

# House Committee on Ways and Means

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Testimony Before the Subcommittee on Trade  
of the House Committee on Ways and Means

February 15, 2007

Mr. Chairman and Members of the Committee:

I am pleased to testify today on behalf of the National Association of Manufacturers (NAM), the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. We seek a vibrant, globally competitive manufacturing industry in the United States.

No other trade subject comes close to commanding the attention that China is getting from NAM companies. China is simultaneously the greatest concern of many of our import-competing members and the fastest-growing global market for large and small exporters and for many companies that operate internationally. China has emerged within a short span of two decades as a strong international competitor in a wide range of manufactured products and a key market for U.S. manufactured exports.

The NAM seeks a positive and mutually-productive trading relationship with China that reflects market forces as closely as possible. China's emergence as a leading world economy has meant significant new opportunities for many NAM members, including increased exports and investment. At the same time, many import-competing U.S. manufacturers see prices of Chinese products so low – sometimes even lower than the cost of the raw materials -- that it is difficult for them to see how they can compete. Others see their customers moving to China and cannot find new ones to replace them.

The NAM's concerns with China cover a range of issues, including protecting intellectual property rights, maintaining a currency value that reflects the strength of the Chinese economy and ending prohibited government subsidization of industry.

We are also concerned that we are seeing a growing Chinese industrial policy that favors domestic producers, making it more difficult for foreign firms to participate in the Chinese economy. While currency and intellectual property theft are huge problems for NAM members and for our trade balance with China, I will confine my remarks in this testimony to China's subsidies.

The NAM worked hard to support China's membership in the World Trade Organization (WTO), and we remain fully supportive of that membership. Bringing China into the WTO required it to begin following the same trade rules as the rest of the world and to open its markets more fully. It has now been over five years since China joined the WTO and it is important that China implement its obligations fully.

There have been many positive benefits. Joining the WTO has encouraged China to open its internal market to international trade and foreign investment and adopt more market-oriented policies for developing its economy after decades of state control and management. At the same time, WTO agreements and principles have provided internationally accepted standards for guiding and evaluating

China's policies affecting trade.

China has now been in the WTO five years, and the NAM concurs with the Administration's 2006 Top to Bottom Review of China Trade Policy that as a mature trading partner, China should be held fully to its commitments. Unlike most other WTO members, China presents a unique challenge for evaluating its WTO compliance. While the Chinese economy has evolved significantly from a state-controlled model, it is still not a market economy. Both the national government and local governments play a significant role, directly and indirectly, in determining business decisions and limiting competition in the marketplace. Some of these policies appear to be driven by economic policy goals aimed at artificially accelerating China's industrial growth and export of manufactured goods.

The rule of law is essential to the free flow of trade in goods and services and governments have a responsibility to adhere to their commitments under the WTO and other international agreements. When governments interfere in trade in violation of the rules, enforcement is important to prevent the growth of distortion in global markets. The NAM believes that the area of subsidies is no exception and, in 2004 and subsequently, the NAM Board of Directors has supported legislation in Congress that would state clearly that U.S. countervailing duty law should apply to both market and non-market economies.

Often U.S. companies can only surmise that inappropriate policies are in place because they know that manufacturers operating on market principles would not engage in similar practices (e.g., selling a product at below the international price for the raw material input or continuing to build new capacity when there is already oversupply on the market.)

To ensure effective WTO compliance, U.S. agencies must be prepared to investigate trade problems even when there is limited documentation and other hard evidence that a violation of trade rules has occurred. The NAM believes strongly in the rules-based trade system. As with any country, when there are violations of trade rules, U.S. companies should have recourse to WTO-consistent remedies under U.S. trade law.

The use of and access to legitimate trade law in cases where it is warranted is necessary for mutually beneficial trade and is the best defense against the growth of protectionism. If affected companies have recourse when faced with unfair trade practices, there is a basic sense that trade works to their benefit.

### ***Direct and Indirect Industry and Export Subsidies***

Direct and indirect industry and export subsidies are a major concern of U.S. manufacturers, particularly those that compete against Chinese-made products. Member companies and organizations have long complained to us that Chinese enterprises must be receiving subsidies because they appear to be selling their products in the United States at below the cost of raw materials and shipping.

