reviews economic and policy developments of important world economies and other economies with which the United States has a large trading relationship. The Act states that "the Secretary of the Treasury shall analyze on an annual basis the exchange rate policies of foreign countries, in consultation with the International Monetary Fund, and consider whether countries manipulate the rate of exchange between their currency and the United States dollar for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade."

Treasury takes the preparation of this report very seriously. We know that it is read closely by Members of Congress as well as the financial community, the general public, and foreign governments. We make every effort to ensure that we produce an accurate yet comprehensive report that incorporates analysis reflecting the realities of today's international monetary and financial systems. In developing our assessments, Treasury undertakes a careful review of major trading partners' exchange rate regimes and policies, the evolution of their external balance of payments positions, their accumulation of foreign exchange reserves, macroeconomic developments within their economies, and their responses to these developments in terms of monetary and financial developments and financial and exchange restrictions.

Treasury has made a concerted effort in recent years to broaden and improve the coverage and analytical rigor of the report. We have done so because of changing global circumstances since 1988, including profound technological change and globalization, which have enabled many more economies today to become systemically important from an economic and financial perspective. In addition, global capital flows have increased greatly since 1988. The interdependence of the United States with the world economy has increased, heightening our sensitivity to the impact of developments overseas.

In recent reports, therefore, Treasury has strengthened our coverage and analysis of global economic developments and the evolution of the U.S. balance of payments position by including a discussion of perspectives on interpreting U.S. current account developments and international capital flows. In this regard, we have discussed the shared international strategy for global adjustment and noted that given the large U.S. current account deficit, the counterpart to that deficit is inevitably to be found in large surpluses elsewhere in the world. We also have provided more extensive descriptions of macroeconomic and financial developments in many of the key countries of particular interest to the public.

Further, Treasury has also included a series of appendices on critical international monetary policy issues. In this regard, we began including a special appendix in which many variables and indicators are analyzed on a systematic basis to develop a better understanding of the currency policies of key countries. In this light, and given the inherent difficulties in defining currency manipulation for the purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade, we have examined a range of indicators that economists would typically look at when dealing with currency manipulation questions. We have analyzed a range of different combinations of indicators and weights in order to shed light on the judgments that we are asked to make. The numerical examples illustrate the sensitivity of the rankings to the weighting scheme chosen and also highlight the fact that, for an array of differing reasons, many countries throughout the world have large external surpluses.

Treasury also has made a special effort in the report, through additional appendices, to discuss important related topics. Recognizing that the International Monetary Fund allows members to choose their own exchange rate regime, we have discussed at length the advantages and disadvantages of various exchange rate regimes and, more specifically, fixed versus flexible exchange rates. In light of the vast accumulation of foreign exchange reserves by some countries, especially emerging markets, we have discussed the costs and benefits of reserve accumulation and

some of the "rules of thumb" on what are thought to be prudent levels of reserves. And in light of the considerable attention being given to misaligned exchange rates, we have discussed some of the methodological problems involved in estimating equilibrium or fair value exchange rates.

Treasury staff also prepares informal papers, known as Occasional Papers (available at: www.treasury.gov/offices/international-affairs/occasional-paper-series/) on a number of other key international monetary policy issues. These staff papers are not statements of Administration or Treasury policy, but they shed light on these important issues. The question of currency misalignment was discussed in detail in a recent Treasury Occasional Paper (www.treasury.gov/offices/international-affairs/occasional-paper-series/docs/ExchangeRateModels.pdf). That paper reviewed many of the concepts of exchange rate equilibrium in use as well as many of the models used to estimate the over or under valuation of a currency. An important finding of the paper is the wide variance of views that exist with respect to misalignment, as well as the sensitivity of the results to various modeling assumptions. In fact, in some cases, depending on the price deflators used, currencies were found to be overvalued using one deflator but undervalued using another deflator. Another main message of the study is that, although the range of estimates can and often do vary considerably, it is possible to draw certain inferences about misalignment provided the results are drawn from a variety of models and the results are largely similar in magnitude and direction. This information must, however, be supplemented with assessments of other reasons why exchange rates, during relevant periods of time, might deviate from perceived equilibrium values.

Treasury reported to Congress, in March 2005, on the procedures and inherent difficulties involved in making designations pursuant to the Act. That report, entitled, "Report to the Committees on Appropriations on Clarification of Statutory Provisions Addressing Currency Manipulation," established that to identify exchange rate manipulation, standard macroeconomic and microeconomic analysis needed to be supplemented with certain indicators, including but not limited to: (1) measures of undervaluation; (2) protracted large scale intervention in one direction; (3) rapid foreign exchange reserve accumulation; (4) capital controls and payments restrictions; and (5) trade and current account balances. We have since incorporated much of this in one of the aforementioned appendices where I indicated the outcomes largely depend on weights assigned and combinations of indicators used. As since noted in Treasury's November 2005 Report, there is no mechanistic or formulaic approach in determining manipulation; a complete assessment requires additional analysis of the interactions among economic variables, specific factors affecting economies, and current policy formulation and implementation.

The March 2005 report also noted the role of "intent" in rendering judgments about designations pursuant to the Act. The language of the Act states that currency manipulation must be undertaken "for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade." "Intent" of the country in question is a consideration as it is inherent in the language of the act. Determining intent behind the policy can be difficult to assess.

The methodology Treasury uses in examining the foreign exchange policies of foreign economies was also the subject of a review by the Government Accountability Office (GAO) in April 2005. The GAO report[1] concluded that Treasury has complied with the requirements in the 1988 Trade Act. The GAO report made no recommendations, but did note that currency "manipulation" is a complex issue that it involves both country-specific and broader international economic factors. The report also considered the views of outside experts on whether the renminbi was undervalued, finding that the views varied widely, with many experts maintaining a view that the currency is significantly undervalued while others contending that undervaluation was not substantial or that estimating it was not possible. According to the GAO, even among experts who believe that China's currency to be undervalued, there was no consensus on how and when China should move to a more flexible exchange rate regime or whether capital account liberalization should be a part of that move.

Another key element of Treasury's strategy to ensure that countries pursue appropriate exchange rate policies is to encourage the International Monetary Fund (IMF), the world's only multilateral institution with a mandate for exchange rates, to improve its work on foreign exchange surveillance. Exchange rate manipulation to gain competitive advantage is inconsistent with the treaty obligations of the 185 member countries of the IMF. Treasury strongly supports IMF Managing Director

[1] GAO–05–351; International Trade "Treasury Assessments Have Not Found Currency Manipulation, but Concerns about Exchange Rates Continue," April 2005.

Rodrigo de Rato's effort to update the IMF's thirty-year old operational rules for exchange rate surveillance.

We take very seriously our responsibilities to ensure that the Report to Congress on International Economic and Exchange Rate Policy is of high quality, topical, and thorough. We have been careful to be very clear about how we approach the issue of designations pursuant to the Act and our reasoning in specific cases.

China

As the exchange rate policy of China is of interest to the Committee Members, I will address it in more detail.

China's currency policy is an important issue in the economic relationship between our two countries. Although China abandoned its fixed exchange rate in July 2005 and the RMB has now appreciated against the U.S. dollar by a bit more than 7 percent, China does not yet have the currency policy we want it to have and that it needs. Secretary Paulson has stated that a major objective of his as Treasury Secretary will be to press the Chinese government to advance toward the goal of an RMB for which the value is freely set in a competitive marketplace, based on economic fundamentals. The Secretary and Treasury staff meets frequently with Chinese counterparts to press this issue.

The Secretary has laid out several key steps China must take to advance toward this goal, including: widening the band on daily exchange rate movement; reducing intervention; developing its capital market; and setting clear monetary policy targets to avoid inflation and increase confidence in the value of the Chinese RMB. These reforms will allow China to develop the market infrastructure it needs for a freely floating currency; we are committed to working towards those reforms. Although China has embraced currency flexibility as a policy goal, Chinese authorities are not moving quickly enough for the United States or the rest of the global community. And they are not moving quickly enough for China's own good. While we agree on China's broad reform agenda, China's leaders believe there is risk in moving too quickly. Secretary Paulson has told his Chinese counterparts repeatedly that the greater risk is in China moving too slowly. The Secretary will again emphasize this message during the upcoming meeting of the Strategic Economic Dialogue to take place here in Washington later this month. We hope that Chinese leaders at that time will have the benefit of meeting with Members of Congress to discuss the U.S.-China economic relationship.

Treasury's foreign exchange report clearly states that China's cautious approach to exchange rate reform exacerbates distortions in its domestic economy and impedes the adjustment of international imbalances. With respect to determining whether or not China manipulates its currency as defined in the legislation, Treasury must take into consideration the intent of Chinese authorities. In the December 2006 Foreign Exchange Report, after careful analysis of China's economic and currency policies, Treasury did not find that China's policies are designed for the purposes of gaining unfair competitive advantage or preventing effective balance of payments adjustments. Treasury will continue to carefully analyze China's policies as we prepare future Reports.

While China's currency policy is critical to the United States and to China, currency movement alone will not significantly reduce China's trade surplus nor eliminate the distortions in the Chinese economy. China's trade surpluses are rooted in the structure of the Chinese economy and are not solely the result of currency policy. China needs to restructure its economy so that household consumption, rather than exports and excess investment, powers growth. Reform of China's financial system is also critically important for the rebalancing process, by providing Chinese households the means to insure themselves against major risks and finance expenditures like education. Better financial services will also help address many of the reasons why Chinese households save so much and can spend so little of their incomes. Vibrant domestic consumption is key to the welfare of the Chinese population and is the only way that China can grow without generating huge trade surpluses.

To be a responsible international stakeholder in the global economy, China needs to take swift and effective action to remedy these imbalances. This is both for the global economy and for China's own sake. Currency flexibility will enhance the ability of China's economic policy makers to use monetary policy to steer China's economy towards steady and sustained growth. Rebalancing the structure of economic activity in China will help to alleviate global economic imbalances and will ensure that China's future growth can be sustained without generating huge trade imbalances.

Japan

The Department of the Treasury closely monitors Japan's foreign exchange policy, which is reported on extensively in each Foreign Exchange Report.

The value of the yen is determined in open, competitive global markets, responding to the forces of supply and demand. Global trading in the yen-dollar market is extremely large, reflecting the importance of Japan in world trade and the global financial system. Since 2001, the yen-dollar exchange rate has fluctuated in the range of 105 to 135 yen to the dollar, and stands today at about 120 yen to the dollar. While Japan has previously intervened in the foreign exchange market, there is currently no intervention and Japan has not intervened since March 2004.