One of our member companies that makes hardware provides a typical example. Their large retail customers in the United States are able to purchase a particular pair of Chinese-made pliers for 49 cents. The U.S. company makes virtually identical pliers, but the problem is that the raw materials' cost in these pliers is 61 cents. This is not the sales price of the U.S. pliers – just the cost of the raw materials. How is it possible for a Chinese company to take 61 cents of raw materials, process them into pliers, package them, ship them across the ocean, and sell them for 49 cents? One way would be if the Chinese company were receiving subsidies.

In 2001, China acceded to the WTO and agreed to be bound by its provisions, expressly including the Subsidies and Countervailing Measures (SCM) agreement. As part of China's accession, the Chinese

government acknowledged the existence of subsidies and agreed to notify its subsidies to the WTO, and to terminate its prohibited subsidies upon accession. Last April, several years after it was due, China finally notified WTO members of government subsidy programs. China listed 78 subsidy programs for the period 2001-04 covering a wide range of programs.

China's list, appears incomplete, however, and did not include a variety of policies and programs that NAM members believe are giving substantial subsidies to Chinese industrial enterprises – such as those provided by China's state-owned banks or by provincial or local governments. Chinese enterprises, for example, appear to have access to the automatic roll-over of unpaid principal and interest; loan forgiveness; continued borrowing despite having non-performing loans; and below-market interest rates.

The SCM agreement defines two categories of subsidies: prohibited and actionable. The WTO defines prohibited subsidies as those that require recipients to meet certain export targets, or to use domestic goods instead of imported goods. They are prohibited because they are specifically designed to distort international trade. They can be challenged in the WTO dispute settlement procedure where they are handled under an accelerated timetable. If the dispute settlement procedure confirms that the subsidies are prohibited, they must be withdrawn.

At the beginning of this month, after bilateral consultations with China made little progress, the U.S. Trade Representative (USTR) initiated dispute settlement proceedings against China, for what appear to be prohibited export subsidies that China should have terminated, but did not. The NAM strongly supports this action and urges that the proceedings be moved forward as rapidly as possible.

For this initial case, USTR has chosen to focus on “prohibited subsidies.” No evidence of an adverse effect is necessary in the case of prohibited subsidies, unlike the situation in actionable subsidies. A prohibited subsidy is prohibited. Period. All that need be established in the case that is now being brought is that the Chinese subsidies in the complaint fit the definition of a prohibited subsidy.

As we have looked at some of the subsidies in the complaint, there does not seem to be much question that these subsidies are prohibited. For example, I understand that in the case of one measure, enterprises that export at least 70 percent of their production may be able to enjoy a corporate income tax rate of 15 percent or lower rate instead of the normal 30 percent rate. That is a very significant subsidy and certainly can distort trade patterns in a way that would affect U.S. imports.

I would like to comment in more detail about a number of subsidies being granted to manufacturers that are illustrative of Chinese subsidization.

**Equipment Generally:** Not all of the subsidies being challenged in this WTO are export-oriented. Import-distorting subsidies are also included. For example, both foreign firms and domestic firms in China apparently get a tax write-off if they buy Chinese equipment for their factories or business installations instead of purchasing imported equipment. My understanding is that this takes the form of an income tax refund equal to 40 percent of the value of the equipment purchased. That is a huge incentive to buy domestically-made equipment rather than imports – and definitely would be a prohibited subsidy.

**Machine Tools:** Additional subsidies appear to target particular industries that the Chinese government wants to develop by giving them preferred access to China's domestic market. One NAM member, for example, told us that 70 Chinese machine tool companies making computer numerically controlled (CNC) machine tools and related products can have 50% of the value-added tax (VAT) rebated to them.

As the VAT tax is 17%, this is quite an incentive for them to lower their prices and distort competition by tilting the playing field against U.S. and other exporters. The machine tool subsidy is of particular concern as China is proving an increasingly difficult market to sell in to and Chinese exports of machine tools to the United States are growing rapidly.