In real, price adjusted terms, the yen is at its lowest value since the early 1980s. The yen's real effective value is the result of a protracted period of deflation in the Japanese economy that coincided with rising prices in the United States and other trading partners of Japan. Japan's long deflationary episode reflects the drawn-out difficulties of Japan's adjustment to the bursting of the asset price bubble in the early 1990s.

Japan's economy is recovering. The recovery has been underway for several years, but it has not been brisk and it has not yet gathered steam. One of the most important contributions Japan could make to the global economy, and to U.S. firms and workers, would be to resume sustainable and robust domestic demand growth and exit completely from deflation.

We discuss foreign exchange issues with Japan and the other G7 partners regularly. Japan has joined repeated G7 statements supporting foreign exchange flexibility.

Thank you.

Chairman LEVIN. Thank you very much.

Mr. Secretary.

STATEMENT OF THE HONORABLE STEPHEN J. CLAEYS, DEPUTY ASSISTANT SECRETARY FOR ANTIDUMPING AND COUNTERVAILING DUTY OPERATIONS, INTERNATIONAL TRADE ADMINISTRATION, U.S. DEPARTMENT OF COMMERCE

Mr. CLAEYS. Thank you Chairmen Levin, Rush and Gutierrez, Ranking Members Herger, Stearns and Paul, and Members of the Subcommittees for inviting me to discuss the issue of currency manipulation and its effects on U.S. businesses and workers. I appreciate the opportunity to share with you the Department of Commerce's views on this issue, particularly as they relate to the U.S. countervailing duty law.

The statute charges the Department of Commerce with the enforcement of the U.S. trade remedy laws. These laws consist of the antidumping law and the countervailing duty law. As Import Administration's Deputy Assistant Secretary for Antidumping and Countervailing Duty Operations, I am directly responsible for enforcing those laws.

China's remarkable economic growth in recent years makes it an important engine in the world economy. China is now the United States' third-largest goods trading partner. Our exports to China totaled $55 billion in 2006, growing at a rate of 32 percent from the previous year. At the same time, China is our second-largest source of imports.

The tremendous growth in trade has benefited both countries, even though this growth has naturally resulted in an increase in trade friction. Commerce currently has 62 antidumping orders against goods from China, having issued 32 antidumping orders against China since 2001.

The antidumping and countervailing duty trade laws deal respectively with unfair pricing and foreign government subsidization of imports. Government subsidies distort the free flow of goods and adversely affect American businesses in the global marketplace. American companies, workers and farmers can compete against anyone in the world. However, they should not be expected to compete against foreign governments providing subsidies to their own industries.

China's policy has raised serious questions in this regard. Its unfair subsidies can create huge, unfair advantages, and China's exports to the United States can also harm U.S. producers exporting to China or competing with Chinese exports to other countries.

Under the CVD law, foreign governments subsidize industries when they provide financial assistance to benefit the production, the manufacture or exportation of goods. Subsidies can take many forms, such as direct grants, tax breaks, or below-market-rate loans. The amount of subsidies the foreign produce receives from the government is the basis for the countervailing duty rate through which the subsidy is offset or countervailed.

For Commerce to find a program to be a countervailable subsidy, it would need to determine that three required statutory criteria apply. The first involves a financial contribution from the government. Second, it confers a benefit, and third is specific, meaning that it is either an export subsidy or import substitution subsidy, or is only available to a limited number of industries or companies.

Whether a petition from a U.S. industry sufficiently alleges these criteria, and whether Commerce determines that a program indeed constitutes a countervailable subsidy, will depend on the facts and arguments presented to Commerce in a particular case.

A related issue is applying the CVD law that a subsidy is provided by China. Since the mid-1980s, Commerce maintained a policy of not applying our countervailing duty law to countries classified as nonmarket economies for antidumping purposes, such as China. Commerce reasoned that subsidies had no measurable economic impact in the 1980s Soviet-style economies that were under consideration when we established the policy.

On March 30th, Commerce revised this policy by announcing its preliminary decision to apply the countervailing duty law to imports of glossy paper from China. Commerce determined that the current nature of China's economy does not create obstacles to applying the CVD law because the nature of the Chinese economy today allows us to determine whether the Chinese government has bestowed countervailable subsidies.

We are committed to identifying and addressing trade-distortive and injurious subsidies from all countries. That is a top priority for us. Commerce will not hesitate to use the tools at our disposal to discipline China's use of unfair subsidies.

Thank you for giving me this opportunity to testify on this important topic today, and I'm happy to take your questions. Thank you.

[The prepared statement of Mr. Claeys follows:]

Prepared Statement of The Honorable Stephen Claeys, Deputy Assistant Secretary for Antidumping and Countervailing Duty Operations, Department of Commerce

Thank you Chairmen Levin, Rush, and Gutierrez, Ranking Members Herger, Stearns, and Paul, and Members of the Subcommittees for inviting me to discuss the issue of currency manipulation and its effect on U.S. businesses and workers. I appreciate the opportunity to share with you the Department of Commerce's views on this issue, particularly as they relate to the U.S. countervailing duty (CVD) law.

The statute charges the Department of Commerce with the enforcement of the U.S. trade remedy laws. These laws consist of the antidumping law, which remedies unfairly priced imports, and the countervailing duty law, which remedies foreign-government subsidized imports. As Import Administration's Deputy Assistant Secretary for Antidumping and Countervailing Duty Operations, I am directly responsible for enforcing these laws.

China's remarkable economic growth in recent years makes it one of the most important engines of the world economy outside of the United States. In trade terms, China is now the United States' third largest goods trading partner. China represents one of the fastest-growing markets for U.S. goods and services. Our goods exports to China, which for the most part are high value-added products, totaled $55 billion in 2006, growing at a rate of 32 percent from the previous year. That makes China our fourth largest export market. At the same time, China is our second largest source of imports. Goods imported from China into the United States totaled $288 billion in 2006.

The tremendous growth in U.S.-China trade has benefited both countries, even though this growth has resulted in, quite naturally, an increase in trade frictions as well as our trade remedy activities involving China. Commerce currently has 62 antidumping orders against goods from China. Since 2001, we have issued 32 antidumping orders against goods from China, compared to the 24 orders put into place between 1993 and 2000.

The antidumping trade rules and countervailing duty trade rules are both tools sanctioned by the World Trade Organization (WTO) to deal, respectively, with unfair pricing and foreign government subsidization of imports. Government subsidies distort the free flow of goods and adversely affect American businesses in the global marketplace. American companies, workers and farmers can compete against anyone in the world. However, they should not be expected to compete against foreign governments providing subsidies to their own industries.

China's policies raise serious questions in this regard. The Chinese press is rife with examples of subsidies given to various industries and products across the spectrum, from agricultural products to steel. Unfair subsidies, whether they come from the central, provincial, and/or local governments to Chinese companies, all have the power to distort trade conditions for U.S. producers, both here in the U.S. market and abroad. These kinds of subsidies can create huge, unfair advantages to China's exports of a wide range of products to the United States. They can also harm U.S. producers hoping to export successfully to China or compete with Chinese exports to third-country markets.

Under the CVD law, foreign governments subsidize industries when they provide financial assistance to benefit the production, manufacture or exportation of goods. Subsidies can take many forms, such as direct cash payments, credits against taxes, and loans at terms that do not reflect market considerations. U.S. trade laws and Commerce's regulations establish standards for determining when an unfair subsidy has been conferred and for measuring the amount of the subsidy. The amount of subsidies the foreign producer receives from the government is the basis for the countervailing duty rate by which the subsidy is offset or "countervailed."

When a U.S. industry files a petition alleging unfair subsidies and seeking relief under the CVD law, Commerce looks at each of the alleged subsidies, consistent with our obligations under U.S. law, to determine whether the petition meets the statutory requirements for initiation. The basis for a countervailing duty petition is an allegation that foreign producers or exporters are receiving countervailable subsidies (as well as an allegation that those subsidies are causing material injury to a domestic industry). As a result, the subsidy allegation must include documentary evidence that such subsidies exist.

Under U.S. law, a countervailable subsidy exists where an authority provides a "financial contribution" to a company that confers a measurable "benefit." The subsidy must also be "specific," meaning that it must either be an export subsidy or import substitution subsidy (i.e., prohibited subsidies) or is only available to a limited number of industries or companies. Commerce must look to see whether the CVD petition addresses each of these elements for each subsidy that is alleged on

the basis of "information that is reasonably available" to the petitioning U.S. industry. If an allegation meets this statutory requirement (and there is a sufficient allegation that the alleged subsidies are causing material injury to a domestic industry), Commerce will initiate a CVD investigation. During the subsequent investigation, Commerce then determines if, in fact, the alleged subsidy meets these criteria and, thus, is countervailable.

In summary, for Commerce to find a countervailable subsidy, it would need to determine that the three statutory criteria discussed above apply: 1) the subsidy involves a financial contribution from the government; 2) the subsidy confers a benefit; and 3) the subsidy is a prohibited subsidy or is otherwise specific. Whether a petition from a U.S. industry sufficiently alleges these criteria and whether Commerce determines that a subsidy indeed constitutes a countervailable subsidy will depend on the facts and arguments presented to Commerce in a particular case.

A related issue is applying the CVD law to subsidies provided by China. For more than 20 years, throughout four Administrations, Commerce maintained a policy of not applying our CVD law to countries that we have classified as non-market economies for antidumping purposes, such as China. This policy was upheld in the 1986 *Georgetown Steel* decision, in which the Court of Appeals for the Federal Circuit affirmed that Commerce has the discretion to decide whether to apply the countervailing duty law to non-market economy countries. Commerce reasoned that subsidies had no measurable economic impact in the 1980s Soviet-style economies that were then under consideration.

On March 30, 2007, Commerce revised this policy by announcing its preliminary decision to apply the CVD law to imports of glossy paper from China. After a careful analysis of the parties' arguments and information on the record of this case, Commerce determined that the current nature of China's economy does not create the obstacles to applying the CVD law that were present in the "Soviet-style economies" at issue in *Georgetown Steel*. For purposes of this preliminary determination, Commerce found that the nature of the Chinese economy today allows us to determine whether the Chinese Government has bestowed countervailable subsidies. Just as China has evolved, so has the range of tools available to make sure that China trades fairly. All interested parties will have ample opportunity to provide comments for the record on this investigation before Commerce makes its final determination later this year.