**Tool and Die:** The U.S. tool and die industry has a huge competitive problem with Chinese companies, and China's notification to the WTO shows that if Chinese producers buy die products produced by one of 160 specified Chinese die manufacturers, they will get 70 percent of their VAT tax refunded.

**Casting and Forging:** Another U.S. industry that is having a very difficult time competing against China is the casting and forging industry. China's notification to the WTO stated that if Chinese purchasers bought casting or forging products from one of 284 specialized Chinese casting and forging companies rather than purchasing foreign imports, they could get a refund equal to 35 percent of the VAT paid on those products.

**Autos and Auto Parts:** And yet even newer subsidies may be under development. In questioning China's subsidy submission to the WTO, the U.S. noted that "China's Ministry of Commerce (MOFCOM) is in the process of selecting 100 Chinese auto or parts manufacturers to be designated as 'state-level auto and parts exporters' who will be targeted for 'financial and export credit support.'

While we have no estimate of the overall effect these and other subsidies are having, we believe the effect is likely to be very substantial. The United States tends to be an exporter of capital equipment, rather than consumer goods, so subsidies that put imports of capital equipment into China at a disadvantage have a potentially strong effect on U.S. exports. This includes many small U.S. companies. In 2005, the latest year for which data are available, 22,000 small and medium-size U.S. firms exported to China, up 50 percent in the time since China joined the WTO. This number has likely continued to grow rapidly since 2005. As these smaller companies attempt to establish a marketing position in China, they already face ample obstacles without having to compete against subsidized Chinese firms.

Some commentators have stated that Chinese wages are so low that little else counts in competing with China. They overlook the fact, however, that labor costs are only one factor in the production process. U.S. manufacturers are highly efficient, with strong labor productivity. In fact, Census Bureau data show that production worker wages and benefits on average are only 11 percent of the cost of U.S. manufactured goods – with 89 percent of the production cost being materials, energy, overhead, marketing, distribution, profits, taxes, and the like. We recognize that U.S. manufacturers need to work with our own government to make the U.S. manufacturing environment a competitive one. However, the idea that low Chinese labor rates trump all is not true.

The U.S. government needs to press for the quick elimination of the subsidies identified in the case just filed with the WTO. In addition, the NAM wants USTR and the Commerce Department to continue seeking information on other possible subsidies, in the form of loan forgiveness and other forms of subsidy. Many of these subsidies may not be "prohibited" and may fall in the "actionable" category requiring considerable evidence of damage. The NAM hopes this subcommittee will inquire as to whether those two agencies are adequately staffed and funded for this exercise, and if not, we hope the subcommittee will encourage the relevant appropriations committees to ensure an adequate funding level.

In addition, the NAM believes that U.S. companies should be able to bring countervailing duty cases against Chinese subsidies, and we have urged the Commerce Department to reverse the 20-year policy

of not applying countervailing duty law in the case of non-market economies. There are two reasons for a change in policy: first, when the Subsidies and Countervailing Measures agreement was modified in 1994, the definition of a subsidy was changed from one that looked at effects to one that defined subsidies by what they are. Second, when China joined the WTO, it expressly agreed to be bound by the terms of the Subsidies and Countervailing Measures agreement, even agreeing to special methodologies for use in assessing subsidies its non-transparent economy.

The NAM supported HR 3283 in the 109<sup>th</sup> Congress, a bill that sought to clarify the intent of Congress as being that countervailing duties should be applicable to subsidies from non-market economies as well as market economies. The NAM continues to support that concept, though we seek some technical changes to last year's bill.

Finally, subsidized foreign investment is an issue that should be explored. WTO agreements have long recognized that subsidies unfairly distort trade in goods. The Agreement on Subsidies and Countervailing Measures (ASCM) subjects those subsidies to disciplines and provides remedies. Similarly, governments recognize that subsidies related to trade in services distort markets and should also be addressed. Article XV of the General Agreement on Trade in Services (GATS) acknowledges that subsidies may distort trade in services. The GATS obliges WTO member countries to enter into future negotiations on the subject and to give "sympathetic consideration" to complaints.