We are committed to identifying and addressing trade-distortive and injurious subsidies from all countries, including China. That is a top priority for us. Commerce will not hesitate to use the tools at our disposal to discipline China's use of unfair subsidies. Thank you for giving me this opportunity to testify on this important topic today and I am happy to take your questions.

Chairman LEVIN. Thank you.

STATEMENT OF THE HONORABLE DANIEL BRINZA, DEPUTY GENERAL COUNSEL AND ASSISTANT U.S. TRADE REPRESENTATIVE FOR MONITORING AND ENFORCEMENT, OFFICE OF THE U.S. TRADE REPRESENTATIVE

Mr. BRINZA. Thank you, Mr. Chairman, Members of the Committees. I am pleased to participate in today's hearing. As you know, within the administration, the Treasury Department is charged with the responsibility for currency and exchange rate matters while the Office of the U.S. Trade Representative is responsible for developing and coordinating U.S. international trade and direct investment policy.

Our work aims at increasing exports by expanding market access for American goods and services abroad and protecting American intellectual property rights around the world. USTR's efforts to achieve market-driven, market opening trade policies abroad fit into a larger economic policy picture, of course. They support Treasury's efforts to get results on currency and other matters in the financial realm, as well as the Commerce Department's work

on global competitiveness, export promotion, and its administration of domestic trade remedy laws.

To provide more concrete perspective on our work, I will give you a brief overview of USTR's recent engagement with both China and Japan, touching on the mechanisms USTR uses to address key trade concerns.

With respect to China, China's accession to the WTO marked a critical step forward toward China fully embracing its role as a responsible stakeholder in an international rules-based system. Since acceding to the WTO 5 years ago, China has taken significant steps in an effort to bring its trading system into basic compliance with WTO rules. U.S. businesses, workers, farmers, service providers and consumers have benefited significantly from these steps, and continue to do so as U.S.-China trade grows.

Despite this progress, China's record in implementing its WTO obligations is decidedly mixed. In our engagement with China, the U.S. follows a dual-track approach to resolving its WTO concerns—bilateral dialog to try to achieve practical solutions, together with a full willingness to use WTO dispute settlement where appropriate to resolve problems.

For example, in March 2004, we commenced a WTO dispute against China's discriminatory value-added tax integrated circuits.

In March 2006, in coordination with the European Communities and Canada, we commenced a WTO dispute settlement case in challenging Chinese discriminatory charges on imported auto parts.

In February 2007, we, later joined by Mexico, filed a WTO consultation request in a case challenging several subsidy programs that appear to be prohibited under WTO rules.

In April 2007, we requested WTO consultations regarding various deficiencies in China's legal regime for protecting and enforcing copyrights and trademarks. In April of 2007 on the same day, the U.S. requested WTO consultations regarding certain barriers to market access for U.S. copyright-intensive industries, including books, music, home videos and movies.

With respect to Japan, non-tariff measures have long been an issue for U.S. companies in Japan's market. As a result, much of USTR's work with Japan continues to focus on removing these barriers. We use a variety of approaches to address specific issues, while also continuing to urge Japan to make more fundamental changes that significantly improve the business environment and further open its economy.

Regular engagement enables to carefully monitor progress and raise concerns before major decisions are made that would affect U.S. stakeholders. For example, with respect to Japan, postal reform and privatization, we have successfully encouraged Japan to take measures to ensure the new postal insurance company meets the same licensing disclosure and supervisory requirements as private-sector financial institutions.

Where we have not been able to work our concerns directly with Japan, and where the WTO dispute settlement process offers an opportunity for effective resolution of a problem, we have not hesitated to use this process to secure changes in Japan's measures. Most recently, we were able to secure a clear conclusion to a longstanding WTO case involving Japan's unscientific requirements on

U.S. apple exports. We will continue to evaluate Japan's practices using the WTO yardstick and bring WTO cases where appropriate.

In summary, USTR is committed to ensuring that we are using the most effective tools at our disposal to pursue open and fair trade relationships with China and Japan. This effort ties into broader Administration engagement on international economic issues, including work by Treasury and Commerce, and work with Members of Congress to achieve our common goals; a more flexible, market-based exchange rate for China's currency and a level playing field for American businesses, workers and farmers.

Thank you for this opportunity to testify. I will be happy to take your questions.

[The prepared statement of Mr. Brinza follows:]

Prepared Statement of The Honorable Daniel Brinza, Assistant U.S. Trade Representative for Monitoring and Enforcement, Office of the U.S. Trade Representative

Introduction

Chairman Levin, Ranking Member Herger, Chairman Gutierrez, Ranking Member Paul, and Chairman Rush and Ranking Member Stearns, and distinguished Members of the Ways and Means Subcommittee on Trade, the Financial Services Subcommittee on Domestic and International Monetary Policy, Trade, and Technology, and the Energy and Commerce Subcommittee on Commerce, Trade and Consumer Protection, I am pleased to participate in today's hearing.

I understand that today's hearing is focused principally on issues related to China and Japan's currencies. As you know, within the Administration, the Treasury Department is charged with responsibility for currency and exchange rate matters, while the Office of the U.S. Trade Representative (USTR) is responsible for developing and coordinating U.S. international trade and direct investment policy. Our work aims at increasing exports by expanding market access for American goods and services abroad and securing a level playing field for American workers, farmers and businesses in overseas markets. USTR oversees negotiations with other countries on these matters. In addition, we seek to resolve trade problems using a wide variety of tools, including bilateral discussions, negotiations, and formal dispute settlement proceedings.

USTR's efforts to achieve market-driven, market opening trade policies abroad fit into a larger economic policy picture, of course. They support Treasury's efforts to get results on currency and other matters in the financial realm as well as the Commerce Department's work on global competitiveness, export promotion and its administration of domestic trade remedy laws. Taken together, the Administration's engagement in the international economic realm uses the best tools available to us to serve the American people's interest in building strong, mutually beneficial economic relations with our global trading partners, including Japan and China.

To provide more concrete perspective on our work, I will give you a brief overview of USTR's recent engagement with both China and Japan, touching on the mechanisms USTR uses to address key trade concerns.

Key China Trade Efforts

China's accession to the WTO marked a critical step forward toward China's integration into the international rules based system. Since acceding to the WTO five years ago, China has taken significant steps in an effort to bring its trading system into basic compliance with WTO rules. These steps have helped to deepen and strengthen economic reforms that China had begun 20 years earlier. U.S. businesses, workers, farmers, service providers and consumers have benefited significantly from these steps and continue to do so as U.S.-China trade grows. Indeed, last year, U.S. exports to China climbed by 32 percent (while China's exports to the United States increased by 18 percent). These data suggest that the Chinese market is becoming more accessible for American companies, and that Chinese consumers are developing an appetite for America's highly competitive goods and services. China today has become our fourth largest export market, and the fastest growing major export market for the United States in the world. It is helping to support thousands of American jobs today and will support even more in the future.

Despite this progress, China's record in implementing its WTO obligations is mixed. While China has fully implemented many of its WTO obligations, there are a number of areas where it still has work to do, as it continues to transition from a centrally planned economy to a free-market economy governed by rule of law.

In our engagement with China, the United States follows a dual-track approach to resolving its WTO concerns—bilateral dialog to try to achieve practical solutions where possible, together with a full willingness to use WTO dispute settlement where appropriate to resolve problems.

The United States remains committed to seeking cooperative and pragmatic resolutions through bilateral dialog with China, and the United States has achieved some important successes. For example, through our recent bilateral dialogs, China made several commitments related to IPR protection and enforcement. It also committed to eliminate duplicative testing and certification requirements applicable to imported medical devices, to make adjustments to its registered capital requirements for telecommunications service providers, and to finalize a protocol allowing the resumption of trade in U.S. beef and beef products. China also reaffirmed past commitments to technology neutrality for 3G telecommunications standards and to ensuring that new rules in the postal area would not negatively affect foreign express couriers. In addition, China committed to commence, by no later than December 31, 2007, formal negotiations to join the WTO's Government Procurement Agreement. The United States has been working with China to make sure that it implements all of these commitments.

However, we have been unable to resolve other important issues through bilateral discussions, despite extensive effort, and we have turned to formal WTO dispute settlement in five instances:

- In March 2004, we commenced a WTO dispute against China's discriminatory value-added tax on integrated circuits. We were able to work successfully with China to resolve this issue during the consultation phase, and China repealed the discriminatory treatment.
- In March 2006, the United States, acting in coordination with the European Communities and Canada, commenced a WTO dispute settlement case challenging Chinese discriminatory charges on imported auto parts. We are now pursuing this case in front of a WTO arbitral panel.
- In February 2007, the United States, later joined by Mexico, filed a WTO consultation request in a case challenging several subsidy programs that appear to be prohibited under WTO rules, either because they are contingent upon exportation or contingent upon the use of domestic over imported goods. The parties held a first round of consultations in March 2006.
- In April 2007, the United States requested WTO consultations regarding certain deficiencies in China's legal regime for protecting and enforcing intellectual property rights related to copyrights and trademarks that affect a wide range of products. The problems identified include high thresholds for criminal prosecution that create a substantial "safe harbor" for wholesalers and retailers who distribute or sell pirated and counterfeit products in China, inadequate rules for disposal of IPR infringing goods seized by Chinese customs authorities, the Chinese copyright law's apparent denial of copyright protection for works poised to enter the market but awaiting Chinese censorship approval, and a possible loophole in China's criminal law that may only allow prosecution for unauthorized reproduction of a copyrighted work if it is accompanied by unauthorized distribution. China already has taken measures that may address this last U.S. concern. Under WTO rules, formal consultations will take place in this case before mid-June.
- In April 2007, on the same day as the filing of the IPR case, the United States requested WTO consultations regarding certain barriers to market access for U.S. copyright-intensive industries, including books, music, home videos and movies. Consultations in this case also are due before mid-June.

USTR provides a detailed discussion of the efforts the United States has made to address these and other areas of concern, using bilateral dialog and WTO dispute settlement, in the "2006 USTR Report to Congress on China's WTO Compliance," issued on December 11, 2006. The report is available on the USTR website (www.ustr.gov).

Key Japan Trade Efforts

Non-tariff measures have long been an issue for U.S. companies in Japan's market. As a result, much of USTR's work with Japan continues to focus on removing these barriers. We use a variety of approaches to address specific issues, while also continuing to urge Japan to make more fundamental changes that significantly im-

prove the business environment and further open its economy. While we continue to make progress in a number of areas, many challenges also remain.

Much of our detailed work with Japan takes place in our bilateral Regulatory Reform Initiative, which is chaired by USTR and includes the participation of several other U.S. agencies. The scope of that forum is comprehensive, including cross-cutting issues ranging from competition policy to intellectual property rights protections, as well as resolving industry-specific concerns. Progress achieved under this Initiative is equally broad in scope and is documented in an annual report. Our last report outlined 45 pages of steps that Japan is taking to address non-tariff issues, and we are currently on track to conclude our next report in the coming weeks that will outline new progress.

We also use other fora to raise our concerns with Japan's practices where needed. USTR leads our bilateral Trade Forum, for example, which has been used as a flexible vehicle to address emerging as well as acute trade concerns. At the senior level, Ambassador Bhatia also participates in our bilateral Sub-Cabinet Economic Dialogue which addresses pressing economic issues while bringing overall direction to our bilateral economic relationship. USTR also of course remains engaged with Japan on a regular basis at all levels in other ways to address market access concerns.

We continue to see progress in some sectors. Recent improvements include heightened transparency of Japan's regulatory process, the introduction of a program aimed at helping thwart illegal cartels and bid rigging, a more rational rate structure for telecommunications wire line interconnection that removes cost distortions that have limited wholesale network access, opening new opportunities for sales of insurance products through banks, and starting a one-stop service for motor vehicle registration.

Regular engagement enables us to carefully monitor progress and raise concerns before major decisions are made that would affect U.S. stakeholders. In the medical device and pharmaceutical sector, for example, we have recently seen Japan dedicate more staff resources to help speed reviews of product applications. With respect to Japan Post reform and privatization, we have successfully encouraged Japan to take measures to ensure the new postal insurance company meets the same licensing, disclosure, and supervisory requirements as private sector financial institutions.

Where we have not been able to work out our concerns directly with Japan, and where the WTO dispute settlement process offers an opportunity for effective resolution of a problem, we have not hesitated to use this process to secure changes in Japan's measures. Most recently, we were able to secure a clear conclusion to a long-standing WTO case involving Japan's unscientific requirements on U.S. apple exports. USTR will continue to evaluate Japan's practices using the WTO yardstick and bring WTO cases where appropriate.

One area where we have not yet reached a satisfactory conclusion, with either Japan or China, is in the area of beef trade. Working closely with the Department of Agriculture, we have been in contact with both countries to seek a full re-opening of the beef market consistent with international standards.

In summary, USTR is committed to ensuring that we are using the most effective tools at our disposal to pursue open and fair trade relationships with China and Japan. This effort ties into broader Administration engagement on international economic issues, including work by Treasury and Commerce, and work with Members of Congress to achieve our common goals: a more flexible, market-based exchange rate for China's currency and a level playing field for American businesses, workers, and farmers.

Thank you for the opportunity to testify. I will be happy to take your questions.

Chairman LEVIN. Thank you very, very much. I'm going to spend time mostly on the currency issue. That's the purpose of the hearing.

To Secretary Brinza, I think you can imagine that there are some serious disagreements here, at least among some of us, on the record of this administration in terms of active pursuit of China's agreements. The failure, in my judgment, to use the annual review process and the WTO. Really, the failure to use 421, four times recommended by the ITC, the administration said no. Then the years that went by when there was essentially nothing filed, one in '04,

and then one in '06, and finally a flurry of activities as Congress changed its maturity.

But let's leave that aside and talk about the currency issue, because that's the focus here. I very much agree with the statement that was in Secretary Claeys testimony, that American companies, workers and farmers can compete against anyone in the world. However, they should not be expected to compete against foreign governments providing subsidies to their own industry.

So, in a sense, whether you look at it technically or not, the issue is whether a very unbalanced currency, and indeed a rigged currency, is a kind of a subsidy. Forget the technicality for a moment. The reality is for American businesses and workers, it's the same as a subsidy. It's an assistance by a government to its producers. There's immense unrest about this continued imbalance.

So, let me ask a straight question first to Secretary Sobel. Do you think that the present structure in terms of currency, China and the U.S., prevents effective balance of payment adjustments or gains unfair competitive advantage in international trade? Take the latter. Does China have an unfair competitive advantage in international trade because of its currency? Is it possible for a yes or no answer?

Mr. SOBEL. Thank you for the question.

Chairman LEVIN. I'm not sure you want to thank me.

[Laughter.]

Chairman LEVIN. I mean, but seriously.

Mr. SOBEL. It's a fair and legitimate question, and it's one we think about often. Let me share with you our thinking a bit more broadly. When we write the Foreign Exchange Report, we do so pursuant to the 1988 Trade Act.

Chairman LEVIN. Okay. But—I understand. I was afraid you were going to talk about that. I was there in '88. I must confess I don't remember all the details. But let me just ask you point blank. Does the weak Chinese currency provide an unfair competitive advantage in international trade?

Mr. SOBEL. I think that the Chinese economy is imbalanced.

Chairman LEVIN. Is what?

Mr. SOBEL. Imbalanced. and I think the exchange rate policy is part of that imbalance.

Chairman LEVIN. Unbalance?

Mr. SOBEL. Unbalanced, yes, sir. The Chinese economy is unbalanced. The exchange rate policy is part of that. Because the exchange rate is undervalued, as Secretary Paulson has said, it has the effect of causing Chinese economic actors and agents to focus more on the production of internationally tradable goods, more so than would otherwise be the case. That that comes at the expense of producing goods and services for the domestic market.

Chairman LEVIN. I understand that.

Mr. SOBEL. So——

Chairman LEVIN. How about—and I'm not—I'm trying not to be argumentative. I'm trying to be clear. Isn't there a yes or no answer to that? Does anybody—can anybody really argue that they don't have an unfair competitive advantage because of that imbalance? Would they have the same competitive advantage if there were a major change in the balance?

Mr. SOBEL. I think that the persisting current account surpluses, large trade surpluses in China are fundamentally associated with the saving and investment relationship in the economy.

I think that we share your frustration about the RMB. Secretary Paulson raises it at every opportunity with Chinese officials. We meet with Chinese officials at all levels from all parts of the government. We talk to the Chinese in G7 meetings. We talk to the Chinese in G20 meetings. We talk to them in the IMF.

Chairman LEVIN. Okay. Let me just—chairs don't have 5 minutes, but I want to try to abide by it.

Mr. SOBEL. Okay. But——

Chairman LEVIN. But why can't you say—why can't you simply acknowledge that it provides them an unfair competitive advantage in international trade?

Mr. SOBEL. I think what I was trying to get at, Mr. Levin, is that even if the RMB moved higher, China's part of a very competitive East Asian economy, and we do not think it would have much of an impact on the bilateral deficit that we have with China.

Chairman LEVIN. How about their competitive advantage? I'll tell why you're resisting. You see——

Mr. SOBEL. As I said, obviously a weaker—an undervalued exchange rate does, as I said, encourage production of exports.

Chairman LEVIN. Which is another way of saying a competitive advantage. See, here's the problem. Then I'm going to quit. The language in the '88 Act talks about unfair competitive advantage and talks about preventing an effective balance of payments. No one can deny that there is a prevention of an effective balance of payments, right? I mean, you can't deny that. There's no balance.

So, what you do is fall back on the word "intent" because it says for the purpose. But no one I think really believes for a second that the Chinese policy isn't purposeful. So, essentially, what Treasury has been doing, and I reviewed your reports over time, like in '05 said the Chinese authorities should by the time of this report do so-and-so, and of course they did not.

Essentially, what you do is to look for reasons not to name them. All my suggestion is the time has come for us to be straightforward with each other and with the American people. Clearly, I think the manipulation—the handling of currency is for the purpose of preventing an effective balance of payment, and to gain unfair competitive advantage. There may be other reasons that you don't want to name China. I think it turns off the American people and this Congress when there isn't a straight out acknowledge that there's a one-way street here or an imbalance that hasn't been adjusted, needs to be, and so far our policies have not helped to bring it about, more than a change that is really in real terms just nominal.

As long as you kind of dance around it, you're going to cause disillusionment and in the end I think some action here. I'll close. When's the April 15 report coming out?

Mr. SOBEL. As you know, Mr. Chairman, Secretary Paulson will be leading the Strategic Economic Meeting on May 22nd and May 23rd. We think it's an important event, and we would like to be able to reflect the meeting in what we submit. So, it will be coming out——

Chairman LEVIN. Afterward?

Mr. SOBEL. Afterwards.

Chairman LEVIN. Okay. That's reasonable. I hope it will be straightforward and not sugar coat.

Mr. SOBEL. Thank you.

Chairman LEVIN. Chairman Gutierrez. Then I think what we'll do, because this is somewhat unusual, maybe Mr. Herger could go after you and then Chairman Rush. Is that okay?

Chairman RUSH. That's quite all right, Mr. Chairman.

Chairman LEVIN. Okay. Thank you.

Chairman GUTIERREZ [presiding]. I just want to follow up on Mr. Levin's question. In June of 2005, Treasury Secretary Snow, then-Secretary, appeared before the Senate Finance Committee. He stated, I quote, "If current trends continue without substantial alteration, China's policies will likely meet the technical requirements of the statute for designation." Of course he was referring to triggers for designating China as a current manipulator. Now I know we're going to wait for your April 15th report for sometime in June.

Given that China has not changed since then-Secretary Snow spoke in June of 2005, are you guys at Treasury getting ready to designate China as a manipulator in the report? If not, why not?

[Pause.]

Chairman GUTIERREZ. Five minutes. It's only 5 minutes.

Mr. SOBEL. Again, as I said in my longer testimony, we——

Chairman GUTIERREZ. I guess, Mr. Secretary, are you going to designate them as a manipulator of currency? Are you ready to designate them?

Mr. SOBEL. We haven't written the report yet.

Chairman GUTIERREZ. You haven't written the report. You don't have an outline of the report? You haven't had any discussion? Are you close to designating them? Are you leaning toward designating them?

Mr. SOBEL. I have no comment on the report, particularly——

Chairman GUTIERREZ. You have no comment.

Mr. SOBEL [continuing]. Because we haven't written it. We do believe that a finding of intent is inherent to making a designation under the Act, and it has not been our view that the Chinese policies are designed for the purposes of gaining unfair competitive advantage——

Chairman GUTIERREZ. Let me just do this.

Mr. SOBEL. Could I also just say, I do think that there has been movement. I do think there has been some movement. But as the Secretary has said, they're moving way too slowly, and we're very frustrated by the pace of——

Chairman GUTIERREZ. I wish your frustration would be revealed in your report. Let me do this. Chairman Levin, most of the questions that were exactly where I was going, I would like to yield the remainder of my time to my friend and colleague from Ohio, Mr. Ryan, to continue with my time.