Subsidies for the acquisition of assets distort the market for those assets in much the same manner as trade subsidies. The United States has long been an advocate for increased disciplines on subsidies, including market-distorting practices that may escape the current rules (such as government-directed credit) and stricter disciplines to address certain types of adverse effects that are not adequately dealt with under the current rules (e.g., overcapacity caused by subsidies in the steel and fisheries sectors). New consideration needs to be given to how we handle subsidized investment in the future.

### **Putting China – and Trade – In Perspective**

The huge U.S. trade deficit with China is continuing to grow. Data just released by the Commerce Department show the 2006 merchandise trade deficit with China was \$232 billion up from \$202 billion in 2005. China now accounts for over 40 percent of our global non-petroleum trade deficit.

Export growth to China is rapid, but starts from a small base. Last year's 32 percent increase in exports to China resulted in a dollar growth of \$13 billion. The 18 percent import growth, though, resulted in a \$44 billion increase. As imports from China are five times as large as exports to China, a significantly higher export growth rate relative to the import growth rate is needed to stabilize and then bring down the deficit.

It is noteworthy, though, that the increase in the deficit last year was 15 percent, significantly below the 25 percent growth that has been seen for some time. Now I am not implying that this is "break out the champagne" news, but it is the first time we have seen a slowing in the growth rate of our deficit with China. Nevertheless, the size of the deficit and its continued growth underscore the need to utilize our trade rights to eliminate subsidies and other distortions of trade with China.

We have deficits with countries other than China, of course, and our global manufactured goods trade deficit in 2006 was nearly \$530 billion. But as we address these deficits, we must be realistic about the effect they are having on our economy. It is important that we all move forward with as good a grounding in the facts as possible.

For example, it is not uncommon to hear that U.S. manufacturing is on its last legs, that we have been hollowed out and that our production base has moved overseas. A look at the factory shipments and industrial production data I have included as the last page of my testimony shows this is not true. Measured by historical standards and recent trends, U.S. manufacturing output is strong. This is not, of course, the case for all sectors. While some are doing very well, others are not. And within sectors some companies are doing well, while others are struggling to stay afloat.

American manufacturing faces many problems and challenges. Global competition is one, both in terms of import competition and in terms of having to face trade barriers around the world and too many unfair trade practices. But we have home-grown problems as well, in terms of higher costs from taxes, regulation, energy costs, etc. In fact, when we ask our member companies to name their biggest problem, they tell us that health care costs and a shortage of skilled workers is at the top of their list.

Some believe all our problems stem from trade, and that trade is the reason that manufacturing has lost 3 million jobs in recent years. Some commentators are fond of pointing out that the United States lost 3 million jobs in the “NAFTA-WTO decade.” The clear implication is that NAFTA and trade generally are the cause of the 3 million job loss. But that is untrue.

It is certainly true that between 2001 and 2003 nearly three million manufacturing jobs were lost – a huge number, close to one in every six jobs. The jobs have not come back since that time, with manufacturing employment trending down gradually since 2003. But since the U.S. manufactured goods deficit with NAFTA in 2001 was \$38 billion and the 2006 manufactured goods deficit with NAFTA was also about \$38 billion, how could the job loss have been caused by NAFTA? Since there was no increase in the manufactured goods deficit with NAFTA, it is hard to see what kind of analysis would indicate NAFTA as the cause of our job loss.

Many people are startled to learn that the manufactured goods deficit with NAFTA is no larger than it was in 2001, for they look at the overall trade figures with NAFTA and see a \$55 billion increase since 2001. However, this increase was entirely due to oil imports. Mexico and Canada supply one in every three barrels of oil we import from the world, and with the price of oil being what it is, the petroleum deficit with them has soared – growing \$55 billion.

Looking at the trade deficit more broadly, Dr. Lawrence Michel, President of the Economic Policy Institute, testified before the full Ways and Means Committee at the end of January that, “In just the five years from 2000 to 2005, more than three million manufacturing jobs disappeared. We estimate that at least one-third of that decline was caused by the rise in the manufactured goods trade deficit.”