Mr. RYAN. Thank you, Mr. Chairman. I just came in a little bit late to Secretary Sobel's comments. Did I—were you saying that you don't think that a revaluation would have an effect on the def-

icit? I just caught the end of what—I thought that's what you said, but I wasn't sure.

Mr. SOBEL. Thank you. Our view is that China is part of a highly competitive East Asian economy and that upward movement in the currency may not have much of an impact in affecting the bilateral deficit.

Our view is that China's imbalances, its persisting surpluses, are fundamentally related to saving and investment patterns in the economy. As you know, if a country has higher national saving than national investment, then it will run a current account surplus. China has an extraordinarily high——

Mr. RYAN. If I could interrupt you, just because our time is limited. But if the value of the RMB goes up, their export-driven economy, at least through exports, is going to slow down. Wouldn't that have some effect on the deficit? My question I guess is, that you guys are pushing—saying you're pushing and pushing and talking and talking and talking, to use your words. If it's not going to have an effect on the deficit, why are you talking to them and trying to force them to move?

Mr. SOBEL. First of all, as I said, we think it will have some impact. But, again, we think the more fundamental issue is to get China to rebalance its economy. China's saving is extraordinarily high. Half of national income is being saved. It's being saved because they've lost their social safety net, and they don't have developed financial markets. So people now have to save for their futures. They have to save for their pensions, because there aren't pensions. They don't have the state security blanket any more. They have to save excessively because they basically have put their money in the banks——

Mr. RYAN. Well, not to interrupt you, but wouldn't a revaluation help them save more? The RMB that they're holding in their pockets would be worth more. I think this is a win for everyone.

Mr. SOBEL. Sir, as I said earlier, we're totally frustrated with the pace of reform in China. We are not satisfied at all with the movement, the upward movement in the RMB, nor are we satisfied with the degree of currency flexibility that exists in the exchange system. I can assure you, Secretary Paulson pushes extraordinarily hard on these issues. As I said in my testimony, it's in China's self-interest to move for the health of their own economy. It's in the world's interest that they move.

I think the point I'm trying to make is that ultimately it's the structure of the Chinese economy that is driving these large surpluses, and that is what needs to change. Exchange rates are part of that process. The exchange rate system needs to become more liberal so China can rebalance its economy to produce much greater domestic demand.

Mr. RYAN. We know that. If I could just say one—we're trying to help you. We're on the same team. We're trying to give the President and you folks who are sitting here the tools that you need to get tough with China and to have some real teeth in some laws that you can go and use when you're negotiating. You said yourself, talk, talk, talk.

Well, many people who sit on this Committee—and this isn't about bashing China—this is about good people in the United

States of America losing their jobs that pay a lot of money and contribute to the tax base of communities, leaving because of an unfair trade practice and an intentional, in my mind, currency manipulation or misalignment or whatever the technical terms we need to use. But that's what's happening on the ground.

People in Ohio and Michigan and, you know, Members of this Committee, are losing their job, and communities can't pass school levies because of this. This is what this is coming down to. This isn't a theory.

So I'm going to encourage you. We want to be a part of the solution. We want to work with you. The legislation that we're talking about is to give you the tools and the President the tools that you guys need to get this job done. We want to be supportive of you and work with you, but it's becoming very difficult when we hear talk, talk, talk for years and years and years, and it's gotten to the point where we're going to need congressional action.

So, I want thank the Chairman——

Chairman LEVIN [presiding]. Thank you.

Mr. RYAN [continuing]. For the opportunity to even participate in this Committee.

Chairman LEVIN. Thank you very much. Mr. Herger?

Mr. HERGER. Thank you, Mr. Chairman. Mr. Sobel, I'm always skeptical of estimates of the real value of Chinese currency with respect to the dollar. The best model would be a real free market in currency which we should all agree is the better judge of the currency values. So, rather than just conclude there is under-evaluation and pick a number, I'm more interested in seeing that the mechanism to determine that rate is a market-driven one.

Part of China's delay in reforming its currency has been in developing a more sophisticated capital market. Some in Congress feel that is an excuse to put off reform of the currency which has a more immediate effect on trade. Would you please, Mr. Sobel, describe the mechanisms the Chinese are developing to create a market-driven currency, what steps it must take, and how long it would take?

In addition, can you explain the importance of China's broader financial reforms and how they must go hand-in-hand with currency reform?

Mr. SOBEL. Thank you. First of all, I want to totally agree with you that the ultimate goal should be a freely floating RMB. I think we totally agree with that. We also agree that a strong financial system is an important component of that.

There are many interlinkages between the financial system and the exchange rate regime. Normally what's happened is that emerging markets that have been moving towards floating are doing so at the same time they're opening up their capital account, and there have always been concerns that if people don't have confidence in the banking system, money will flow out rapidly.

Also, a country needs a sufficiently deep financial system that it can absorb inflows and outflows. It needs hedging instruments so that economic agents engaged in international trade can hedge receipts and adjust to volatility. For that you need a benchmark yield curve throughout the maturity structure. You need a credible central bank.

It's easy to run a pegged-exchange rate regime, but if you're going to run an independent monetary policy, we take for granted things such as domestic money market operations and what not. But you need Treasury bill markets and you need banks that are able to intermediate funds. China doesn't really have a lot of those basic requisites.

Now, Secretary Paulson gave a speech in March in Shanghai on the Chinese financial system and the progress that's been made. He underscores that far more is needed. China, for example, still has—even though it is moving to begin to clean up the banking system—many nonperforming loans (NPLs). The capital market is very underdeveloped. There's hardly any corporate bond market because of excessive regulation and the like.

So, we've been working with them. We're trying to urge them to develop the financial system. What's happening now is that because of this massive reserve inflow into China, they are pumping out a lot of liquidity into the system, and this is creating inflationary pressures. It's contributing to the overheating and the excess investment in the economy, and it also has the potential to reduce the quality of lending standards.

So, if China wants to have an independent monetary policy where they can just target inflation, they're going to need to allow much greater currency flexibility, and at the same time have robust financial institutions in place which are capable of dealing with the central bank.

Mr. HERGER. So, how are they coming about doing this? As you can tell, we're very impatient on their degree of improvement. We are looking at an economy that basically came out of the 1930s and is jumping into the 21st century. But I'm sure you feel the impatience of everyone on this Committee to put the pressure on and to work with them in every way we can, but at the same time not destroy our relationships.

Mr. SOBEL. Let me assure you, Congressman, we share your frustration. We share your impatience. Again, how are they coming along? They're coming along gradually and slowly. I think they've taken some very good steps in the banking sector to try and recapitalize some of the major banks as well as in that regard, to launch IPOs which have subjected these banks to better risk management practices and to better accounting standards and better disclosure standards.

The securities market faces a very long road ahead of it. They need, in our view, to move much faster in developing a corporate bond market. So, again, I think in some areas there's greater progress than others, but it's a very long road ahead, and we agree with you. We share your impatience.

We are also working very hard to open up the Chinese financial system to foreign participation, because we believe that foreign participation could bring in greater technology, know-how, capital and the kind of skills that could help China get there faster.

Mr. HERGER. Thank you.

Chairman LEVIN. Thank you. Chairman Rush.

Chairman RUSH [presiding]. Thank you, Mr. Chairman. With all due respect to the witnesses, I have a number of questions that I

will ask, respectfully ask that you keep your answers to a minimum, please.

Mr. Claeys, in your testimony, you stated that subsidies to industries may take many forms. The weak yen has allowed Japanese auto manufacturers to accrue an average subsidy of about $4,000 on a mid-size sedan. In addition, Japan's major automakers reported huge windfall profits in '06 as a result of the weak yen.

My question is, how is one to conclude that the weak yen dollar exchange rate is not an unfair de facto export subsidy to Japanese manufacturers, which comes at the price of American jobs and American industry?

Mr. CLAEYS. Thank you, sir. The issue that the Department of Commerce needs to decide is not only is something a subsidy, but is it a countervailable subsidy under the laws as written. For a subsidy to be determined to be countervailable, as I mentioned earlier, it has to meet three elements. It has to constitute a financial contribution. It has to confer a benefit. It has to be either an export subsidy or specific to a certain sector.

The Department makes these determinations within the context of a case that's oftentimes brought to us by a domestic industry that feels that it is unfairly—it's being injured or threatened with injury by unfair imports that they are subsidized.

So, for the Department to determine whether Japan's currency policy or any other type of subsidy progress is countervailable, we need to analyze it within those criteria, and then also within the context of a case that's brought before us by a domestic industry. So, I can't at this time say, you know, yes or no, because it will depend upon the arguments and the facts that are brought before us within—you know, if the issue is brought before us in a particular case.

Chairman RUSH. Mr. Sobel, as you are well aware, the Treasury Department did not cite Japan as a currency manipulator in its December '06 report to Congress on exchange rates. Some have argued that Japan's jawboning on currency as well as its maintenance of massive foreign currency reserves signal its continued and future intent to intervene in currency markets. Moreover, Japan has both a significant current amount surplus and bilateral trade surplus with the U.S.

These three facts, intent to manipulate exchange rates and the maintenance of current account and bilateral trade surpluses, are the three distinguishing characteristics of a currency manipulator as defined in the '88 Omnibus Trade and Competitiveness Act.

In light of these three elements, why did the Treasury Department not cite Japan for currency manipulation in '06 or in other years of the immediate past, for that matter?

Mr. SOBEL. Thank you. First of all, let me say that we very much appreciate the difficulties being faced in the U.S. automotive——

Chairman RUSH. You have about one minute for the answer, please.

Mr. SOBEL. I also want to say that we also recognize that the yen is trading at a two-decade low and trade-weighted terms. The Secretary has stated that the yen's value is determined freely in

large and open foreign exchange markets around the world. Japan has not intervened since March of 2004.

If I could say very quickly, I follow foreign exchange markets on a daily basis for Treasury. What's going on is that there are huge interest differentials in international capital markets. Japan is an economy that is only recovering tepidly, and it still hasn't really gotten out of deflation, so interest rates are rock bottom in Japan.

In Europe, the economy is growing fairly well. Expectations are for further hikes in the marketplace. In the United States, interest rates are higher. Capital is flowing out of Japan to other markets, including from Japanese retail investors. So, there's a market-driven process where capital is flowing out of Japan.

Now you could ask me maybe should Japan should have a different fiscal and monetary policy. Our view is that we have sympathies for Japan's desire to consolidate its public finances——

Chairman RUSH. Thank you very much.

Mr. Chairman.

Chairman LEVIN [presiding]. I believe we have Mr. Stearns next.

Mr. STEARNS. In all deference to my colleague, Mr. Rush, it didn't sound like you really answered his question. He was trying to be I thought rather clear of what he wanted an answer, and I'm not sure that—I think the frustration we have up here, you talked about frustration, but even the answers we're getting from you folks, and I'm on your side of the aisle here. I'm trying to support you. So, I think you need to be a little bit more focused here.

Let me just ask each of and just a yes or no answer. I always like to try to do this. It's sometimes difficult. Does the administration have sufficient tools to address currency manipulation as it stands now? Just yes or no. I'll start with Mr. Sobel, just yes or no, whether you have the tools to address currency manipulation. You've got to answer yes or no. If you say no, nothing's going to happen to you. There's no trap door.

[Laughter.]

Mr. SOBEL. Just, the point I want to make is, we write the report. We work within the language to keep it up to date and flexible.

Mr. STEARNS. No, but the question is basic. It's just a yes or no answer. Do you have the tools right now to handle—to address currency manipulation? Just you as a professional in your present job, do you have the tools? Would you say yes or no? If you're undecided, you can do undecided.

Mr. SOBEL. I——

Mr. STEARNS. Is that the hardest question you've had today?

Mr. SOBEL. The hardest question I've had today.

Mr. STEARNS. Okay.

Mr. SOBEL. We——

Mr. STEARNS. Well, let me move on. The next gentleman. What do you say?

Mr. CLAEYS. Well, sir, probably you're not going to be happy with my answer in that——

Mr. STEARNS. Well, just yes or no.

Mr. CLAEYS. Well, the Department of Treasury has the lead on all currency issues.

Mr. STEARNS. I understand.
Mr. CLAEYS. So, therefore, the Department of Commerce——
Mr. STEARNS. But you can give your opinion.
Mr. CLAEYS. I have to defer, rightly, since the issue falls——
Mr. STEARNS. But as a professional, you could say you're on—you're up here testifying, you know, you're one of the experts here we look to, and we're asking you in your position, present position now, you're Deputy Assistant Secretary for Antidumping and Countervailing Duty Operations, International Trade Administration. Just in the time you've been there. How long have you been there?
Mr. CLAEYS. I've been in the current position a year-and-a-half.
Mr. STEARNS. Okay. In that year-and-a-half, have you found that you have enough tools to address currency manipulation?
Mr. CLAEYS. I can say we have the sufficient tools to address countervailable subsidies.
Mr. STEARNS. Okay. Your answer is yes. Okay. Mr. Brinza, what's your feeling here?
Mr. BRINZA. I think, Mr. Stearns, similar to my colleague from the Commerce Department. As you know, the Department of Treasury does have the lead on currency manipulation, so——
Mr. STEARNS. Can you speak a little closer to the mic? I can't——
Mr. BRINZA. I'm sorry. I was saying similar to my colleague from the Department of Commerce, USTR is in the same position, which is that we defer to the Department of Treasury in terms of——
Mr. STEARNS. Okay. So, you're really saying that because you have to defer to the Department of Treasury, you can't answer this. I mean, would you on a personal note, I mean, would you want to venture how you feel about this? I guess I'm trying to move toward, do you need additional or improved tools that we should grant you? If so, what they are.
One suggestion from my staff is should we start with creating unilateral tools or by improving the tools available to us in the international community?
I think perhaps earlier my colleagues have asked you about H.R. 782. Let me just ask each of you, obviously if we don't see anything happening here, we've got a bipartisan bill, H.R. 782. Mr. Sobel, if we passed H.R. 782, what's your feeling about that bill?
Mr. SOBEL. Well, I mean——
Mr. STEARNS. Do you think it would be the end of the world if we passed this bill?
Mr. SOBEL. We do not have——
Mr. STEARNS. Do you support the bill or against it?
Mr. SOBEL. We do not have any position on——
Mr. STEARNS. You have no position on the bill?
Mr. SOBEL. We do not have a position on any specific bill. If Congress chooses to propose new legislation, we will certainly work with Congress.
Mr. STEARNS. Okay. How about the U.S. Department of Commerce? How about you? Do you have any feeling on the bill?
Mr. CLAEYS. As the same with Treasury, we have no position on the bill, though we welcome the opportunity to work with the Committee on drafting it.

Mr. STEARNS. Okay. So,—and what about the U.S. Trade Representative? What's your feeling?

Mr. BRINZA. Very similar, sir. We would be developing a position in tandem with our colleagues in the administration and be happy to work with the Committees on that.

Mr. STEARNS. Okay. Mr. Sobel, are there tools available in the international realm for the administration to address currency manipulation?

Mr. SOBEL. Could you repeat that?

Mr. STEARNS. Are there tools available in the international realm for the administration to address currency manipulation? I mean, for example, can the IMF do anything?

Mr. SOBEL. I was just going to mention the IMF.

Mr. STEARNS. I mean, we're told—critics claim that the IMF is not equipped to deal with currency manipulation for the purpose of creating unfair trade advantages. In your opinion, is this true?

Mr. SOBEL. The language in the '88 Act mirrors the language in the IMF articles and also the fund agrees with that in a finding of intent is needed. However, what we've been focused on lately is working with the IMF to improve the IMF's conduct of foreign exchange surveillance. We think that one of the central tasks of the IMF is to exercise firm surveillance over members exchange rate policies.

We've been working to have the IMF 1977 decision on exchange rate surveillance, which governs how it operationally does its work in this area, updated. We think it's an out-of-date document that needs to reflect the realities of today's marketplace and experiences that have been gained, and we think that's important not only so that the fund has a modern document, but secondly because we think that updating it will send a powerful political signal to the global community and to the fund's staff that this task needs to be emphasized more seriously.

Now rewriting the decision in and of itself will not get the job done. A revised decision will have to be implemented very vigorously.

Chairman RUSH [presiding]. Would you please bring your answer to a close? Okay. Mr. Sherman is recognized.

Mr. SHERMAN. Thank you, Mr. Chairman. We've got three Subcommittees represented here. One could argue there could even be a fourth, although I think three may be a record, and that is the Foreign Affairs Committee could also be represented here.

We've got Treasury, USTR and Commerce represented here. One could argue that State ought to be here as well. Because the unanswered question is whether our pitiful policy on currency is somehow, especially as to China, is somehow a plan to acquiesce to them on that issue in return for help on foreign policy issues.

Let me report, because I do chair the relevant Foreign Affairs Subcommittee, that that is hardly the case. China is a major obstacle toward any reasonable effort to prevent Iran from developing nuclear weapons. It is the chief protector of the Sudanese committing genocide, and it is of slight help on North Korea's program, but it is also the major reason that program can continue, since that regime is totally dependent on subsidies from China.

Thus I know those watching these hearings will wonder, why has Congress and the administration surrendered American jobs and I think ultimately America lives in order to allow China to continue its current currency policy and trade policy?

Let me make it clear. We're not giving that up in order to achieve foreign policy objectives. We're doing so because of the overwhelming power in this town of the importers. Now I've got a whole lot of questions I'll probably ask you to respond for the record or I'll give you some time at the end. But I've got so many questions, I do want to at least get them into the record.

I am surprised to hear testimony that the trade relationship between the United States and China benefits both countries. It is in fact the most cancerous and lopsided trade relationship in the history of mammalian life. Not only do we have a $232—or $233 billion deficit, but that deficit is five times the size of our exports. We could imagine a beneficial trade relationship with China, but to regard this lopsided relationship as beneficial can only be done from a pro-importer view.

I would also point out that this large trade deficit is setting up the world for the kind of dislocations that the world economy has not faced since the 1930s.

I hope the Treasury would respond for the record as to whether we have an emergency plan if the dollar drops by 20 percent in a week or 40 percent in a month. I realize it hasn't dropped by that much, but it's hard to think of a more bizarre and lopsided trade policy or a more—or a larger trade deficit. Things that can't continue forever don't. The trade deficit can't. It won't, and it may not be pretty. When it ends, it may not be smooth.

I also hope the gentleman here would respond to whether it would be in America's interest to have a weak dollar policy, whether we're allowing our machismo to interfere with what would be good for American workers. I'll point out that Japan certainly has a weak yen policy, at least to the full extent allowed by law.

It is I think you'll conclude helpful to us to have a strong dollar and that we import capital, but that in a way means that we're papering over a problem with our Federal budget deficit and with our low savings rates.

The real question before is, why are we talking to China instead of acting? Only in Washington is "pushing hard" a synonym for doing nothing but begging in many different forums that China change its policy. China has not.

There are people in my district, one person I'm thinking of in particular, who lost their job as a result I think of the Chinese currency manipulation, became an alcoholic, committed suicide, and died. I'm sure we all have those situations in our own district. Usually when a crime is committed and death results, police action is immediate. Yet it is clear that Chinese currency manipulation is criminal, that deaths in the United States have resulted, and the response is that we beg China to consider some future change. Rarely is someone causing that amount of harm and doing so criminally asked when they're going to stop their ongoing policies.

So, I look forward to hearing from you gentleman what we're going to do in order that I don't have to go back to my district and explain that the power of the importers here in Washington is so

great that people will have to continue to lose their jobs due to an unlawful violation of the world's currency rules by China. I yield back. I look forward to your answers for the record.

Chairman RUSH. The Chair recognizes Mr. Brady.

Mr. BRADY. Thank you, Mr. Chairman. I know of no recorded Chinese suicide efforts in our community, and getting back to the subject, clearly an artificially low currency in China impacts their exports, makes it more difficult for our imports over there. Whether we care to believe it or not, it also in effect subsidizes lower consumer prices here in America, contributes to a lower interest rate and a lower inflation rate.

I think our goal in Congress is to find a way to maximize our exports to China, to provide the greatest economic benefit to our products, but also do it in a way that we do the least economic harm in the country to our consumers. We have a number of pieces of legislation to deal with this issue. I'm skeptical of much of them. My fear is that we are using a sledge hammer rather than a surgical knife to attack this issue, and there will be a boomerang effect on some of our families and economy.

So, the question, though, is given the frustration in Congress, why shouldn't Congress create new legislative tools to address this currency? Why should we rely upon this dialog to produce results? Because there is such a high level of frustration here in Congress. When can we expect to see results that can show us that there is movement in a balanced way to a market-based currency in China?

Why don't we just go down the line if we could. Mr. Sobel.

Mr. SOBEL. Thank you. Just to say, to repeat that we don't have any specific position on any bills. We look forward to working with Congress. I think the Secretary believes that the U.S. economy benefits from openness and that will be an important lens through which the Treasury views any legislation.