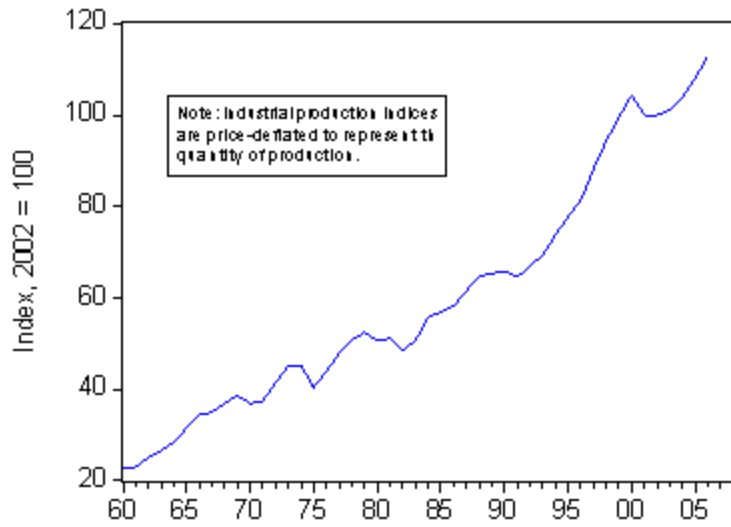
That is possible, as in the period when those 3 million jobs were lost, there was a big jump in our global manufactured goods deficit – a \$90 billion increase, in fact. But the inference most people seem to draw from this is that it was imports that caused that job loss – particularly U.S. multinational imports from low-wage countries. But that is not what the figures show. The data show that the \$90 billion increase in the manufactured goods deficit in that period was due to a \$20 billion increase in imports, and a \$70 billion drop in exports. Thus, to the effect that trade was a factor in the job loss, about 80 percent of the trade impact came from falling exports, not rising imports.

None of this is to say that U.S. manufacturing doesn't face serious problems – including from import competition from China. We do, but as we approach these problems we must do so armed with the facts and with an understanding of how we got where we are and how best to solve our problems so we can have the vibrant and growing manufacturing sector this country cannot survive without. Manufacturing is how we will pay our way in the world and manufacturing is the principal source of the innovations

and productivity that we need for continued increases in our standard of living.

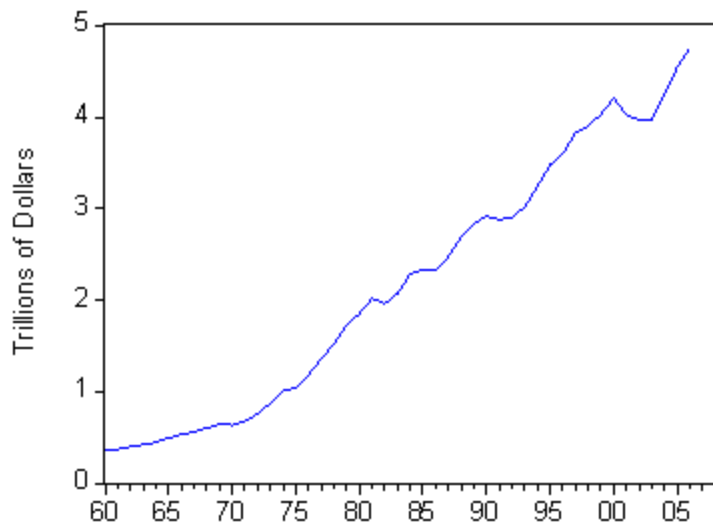
Thank you, Mr. Chairman, for holding this important hearing, and the NAM looks forward to continuing to work closely with you, other members of the committee, and the committee's excellent staff.

### INDEX OF DOMESTIC U.S. MANUFACTURING PRODUCTION



Source: Federal Reserve Board

### U.S. FACTORY SHIPMENTS OF MANUFACTURED GOODS



Source: Manufacturing, Mining, and Construction Statistics, U.S. Census Bureau

NATIONAL ASSOCIATION OF MANUFACTURERS