One thing I would like to say is that it's important that we keep working with China to reform its system. The Secretary strongly believes that the Strategic Economic Dialogue is the best vehicle for doing that, for tackling the imbalances in the economy.

I think many of us have some concern that some tools potentially could put China in a defensive posture with respect to engaging with us, rather than working with us to reform its currency system.

In terms of getting results with the Chinese, I think that reforming the Chinese economy and making it a market system is going to involve a longer-term process of engagement. Reforming financial markets, changing the economy to reduce savings and creating the social safety nets and the things that are needed to boost domestic demand, reforming the exchange rate system, will take a while. But I think that we will need to make sure that we achieve results over time, and I think that that is an important focus of the Secretary and the Strategic Economic Dialogue.

Mr. CLAEYS. Congressman, Congress's responsibility in this realm or in general is to enforce the anti-subsidy countervailing duty law. I believe that we have already sufficient legal tools to apply the countervailing duty law to those subsidies that should be subject to the law in the way the law is written, and also in accordance with our international obligations.

Mr. BRINZA. Thank you. With respect to whether we need additional tools or with respect to whether we need additional tools in order to address currency manipulation, we would defer to the Department of the Treasury, who has the responsibility for that.

In terms of trade policy, we believe we have sufficient tools in order to be able to address those matters that would raise a difficulty under our agreements.

Mr. BRADY. Thank you. Thank you, Chairman.

Chairman RUSH. The Chair intends to engage in a second round of questioning and I recognize myself. Mr. Sobel, do you believe that Japan is using a low interest rate policy in order to keep the yen undervalued? If so, is that not a de facto form of currency manipulation?

Mr. SOBEL. Thank you for that question, because I wanted to carry on a little bit from earlier. The Japanese economy was very weak throughout the 1990s, and that period of weakness continued early into this decade.

Japan was mired in deflation. Japan acted to substantially expand its money supply to help sustain the recovery and begin to exit from deflation. As we said in the testimony, recovery of the Japanese economy is not as brisk as we would like to see it. With deflation continuing—prices basically are still hovering around flat, give or take a few tenths of a point here and there—Japan has not firmly exited from deflation.

In those circumstances, we understand that Japan is running a highly accommodative monetary policy.

Chairman RUSH. All right. So, the answer is yes. Can I summarize your answer as yes?

Mr. SOBEL. The specific question was?

Chairman RUSH. Is Japan using a low interest rate policy in order to keep the yen undervalued? According to——

Mr. SOBEL. They're trying to exit from deflation. They're trying to support their economy's exit from deflation. That is my answer.

Chairman RUSH. Okay. Is that not a de facto form of currency manipulation?

Mr. SOBEL. Again——

Chairman RUSH. Okay. Let me move on to the next question. Japan now has significant occurring account in bilateral trade surpluses. It also has a great amount of foreign reserves. Explain to us why this low interest rate is warranted, why these low interest rates are warranted.

Mr. SOBEL. Again, sir, the accommodative monetary policy is warranted in order to help Japan sustain its recovery and to exit firmly from deflationary pressures in the economy.

Chairman RUSH. How long are we to wait for Japan to exit its recovery, from its recovery period?

Mr. SOBEL. We're hopeful that Japan will soon restore more robust growth and higher productivity.

Chairman RUSH. Okay. Thank you. What plans does the administration have for raising the topic of Japanese and Chinese currency manipulation at the upcoming meetings of the Strategic Economic Dialogue and the G7?

Will the administration voice the concerns of many in this Congress that the persistence of Japan and China in maintaining arti-

ficially low exchange rates harms American industry and workers? Furthermore, what course of action will the administration suggest at these meetings in order to correct imbalances in the international exchange rates?

Mr. SOBEL. Let me assure you that, again, we share your frustration with the pace of change in the RMB. The Secretary raises this at every opportunity he can with the Chinese; the need for the RMB to move faster, the need for greater currency flexibility. We totally support your sentiments in this regard. I can assure you that when the Strategic Economic Dialogue happens later this month, the Secretary will have a full discussion of this issue with the Chinese representatives.

As I said in my testimony, in my longer testimony, we very much want to bring Chinese leaders to meet Members of Congress so they can directly hear your thoughts and views on these issues.

Chairman RUSH. Thank you. Mr. Brady?

Mr. BRADY. No further questions.

Chairman RUSH. Well, that concludes this hearing. I again want to thank all the witnesses for your participation, and this hearing is now adjourned.

[Whereupon, at 3:21 p.m., the Subcommittees were adjourned.]

[Questions submitted by the Members to the Witnesses follow:]

Question submitted by Mr. Neal to Mr. Sobel

Question: Mr. Sobel, I understand China is requiring that a foreign non-life insurance company doing business there must first apply to convert its "branch" office into a "subsidiary" before it can expand its operations in China. I also understand that China has not acted on these U.S. conversion applications for almost 2 years, and by doing so is improperly limiting foreign companies' access to its market, while giving Chinese companies a competitive advantage and a head start. I understand that China has granted subsidiary licenses to two Korean and Japanese companies, but no U.S. companies. All of this raises some serious questions.

To your credit, I understand that USTR and Treasury have raised this issue several times with China in the context of the Strategic Economic Dialoguee. Can you tell us how these queries have been received, and more specifically, whether you think this issue can be resolved bilaterally or will it take a formal dispute process at WTO before China will honor its obligations?

Answer: [PENDING]

Question submitted by Mr. Neal to Mr. Brinza

Question: Mr. Brinza, you may be familiar with a dispute impacting a Massachusetts company and a major employer in my home state. EMC has been experiencing difficulties over the past decade registering its well-known trademark in China. It has been denied registration on the basis that a China company, Proview International, with an entirely different business had a pre-existing mark. Although EMC's trademark predates the Chinese one by over a decade, the government agency has refused to recognize the U.S. company mark allowing the other company to expand into this area with the blessing of the China trademark agency. Recently, this other company sent a demand for $50 million to EMC to get back its own trademark, even though EMC has over 100 trademark registrations covering all major countries except China. How can this problem be rectified?

Answer: [PENDING]

Question submitted by Mr. Rush to Mr. Evans, Mr. O'Shaughnessy, Mr. Roach, Mr. Bergsten, Mr. Mohatarem, Ms. Lee, and Mr. Hickey

Question: One phenomenon that has received much attention in the press lately is the carry trade. In Japan, where the interest rate is quite low—

valued currently at half a percent—currency traders borrow yen in order to purchase higher-yielding dollars. The offshoring of yen as a result of the carry trade serves to keep the value of the yen artificially low vis-à-vis other currencies. Professor Steven Hanke of the Johns Hopkins University estimates that the yen carry trade accounts for perhaps one trillion dollars in yen-denominated borrowings. Given this, could one conclude that Japan is pursuing a low interest rate strategy in order to artificially depress the value of its currency? Would this not constitute an indirect form of currency manipulation?

Answer from Mr. Evans: [PENDING]
Answer from Mr. O'Shaughnessy: [PENDING]
Answer from Mr. Roach: [PENDING]
Answer from Mr. Bergsten: [PENDING]
Answer from Mr. Mohatarem: [PENDING]
Answer from Ms. Lee: [PENDING]
Answer from Mr. Hickey: [PENDING]

Question submitted by Mr. Rush to all witnesses

Question: I understand that the yen-dollar exchange rate has allowed Japanese auto manufacturers to accrue an average subsidy of about $4,000 on a mid-sized sedan. In addition, Japan's major automakers reported huge windfall profits in 2006 as a result of the weak yen. These profits are in turn re-invested in production facilities located in Japan, despite flagging domestic demand for automobiles. Added to this is the fact that Japan exported more vehicles to the United States in 2006 than it has since the mid-1980s. How is one to conclude that the weak yen-dollar exchange rate is not an unfair de facto export subsidy to Japanese manufacturers, which comes at the price of American jobs and industry?

Answer from Mr. Evans: [PENDING]
Answer from Mr. O'Shaughnessy: [PENDING]
Answer from Mr. Roach: [PENDING]
Answer from Mr. Bergsten: [PENDING]
Answer from Mr. Mohatarem: [PENDING]
Answer from Ms. Lee: [PENDING]
Answer from Mr. Hickey: [PENDING]
Answer from Mr. Sobel: [PENDING]
Answer from Mr. Claeys: [PENDING]
Answer from Mr. Brinza: [PENDING]

Question submitted by Mr. Rush to Mr. Sobel

Question: The Treasury Department responded in part to a 2005 report by the General Accountability Office entitled, "Treasury Assessments Have Not Found Currency Manipulation, but Concerns about Exchange Rates Continue," by commenting that it does not take into account the impact of the exchange rate on the economy. Several of our witnesses today, and indeed others, have argued that currency manipulation leads to the loss of jobs in U.S. exporting industries. This is a strong statement. Given this assertion and moreover the clear impact that exchange rates have on the flow of trade, why does the Treasury Department not take into account the effects of currency manipulation on the domestic economy?

Answer: [PENDING]

[Submissions for the record follow:]

American Foundry Society
Schaumburg, Illinois 60173
May 23, 2007

Chairman Sander Levin
House Ways and Means Trade Subcommittee
1104 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Levin:

On behalf of the American Foundry Society (AFS), thank you for the opportunity to submit testimony to the House Ways and Means Subcommittee on Trade regarding the impact of Chinese currency manipulation on the metalcasting industry.

AFS applauds you and your colleagues for holding a truly historic "tripartite" hearing on currency undervaluation and its effects on U.S. business and workers on May 9th. The hearing provided an opportunity to highlight the devastating impact of cheap imports which has led to China's skyrocketing trade surplus with the United States and the significant loss of American manufacturing jobs. This sort of mercantilist behavior harms the United States and jeopardizes the economic and financial stability of the rest of the world as well.

Overview of Foundry Industry

AFS is the leading metalcasting association in America with more than 9,000 members representing over 3,000 metalcasting firms, their suppliers and customers. The metalcasting industry directly employs over 200,000 men and women. Our member companies' produce cast metal components that are found in over 90 percent of all manufactured goods and equipment. There are currently 2,190 foundries nationwide, with a large concentration in the Midwest.

Our industry supports the viability of numerous other key sectors including automotive, electronics, national defense, construction, telecommunications, and agricultural. Your car couldn't run without the cast engine block. Grocery stores would be empty without farm machinery made from castings. Your home would be cold, waterless and powerless without cast furnaces, faucets and electrical components. The safety of your home depends on the cast fire hydrant on the corner.

Impact of Chinese Currency Manipulation on the Foundry Industry

The future of the U.S. foundry industry is being severely threatened by low-priced castings, imported primarily from China. A number of U.S. trading partners, most prominently China, actively have pursued for years policies that undervalue their currencies.

American foundries and workers cannot compete when the playing field is rigged. And that is what China has been doing—rigging its currency at a level that economists agree is substantially below its fair value. China's currency manipulation has a real impact on our member companies and their workers. For too long, foundries have been losing work because of the influx of low cost imported castings, laying off employees, and shutting their doors. It is time to take concrete action to stop this un-level playing field.

Economists estimate that the yuan is undervalued by as much as 40 percent, giving Chinese companies an unfair trade advantage that has helped push the U.S. trade deficit with China to a record $233 billion last year. The resulting competitive advantage props up its exports, production and jobs at the expense of producers in the United States. It has provided Chinese foundries with a nearly insurmountable advantage over U.S. foundries. Meanwhile, metalcasters continue to lose contracts to their Chinese counterparts since the cost of raw materials alone is equal to or higher than the pricing of finished parts being dumped in the U.S.

Furthermore, our members are not just competing against other global companies—they are competing against other governments that strongly support their manufacturing sectors with currency manipulation and trade barriers against our U.S. products. Additionally, China's complex web of subsidies also increases its exports in clear violation of World Trade Organization rules. The Chinese government is subsidizing the purchase of raw materials and energy and/or providing them below cost via state-owned enterprises. In fact, China's government controls the price of gasoline and electricity, thereby allowing Chinese manufacturers to obtain these vital items at subsidized prices.

Moreover, American foundries must compete against Chinese foundries that have cheap labor costs, do not pay or pay very little for health insurance and legacy costs, and do not have to meet our strict environmental and safety standards. The Chinese social safety net is inadequate. There's no universal Social Security, and less than 20 percent of workers have pensions. Less than 15 percent are covered by unemployment insurance.

The U.S. International Trade Commission (ITC) conducted a Section 332 fact-finding investigation, at the request of the House Ways and Means Committee, into the competitive conditions facing the U.S. metalcasting industry.

The report, issued in May 2005, revealed that foundry customers "significantly increased their purchases of foreign-produced castings at the expense of U.S.-produced

castings, primarily because of lower foreign pricing." [1] Furthermore, the ITC report indicated that China was a major source of the cheap imports flooding the U.S. market. This huge surge in imported castings has directly contributed to the loss of thousands of foundry jobs and numerous foundry closures in recent years, as well as having a negative impact on the total U.S. manufacturing sector.

Our member companies have seen significant production outsourced to China to take advantage of this unfair trade advantage. Here are just a few examples of what American foundries are facing:

- Over 700 foundries have closed during the past ten years—which means over 50 foundries are closing each year. These closures have a devastating impact on communities across this country. *Foundries provide reliable, good-paying and rewarding jobs for their constituents, while substantially adding to the tax base at all levels of government.*
- Earlier this month, Ford Motor Co. announced that it will be closing down its foundry, Cleveland Casting, in Brook Park, Ohio by 2009, and thus, eliminating over 1,000 good paying jobs. The facility produces cast-iron engines for Ford F-Series Super Duty trucks, Ford E-Series vans and Ford Expedition and Lincoln Navigator SUVs. It is one of several foundries being closed by the automaker this decade.
- Many companies that have upgraded their plants to be highly automated don't have enough work to pay off their investment. This creates a situation for foundries where all of the volume has gone away thus causing them to lose the contribution margin to absorb the fixed overhead.
- An Indiana foundry employing over 100 employees has lost over 35 percent of its casting business to China since 2001.
- A Texas-based foundry which supplies the automobile industry in North America describes how some of its major customers such as TRW and Bosch have outsourced brake castings to foundries in China. These customers then use the subsidized low prices from China as their "World" price and demand such from their American suppliers, which have gradually dragged the market price for brake castings to all time lows. This U.S. foundry has managed its costs down to where it is selling castings today for 35% less per ton than in the mid-70's (no adjustments for inflation taken into account!) It has almost no room for further cost reduction, being squeezed by prices on one end, and increasing costs for energy and raw materials on the other.
- Suppliers to our industry report that customer after customer now imports tooling that in years past would have been built in the U.S. at a fair price. Presently, an Indiana tool & die shop has one tool in its 15-man shop and not one prospect in sight. The once proud tool manufacturing sector has been reduced to a mere shell of its former self.
- A Pennsylvania foundry reports that it has lost over $1,000,000 in sales as a result of lower priced Chinese castings.
- A Georgia-based family-owned foundry is currently facing the possibility of losing a $500,000 contract for a regular customer in Houston, Texas, to a Chinese company.

What Can Congress Do Regarding Currency Manipulation

With little to show after four years of U.S. pressure on China to revalue its yuan currency, we urge you and your fellow lawmakers to pass legislation, The Fair Currency Act (H.R. 782), which would define currency manipulation as a subsidy under U.S. trade law and make it easier for the U.S. Commerce Department to impose new tariffs on Chinese goods under a countervailing duty law against foreign government subsidies. If enacted, this legislation would help U.S. manufacturers and workers to counteract currency undervaluation by China and other countries that injures our economy. Countries that engage in "exchange-rate misalignment" should be put on notice that such behavior is not acceptable and has legal consequences.

Unfortunately, the U.S. Department of Treasury in its semi-annual reports has persistently chosen not to cite China for exchange-rate "manipulation" within the meaning of the International Monetary Fund's Articles of Agreement. The report claims that it cannot be determined if China's policy of undervaluation is intended to gain an unfair competitive advantage in trade or to prevent adjustments in China's balance of payments. AFS feels this longstanding approach by the Treasury Department has been fruitless and will remain so, and a legislative strategy needs to

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[1] Foundry Products: Competitive Conditions in the U.S. Market. U.S. International Trade Commission—Investigation No. 332–460, May 2005.

be adopted to hold countries like China to account under their international legal obligations.

Since China continues to enjoy the benefits of membership in the international economic community, it is only fair that it abide by the community's rules and responsibilities. The time for change is now, before our industry and the rest of U.S. manufacturing is put further at risk. AFS is committed to working with you on this important matter.

Sincerely,

Jerry Call
Executive Vice President

Prepared Statement of the Retail Industry Leaders Association

The Retail Industry Leaders Association (RILA) appreciates the opportunity to submit written comments for today's hearing on currency manipulation. RILA promotes consumer choice and economic freedom through public policy and industry operational excellence. Our members include the largest and fastest growing companies in the retail industry—retailers, product manufacturers, and service suppliers—which together account for more than $1.5 trillion in annual sales. RILA members provide millions of jobs and operate more than 100,000 stores, manufacturing facilities and distribution centers domestically and abroad.

RILA supports the longstanding U.S. policy of economic engagement with China and Japan and opposes legislation that threatens to cut off access to the U.S. market as a means of pressuring China and/or Japan on policy issues such as exchange rates. RILA advocates a balanced trade policy—one that recognizes the tremendous opportunities and benefits that trade and investment with China and Japan bring to the U.S. economy, while also effectively addressing market access barriers and other unfair trade practices that affect U.S. companies doing business with these countries. RILA supports a rules-based resolution of trade disputes in a manner consistent with World Trade Organization (WTO) obligations.

While RILA members strongly support positive economic engagement with both China and Japan, our comments today are focused on China. U.S. exports to China are rapidly growing. In 2006, China and Hong Kong combined ranked as the third-largest U.S. export market, with exports of goods totaling more than $73 billion. Furthermore, U.S. exports to China are growing far more rapidly than exports to any other major market. U.S. exports to China in 2006 were 240 percent higher than in 2000, the last full year before China joined the WTO. By comparison, the second-fastest-growing market for U.S. goods during this time was the Netherlands, with cumulative growth of 42 percent.

U.S. services exports to China are also growing. The U.S. already has a small services trade surplus with China—$2.6 billion in 2005—and that surplus is forecasted to grow to $15 billion or more by 2015 as more U.S. companies take advantage of market access openings negotiated as part of China's WTO accession.

Congressional actions toward China should focus on positive economic engagement with China with a broader focus than simply currency exchange rates. The effect of China's exchange rate policy on bilateral trade is likely overstated. According to Stephen Roach, chief economist at Morgan Stanley, the trade deficit with China is also the result of other factors, including a high U.S. personal consumption rate, a very low U.S. savings rate—just over 1% over the past three years—by domestic businesses, households, and the government, and a high personal saving rate in China (about 30% of household income). The low U.S. savings rate means that America must import surplus saving from abroad to fuel U.S. economic growth.

Congress should enact policies that promote more U.S. domestic saving, and encourage China to move from an economy based on export growth to one based on growth in domestic consumption. For example, Congress should encourage China to break down the remaining barriers to foreign investment in China's retail sector. Growth in the supply of retail outlets in China will increase consumer choice and competition and enable Chinese consumers to increase their purchases.

While RILA members seek to benefit from the growing trade opportunities with China, we also recognize that the valuation of China's currency is a significant concern for both the Administration and Congress. RILA believes that China should indeed implement steady, measured, but concrete movement toward a market-determined exchange rate. Toward this end, RILA supports efforts by Treasury Secretary

Henry Paulson in the context of the Strategic Economic Dialogue to encourage broader financial sector reforms that will enable China to accelerate its removal of capital controls and allow market forces to fully determine the value of its currency.

Some of the legislative proposals such as H.R. 782 and S. 796 to address China's currency regime would be counterproductive as they are inconsistent with WTO rules. Such measures could prompt harmful Chinese retaliation against U.S. exports to China. Specifically, the WTO Agreement on Subsidies and Countervailing Measures (WTO SCM) requires that a countervailable subsidy: (1) confer a benefit, (2) involve a "financial contribution" from the government, and (3) be "specific" to an enterprise or industry. China's currency policy likely doesn't meet these criteria because the government is not transferring anything of value to firms, and the policy is not specific to a particular enterprise, industry, or group of enterprises or industries. While these bills revise U.S. law to assert that exchange rate misalignment satisfies the WTO criteria, that does not in itself make the legislation WTO-consistent.

In conclusion, U.S. trade and investment with China and Japan benefit RILA members and the U.S. economy directly through imports and exports as well as through broader effects such as lower prices and higher productivity. RILA supports efforts to find solutions to these issues that are balanced and do not undermine the significant opportunities and benefits to the U.S. economy that come from trade and investment with these countries.